V'Smart Academy

CA FINAL AUDIT

PARAM

QUESTIONNAIRE



THE ULTIMATE ALL IN ONE QUESTION BANK

VOLUME - 1

- Applicable for Nov23
- All Questions are linked with Bhaskar Regular Notes

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Only for Study related doubts 9096 0000 33

PREFACE

It gives us immense pleasure in presenting CA Final Question Bank "**PARAM"**

The book has following features:

- More than **750+ questions** covering the entire syllabus on Audit Subject.
- Coverage
    - **Study Material Questions** - 2017 to 2022.
    - **RTPs & MTPs** from May 2016 to May 2023 (15 exams)
    - **Past Exam Papers** from May 2016 to Nov 2022 (14 exams).
    - Relevant Questions from old course Study Material, MTPs, RTPs, Past Exam Papers, Practice Manual as mentioned above have also been included.

- Format
    - **Standardized format** is used entirely.
    - Big theoretical questions are divided in small parts
    - **Case study-based questions** are divided in 4 parts
    - Questions which are not related directly to any particular concept in regular Bhaskar Book are marked as #Unique.

- Linking with Bhaskar regular note
    - Students can easily use charts, shortcuts or in detail any concept from Bhaskar regular notes with the help of **Concept Number(CNO)** given in each question.
    - This will make concept and question neural association better.

- Short Cuts & Memory techniques
    - **Line wise headings and summary** are provided above the answers.
    - **Mnemonics are provided** to help in retention & **Charts** to give bird eye view.
    - **Flow Technique** is used to help in memorization

- Original language
    - **Language by ICAI is retained** in answers.
    - **Shortcuts and Summaries** are given separately
    - Internal flow of the answers has been changed where required to make the answer easy but no change in language is made.

- Examples
    - **Examples are given** to understand tricky concepts
    - They are highlighted in italics

- Distinct Non-Changing Question number **(QNO)** & Heading
    - Every question has **Heading** and Question number.
    - Easy to revise through such headings

- Easy for doubts solving and discussions as you can ask doubts on Auditguru.in /discussion-points on the basis of question number(QNO).
- QNO doesn't change from edition to edition, making it easy to identify new questions.

- **Source** of each question
  - Helps in understand flow of question, from where it came to exams, whether from RTP / MTP / PM / SM
  - Helps in deciding how much importance should be given to questions

- **Author's note** has been included:-
  - For contradictory answers
  - Tricky areas where students can do mistake
  - To explain the difference between similar questions
  - To provide guidance to enhance understanding

- Deleted Questions:-
  We design our books and include content in such a manner so that studies become efficient and effective. Thinking on same lines this time I decided to delete some questions because they were very bulky or not asked since many years or they are too easy to be asked at CA Final exams. But still if any student wants to go through these deleted questions they can get it from our Telegram channel "Auditguru" or simply put mail on support@auditguru.in

From inception to consummation, this project requires dedicated work, deep thinking, and hours of continuous desktop work. Our immense gratitude to our parents and family for their continuous support, which encourages us to accomplish our work. We also extend our heartfelt gratitude to the efforts of people for bringing this project into reality.

I am thankful to CA Vaishnavi, CS Rajni, CA Priyanka, Devesh, ACCA Akash, CA Neha, CA Anjanesh, Vaibhav B, Vaibhav R, Kunal, Rahul, Gitanjali for their support and sincere efforts.

We hope that students will be immensely benefitted with this book. However, there is always scope for improvement. We will be grateful to the students for their valuable feedback for improvement of this book. **Please email us at support@auditguru.in or Message, WhatsApp on 9322011915**

Happy Studying!!!!

RAVI TAORI

AKASH HIRANI

NEHA JANGRA

Special Thanks to Snehal Taori Ma'am for her important contribution in making this book.

Note:
Repetitive or Similar questions are clubbed into one question number (QNO), to avoid duplication. This will make studies efficient and effective.

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01 Auditing Standards, Statements and Guidance Notes - An Overview

Part 1 -- SA Introduction

QNO 0.200	AUP Assignment BHASKAR CNO— INTRO.060	New Course – (M23R)
	CA P is the auditor of Master Data Ltd. for the year 2021-22. The company requests the auditor to undertake an exercise involving only verification of trade receivables for half year ending 30th September 2021. The company wants to be satisfied that trade receivables are properly confirmed and reconciled. **In this regard, CA P has to verify the arithmetical accuracy of trade receivables, obtain confirmation of trade receivables and ensure verification of proper reconciliations with confirmations.** **He is in a dilemma as to whether he can give a report providing assurance to the company in this respect. Guide CA P with reasoning. Assume that above exercise can be undertaken and there is no legal bar**	
	In the given case situation, auditor has to verify trade receivables for half year ending 30th September,2021. Such a process/exercise is only a fact finding and reporting exercise. The auditor has to report the facts as these are. Like, he would have to state whether confirmation from a particular debtor has been received or not. The auditor can issue an assurance report in case of audit and review engagements. By providing assurance, the auditor provides comfort to users of financial statements. Assurance in the above context refers to the auditor's satisfaction as to the reliability of an assertion made by one party for use by another. To provide such assurance, the auditor assesses the evidence collected as a result of procedures conducted and expresses a conclusion. The degree of satisfaction achieved and, therefore, the level of assurance which may be provided is determined by the procedures performed and their results. However, the types of services described in the given situation falls in the related services domain. These are, in the nature, of agreed-upon procedures to be carried out by the auditor. The auditor cannot issue an assurance report while providing such kind of services. He can only issue a report stating facts as they are without providing any sort of assurance. He can report only facts. Therefore, the auditor cannot give a report providing assurance for such type of services. He can only issue a factual report.	

Part 2 -- SA 200 Series

SA 200

QNO 0.300	Reasonable Assurance Bhaskar CNO - SA200.020	New Course-(M22M)
	Yupee (P) Ltd. got incorporated on 15th May 2021 and Mr. Harsh, the director of Yupee (P) Ltd. proposed to Kamal & Co. on 24th May 2021, for being appointed as its statutory auditor. Mr. Kamal, the sole proprietor of Kamal & Co., after checking the compliance with all the statutory requirements, accepted the said offer and issued an audit engagement letter vide email to Yupee (P) Ltd. Mr. Harsh found all terms of audit engagement to be proper but in the paragraph relating to auditor's responsibly in the engagement letter, as produced below:- **"We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement." Certain queries raised in his mind that what does reasonable assurance meant? Which Standard on Auditing requires the auditor to obtain such reasonable assurance? Is it possible to give absolute assurance on such financial statements?**	

	Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above.
Answer	As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is required:- "To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework." Reasonable assurance is a high level of assurance and is less than absolute assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. **The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance** that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from: (i) The nature of financial reporting; (ii) The nature of audit procedures; and (iii) The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

QNO 0.500	**Potential Effect of Inherent Limitations of Audit** **Bhaskar CNO - SA200.050**	**New Course-(M21E)**
	M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal control for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent of limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatement due to potential effects of inherent limitations.	
Answer	**Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -** As per SA 200 - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and as per SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor. In view of above, it can be concluded that auditors did not give correct statement. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include: **Shortcut :- FaRaNG**	

	(i) **F**raud, particularly fraud involving senior management or collusion. (ii) The existence and completeness of related party **r**elationships and transactions. (iii) The occurrence of **n**on-compliance with laws and regulations. (iv) Future events or conditions that may cause an entity to cease to continue as a **g**oing concern.

SA 210

QNO 2.010	Mandatory matters in engagement letter Bhaskar CNO - SA210.060	Old Course - (M19R, M19M,N20R) New Course-(M19M,N20R,N21M,S21M,N22M,M23R)

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited?

OR

AKJ Ltd. is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors.

The statutory auditors want to enter into an engagement letter with the company in respect of their services, but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter?

Answer

Part I -- Relevant Standards & Laws

- SA 210, Agreeing the Terms of Audit Engagements

Part II -- Requirements of Relevant Standards & Laws

➢ **As per SA 210 Agreeing the Terms of Audit Engagement**

The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- The **objective and scope** of the audit of the financial statements.
- The **responsibilities of management.**
- Identification of the **applicable financial reporting framework** for the preparation of the financial statements; and
- The **responsibilities of the auditor.**
- Reference to the **expected form and content of any reports** to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Part III -- Facts

➢ In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors.

Part IV -- Conclusion

	➢ However, engagement letter issued by MEA Ltd. Does not specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management.

QNO 3.000	Revision of Engagement Letter Bhaskar CNO - SA210.080	Old Course - (M13E,P17M,M18M,N20E)
	R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.	

Answer

Part I -- Relevant Standards & Laws

- SA 210, Agreeing the Terms of Audit Engagements

Part II -- Requirements of Relevant Standards & Laws

➢ **Not Required Sending new EL each period no required. Its Auditor's Decision**

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

➢ **Factors Affecting Decision**

- **External Changes: - Legal & Regulatory / FRF.**
  - A change in **legal or regulatory requirements**. (New company act / GST)
  - A change in the **financial reporting framework** adopted in the preparation of the financial statements. (Ind AS)
- **Changes from Management Side: - Nature, Size of Business / Ownership / Senior Management / Indications of Misunderstanding.**
  - A significant change in **nature or size of the entity's business.** *(E.g. Started manufacturing along with trading and now turnover has increased 3 times as compared to last year)*
  - A significant change in **ownership.** *(E.g., Takeover from other business group, pantaloons taken from Biyani to Aditya Birla Group)*
  - A recent change of **senior management**. *(E.g., MD / CEO / CFO are replaced)*
  - Any indication that the entity **misunderstands** the objective and scope of the audit. *(E.g. They ask for Fraud Report / Compliance Report / Tax Report / Fixed Asset assessment report etc.)*
- **Changes from Auditor Side: - Terms of Audit / Reporting Requirements.**
  - Any revised or **special terms of the audit engagement**. *(E.g., Separate Branch Auditors / Use of CAAT / Use of Expert etc. which are justified)*
  - A change in **other reporting requirements.** *(E.g., Reporting on Internal Financial Control)*

QNO 3.050	Preconditions for an audit- Bhaskar CNO - SA210.020 / SA210.040	Old Course - (N19R) New Course-(N19R)
	"Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. **What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement?"**	

Answer ***(Before asking any information & thinking about acceptance & continuance as per SQC 1 & SA 200, these conditions should be satisfied)***

➢ **Preconditions of an audit**

- **Acceptable FRF: -** The use by management of an **acceptable financial reporting framework** ***(Exp:- Reliable / Relevant etc)*** in the preparation of the financial statements and
- **Agreement: - the agreement** of management and, where appropriate, those charged with governance to the **premise on which an audit is conducted.**

  ***(Exp:-** Management should agree and take responsibility of financial reporting)*

➢ **Auditor's Responsibility to Check 2 Conditions**

In order to establish whether the preconditions for an audit are present, **the auditor shall:**

- **Acceptable FRF: -**
  Determine **whether the financial reporting framework** to be applied in the preparation of the **financial statements is acceptable**; and
- **Agreement: -**
  Obtain the agreement of management that it acknowledges and understands its responsibility:
  - **Preparation of Financial Statements**
    For the **preparation of the financial statements** in accordance with the applicable financial reporting framework, including where relevant their fair presentation.
  - **Internal Control System**
    For such **internal control** as management determines is necessary **to enable the preparation of financial statements that are free from material misstatement,** whether due to fraud or error; and
  - **Information to Auditor**
    To **provide the auditor** with:
    - **Access to all information** of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters.
    - **Additional information that the auditor may request** from management for the purpose of the audit; and
    - **Unrestricted access to persons** within the entity from whom the auditor determines it necessary to obtain audit evidence.

➢ **Don't Accept Assignment**

If the **preconditions for an audit are not present,** the auditor **shall discuss the matter with management.**

Unless required by law or regulation to do so, **the auditor shall not accept the proposed audit engagement:**

- If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is **unacceptable;** or
- If the **agreement as discussed above has not been obtained.**

➢ **Limitation On Scope Prior To Audit Engagement Acceptance**

If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor **believes the limitation will result in the auditor "disclaiming an opinion" on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.**

➢ **Conclusion: -**

In the instant case, Mr. Ram should not accept the appointment as statutory auditor of XYZ Private Limited due to limitation imposed on his scope of work.

SA 220

QNO 3.080	Client Relationships and Audit Engagements (Acceptance & Continuance) BHASKAR CNO-SA220.080	New Course- (N22M)
	NEMI Limited (manufacturer of textile goods) got an order of manufacturing of PPE kits in December 2021. But there was shortage of machinery and manpower to accomplish the ordered requirement of PPE kits. NEMI Limited approached another manufacturing unit Rathnemi Limited for purchase of the unit. Rathnemi Limited was interested in the sale of unit, so the deal went through, and NEMI Limited acquired ninety five percent shares of Rathnemi Limited. The new management of Rathnemi Limited proposed and appointed Mani Associates, Chartered Accountants, (already auditors of NEMI Limited) as new auditors of Rathnemi Limited. Mani Associates accepted the assignment without considering information whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. Comment with respect to appropriate Standard on Auditing what type of information assists the engagements partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate or not?	
Answer	Acceptance and Continuance of Client Relationships and Audit Engagements : As per SA 220, "Quality Control for an Audit of Financial Statements" , SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate: (i) The integrity of the principal owners, key management and those charged with governance of the entity. (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources. (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.	

QNO 4.000	Responsibility of Engagement Partner & Resolving Difference of Opinion Bhaskar CNO - SA220.100	Old Course - (N11R, N16R)
	You are an audit senior working for the firm Bohra & Company You are currently carrying out the audit of Wisdom Ltd, a manufacturer of waste paper bins You are unhappy with Wisdom Ltd.'s inventory valuation policy and have raised the issue several times with the audit manager He has dealt with the client for a number of years and does not see what you are making an objection about He has refused to meet you on site to discuss those issues As the audit manager had dealt with Wisdom Ltd for so many years, the other partners have decided to leave the audit of Wisdom Ltd in his capable hands Comment on the situation outlines above.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SQC 1, Quality Control for Firms that perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements ▪ SA 220, Quality Control over Audit of Financial Statements **Part II -- Requirements of Relevant Standards & Laws** ➢ **Engagement Partner- Should take Responsibility / If he is not involved then other requirements like independence, directing, supervision, review are also compromised / Just Assigning audit to experienced staff not sufficient:** An engagement partner is usually appointed to each audit engagement undertaken by the firm, to take responsibility for the engagement on behalf of the firm. Assigning the audit to an experienced	

	audit manager is not sufficient. The lack of an audit engagement partner also means that several of the requirements of SA 220 on "Quality Control for an Audit of Financial Statement", about ensuring that engagements in relation to independence and directing, supervising and reviewing the audit are not in place. ➢ **Conflicting Views / Difference of Opinion ---- There should be policy for dispute resolution / EP supposed to resolve dispute using firm's policy** SA 220 on "Quality Control for an Audit of Financial Statement", requires that the audit engagement partner takes responsibility for setting disputes in accordance with the firm's policy in respect of resolution of difference of opinion required by SQC 1" Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements". **Part III -- Facts** ➢ **EP not involved / Conflicting Views Exist / Refusal to Discuss** In this scenario the audit manager and senior have conflicting views about the valuation of inventory. This does not appear to have been handled well, with the manager refusing to discuss the issue with the senior. **Part IV -- Conclusion** ➢ **Lack of EP involvement / failure to resolve dispute / indicates no policy for dispute / Non-Compliance of SQC 1 & SA 220** In this case, the lack of engagement partner may have contributed to this failure to resolve the disputes. In any event, at best, the failure to resolve the difference of opinion is a breach of the firm's policy under SQC1. At worst, it indicates that the firm does not have a suitable policy concerning such disputes required by SQC.1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".

QNO 5.000	**Change in Engagement Partner to Review Work (Death, Bad Health Etc)** **Bhaskar CNO - SA220.100**	**Old Course - (N15R,P17M,M18M,M21M)** **New Course-M18M, M21M)**
	M/s Suresh Chandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2014-15. CA Suresh, one of the partners of M/s Suresh Chandra & Co., completed entire routine audit work by 29th May 2015. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA Chandra, another partner of M/s Suresh Chandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA Suresh. State with reasons whether CA Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 220"Quality Control for an Audit of Financial Statements" ▪ Basic Principle of Auditing on Delegation of Work **Part II -- Requirements of Relevant Standards & Laws** ➢ **Takeover, New Partner Should Review Work Done** Whenever there is takeover of assignment by new engagement partner, new partner should carefully review work of old engagement partner. ➢ **Review Procedures: -** • **1.Compliance of Law, Regulations, Prof Standards 2.Significant Matters Raised & Considered 3.Appropriate Consultations 4.Conclusions Documented 5.Evidence is Sufficient & Appropriate 6.Objectives Achieved 7.Need to Revise NTE** • The work has been performed in accordance **with professional standards and regulatory and legal requirements**;*(E.g., Sec 143 / IRDA Regulations / SAs)* • **Significant matters** have been raised for further consideration;*(E.g., Accounting for demerger)* • **Appropriate consultations have taken place and the resulting conclusions** have been documented and implemented;(Consult Mr A in firm who has audited many such cases)	

- The work performed supports the **conclusions reached and is appropriately documented**; *(E.g., Check whether documents and explanation provide basis for accounting done)*
- The **evidence obtained is sufficient and appropriate** to support the auditor's report; and *(E.g., Check that all areas are appropriately covered)*
- The objectives of the **engagement procedures have been achieved.** (We are able to form opinion with reasonable assurance)
- There is a need to **revise the nature, timing and extent** of work performed; *(E.g., High Court should be obtained, also written representation of CFO on accounting)*

➢ **Basic Principle of Auditing on Delegation of Work**

- **Basic Principle of Delegation of Work Governing Audit ---Auditor can delegate work but not responsibility.**
  Further, one of the basic principles, which govern the auditor's professional responsibilities, and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information.

- **Reliance of Work with Adequate Skill & Care.**
  However, he will be titled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.

- **Direct / Supervise / Review Work.**
  However, the auditor should carefully direct, supervise and review work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

Part III – Case Discussion

➢ **Report not signed because of death, other ca signed without review just relying on work done by his partner.**
In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Suresh. However, the report couldn't be signed by him due to his unfortunate death. Later on, CA. Chandra signed the report relying on the work performed by CA. Suresh.

Part IV – Conclusion

➢ **Non-compliance of SA 220 & no adequate skill and due care exercised.**
Here, CA. Chandra is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Suresh provided he further exercises adequate skill and due care and review the work performed by him.

Author's Note

Second point in part-I which deals with "Basic Principle of Auditing on Delegation of Work" is not given in SA 220, this is taken from Traditional Theory of Audit. It is easy to understand and retain and underlying principles is also same as SA 220. As ICAI has covered this in their recent answer students should also cover

QNO 5.010	Date of Signing, Only After Date of Completion of EQCR Bhaskar CNO - SA220.120	Old Course - (M19M) New Course-(N18M,M19M)

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment.

Answer

Responsibility of Engagement Partner:

As per SA 220, "Quality Control for an Audit of Financial Statements", the **engagement partner shall take responsibility for reviews being performed** in accordance with the firm's review policies and procedures. For audits of financial statements of **listed entities,** the engagement partner shall:

- Determine that an engagement quality control reviewer has been **appointed.**
- Discuss **significant matters** arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- Not date the auditor's report until the completion of the engagement quality control review.

SA 700, "Forming an Opinion and Reporting on Financial Statements", requires

The auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Significant Matters will be promptly resolved.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement **allows significant matters to be promptly resolved** to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

Part III – Facts

- In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.
- Thus, in the given case, signing of auditor's report i.e., on May 12, 2018 which is before the completion of review engagement quality control review i.e., May 15, 2018, is not in order.

QNO 5.020	**Independence--Responsibility of Partner and EQCR in listed company** **Bhaskar CNO - SA220.060/SA220.120**	**Old Course - (M19R,N19M)** **New Course-(M19R,N19M,S20M,M22R)**
	During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.	

Answer

- As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:
  - Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
  - Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
  - Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.
  - The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, **Engagement Quality Control Reviewer** (EQCR), on performing an engagement

	quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement. In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

SA 230

QNO 6.000	Factors affecting Form Content & Extent Bhaskar CNO - SA230.040 Bhaskar CNO - SA220.0	Old Course - (N15E, M17M, M20R) New Course- (M20R)
	Mr. A, a practising Chartered Accountant, has been appointed as an auditor of True Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit?	

Answer

Part I -- Relevant Standards & Laws

- SA 230, Audit Documentation

Part II -- Requirements of Relevant Standards & Laws

➢ **Factors affecting Form Content & Extent**

- **It is in flow of audit process: - .As auditor reaches premises of client he will know size & complexity→ Risk Assessment→ Audit Procedures→ Audit Methodology→ Significance of Audit Evidence→ Exceptions→ Basis of Conclusion**

The form, content and extent of audit documentation depend on factors such as:

- The **size and complexity** of the entity. *(↑Size ↑Extent, ↑Complexity ↑ Extent)*
- The identified **risks of material misstatement.** *(↑Risk ↑Extent)*
- The nature of the **audit procedures** to be performed. *(Test of controls →Flow Charts Content / Analytical Procedures → Graphs & Ratios)*
- The **audit methodology and tools** used. *(Manual Inspection of Records →Physical Form / CAAT →Electronic Form)*
- The **significance of the audit evidence** obtained. *(High Court Order of Amalgamation →Photocopy Document Form / Regular Purchase Order →Inspection + recorded PO number)*
- The **nature and extent of exceptions** identified. *(fraud + material →Extent ↑ / error + material →Extent ↓)*

The **need to document a conclusion** or the basis for a conclusion **not readily determinable from the documentation of the work performed or audit evidence obtained.** *(Complex working →Detailed Calculation will be covered in content / Simple → Only references will be given in content)*

QNO 7.000	Access to Working Papers UNIQUE	Old Course - (N14E, P17M)
	Discuss the Auditor's responsibility **to** provide access to his audit working papers **to Regulators and third parties.**	

Answer

Part I -- Relevant Standards & Laws

- Schedule 2, Part 1, Clause 1 of CA Act
- SQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and -Other Assurance and Related Services Engagements".
- SA 200 on "Overall Objectives of the Independent Auditor
- SA 230 on "Audit Documentation"

Part II -- Requirements of Relevant Standards & Laws

➢ **As per Schedule 2, Part 1, Clause 1 of CA Act**

No Access to Third Parties Unless Required by Law or Permitted by Client

The auditor should **not provide access to working papers to any third party without specific authority or unless there is a legal or professional duty to disclose. Clause (1) of Part I of Second Schedule** to the Chartered Accountants Act, 1949 states that 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, without the consent of his client or otherwise than as required by law for the time being in force.

- **SQC 1—Same two Conditions**
  Further, 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", provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor.

- **SA 200 – Respect Confidentiality & Same two Conditions**
  SA 200 on "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing" also reiterates that, "the auditor should **respect the confidentiality of the information** obtained and should not disclose any such information to any third party without specific authority or unless there is a legal or professional duty to disclose". If there is a request to provide access by the regulator based on the legal requirement, the same has to be complied with after informing the client about the same.

- **SA 230 – Can be used for additional purposes like external inspections if it is required by applicable law or regulatory requirement.**
  As per SA 230, Audit documentation **serves a number of additional purposes,** including the enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements**.**

Part III -- Conclusion

- **Access to Regulators – Should give Access as required by law or regulations.**
  Therefore, it is auditor's responsibility to provide access to his audit working papers to Regulators as required by applicable law or regulations.

- **Access to Client – At his discretion, should not affect validity, purpose of the work and in case of assurance, should not affect Independence.**
  He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does **not undermine the validity of the work** performed, or, in the case of assurance engagements, the **independence** of the auditor or of his personnel.

- **Access to Third Parties – Auditor's Discretion, Subject to 2 Conditions**
  Whereas it's at auditor's discretion, to make portions of, or extract from his working paper to third parties.

QNO 8.000	**Right to Lien** **Bhaskar CNO - SA230.100**	**Old Course - (M17E)**
	Auditor's right to Lien as per Companies Act, 2013	

Answer

Part I -- Relevant Standards & Laws

- General Principles of Law
- The Institute of Chartered Accountants in England and Wales Conditions
- Sec 128 of Company Act
- Refence to Saxena Vs Sharma Case Law & ICAI Ethical Standard Board Announcement

Part II -- Requirements of Relevant Standards & Laws

- **General Principles of Law – Person with lawful possession of property and worked on it, can exercise lien for non-payment of his dues – Same logic can be applied to Client Books**
  In terms of the **general principles of law,** any person having the **lawful possession** of somebody else's property, on which **he has worked**, may retain the property **for non-payment of his dues** on account of the work done on the property. **On this premise,** auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

➢ **ICAEW Conditions**

- **The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions: – Auditor Can exercise lien subject to Conditions – Possession as per Authority of Client / Documents belong to Client / Client Owes Money / Fees Money is Connected with Work on those documents**

  Auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fee for work done on the following conditions:
  - Documents retained must **belong to the client** who **owes the money;**
  - Documents must have come into **possession of the auditor on the authority of the client**;
  - The auditor can retain the documents only if he has **done work on the documents assigned to him;**
  - Such documents can be retained which are **connected with the work on which fees have not been paid.**

➢ **As per Sec 128**

Sec 128 of Company Act – Books should be kept at registered office / So it is impractical for auditor to keep possession / Company has to allow access to auditor / directors / authorised persons.

Under section 128 of the Act, books of account of a company **must be kept at the registered office**. These provisions ordinarily make it **impracticable for the auditor to have possession** of the books and documents. The company provides reasonable **facility to auditor for inspection of the books of account by directors and others authorised to inspect** under the Act.

➢ **Requirements of Saxena Vs Sharma & ICAI ESB Announcement**

In Saxena Vs Sharma Case Supreme Court Said that professionals should not exercise line on client documents as it would lead to a problem in running client business. ICAI ESB also said if CA exercises lien it will be misconduct.

Part III -- Conclusion

➢ **As per general principles & ICAEW exercising lean may seem logical but as per Sec 128 / Supreme Court Judgement / ESB Announcement it is impractical to exercise lien and it will lead to misconduct.**

Taking an overall view of the matter, **it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.** His working papers being his own property, the question of lien, on them does not arise.

QNO 8.500	**No need to Document Everything** **#UNIQUE**	**New Course-(M22E)**

You are the team leader of 10 members for an audit of a Multinational Company. All the team members are concerned about audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing.

Answer

SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

(i) the existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

(ii) the existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.

(iii) An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.

	(iv) In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file: • For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries. • Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".

SA 240

QNO 10.000	**Fraudulent Financial Reporting** **Bhaskar CNO - SA240.020**	**Old Course -(M12E, P17M)** **New Course- (N20E,N21M)**
	In the course of audit of A Ltd you suspect the management has indulged in fraudulent financial reporting. State the possible source of such fraudulent financial reporting**.** **OR** **In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations.** Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls**.**	

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **As per SA 240**

- **Definition of FFR – Intentional Misstatements to Deceive Users**
  Fraudulent Financial Reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users.
- **Three Ways of FFR**
  Fraudulent financial reporting may be accomplished by the following:
  - **Define Omission – Intentional Omission of Events, Transactions or Other Significant Information -- Then explain 2 ways of doing it -- By Omitting, Delaying, Advancing Transactions / Concealing, Not Disclosing Facts)**
    Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
    Examples
    - Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period. *(E.g., delaying recording of claims received from suppliers for late payment, from employees regarding compensation etc)*
    - Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements. *(E.g. Did not disclose that increase in share capital is through bonus issue and not due to fundraising, did not disclose that increase in fixed assets is due to upward revaluation)*

- **Define Manipulation – Includes falsification, forgery, alteration of records & documents – Then explain 2 ways of doing it – Fictitious Journal Entries/ Altering Records)**
  Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
  Examples
  - Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. *(E.g., Passing accounting entry for payments to creditors to improve current assets ratio, Recording fake sale entries etc)*
  - Altering records and terms related to significant and unusual transactions *(E.g., MBA fees paid for children of directors was shown as employee development expenses)*

- **Define Misapplication—Intentional Misapplication of Accounting Principles – Then explain 2 ways of doing it – Adjusting Assumptions / Engaging in Complex Transactions to Misrepresent**
  Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

  Examples
  - Inappropriately adjusting assumptions and changing judgments used to estimate account balances. *(E.g., Suddenly increasing useful life to reduce depreciation & increase profits, Increasing % completion of WIP to increase profits)*
  - Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity. *(E.g., loan taken & repaid was structured into sale & repurchase, loan taken was shown as lease (which is finance lease)*

➢ **As per Sec 143 (12)- Reason to Believe – Fraud by of Officer or Employee on the company—report to CG (if fraud >=1 crore) or to Audit Committee , BOD (if fraud is less than 1 crore)**
Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, **has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees** of the company, he shall **immediately report the matter to the Central Government (in case amount of fraud is Rs 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs 1 crore)** within such time and in such manner as may be prescribed.

➢ **Clause (xi) of CARO 2020 - Report on fraud by/on the company noticed or reported.**
whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

QNO 11.000	**Fraud Risk Factors (MISSAPPROPRIATION OF ASSETS)** **Bhaskar CNO - SA240**	**New Course-(N21E,M23M)**
	M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation. Guide CA Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing.	
Answer	**Guidance to CA Kumar with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:** As per **SA 240, "The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements",** misappropriation of assets involves the theft of entity's assets and is often perpetrated by employees	

in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

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

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

Incentives/Pressures

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

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

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

Opportunities

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

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

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

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

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

Attitudes/Rationalizations

(i) Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
(ii) Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
(iii) Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
(iv) Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
(v) Tolerance of petty theft.

QNO 11.500	Fraud Risk in Revenue Recognition Bhaskar CNO - SA240.120	New Course-(M22R)
	Arihant Limited was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ` 35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings. In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.	
Answer	As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and 330," The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and assertion level. The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition. Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to ` 35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings. Therefore, the auditor while performing the risk assessment procedures should consider the complexity and nature of the revenue for determining the fraud risks in revenue recognition. Also, there were no adequate controls addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have recognised fraud risk by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is required to report all the frauds identified during the course of the audit involving amounts above ` 1 crore within the prescribed time frame to the Central Government	

QNO 12.000	Inquiry with Management (Fraud) UNIQUE	Old Course - (N16E)
	Is it appropriate for the auditor to make inquires of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it? Discuss	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements **Part II -- Requirements of Relevant Standards & Laws** ➢ **As per SA 240** • **Management's Responsibility – To Prepare Financial Statements which are free from MMST / So they have to prevent & detect frauds** Management accepts responsibility for the entity's internal control and for the preparation of the entity's financial statements. • **Auditor Should Do Inquiry of Management's Assessment of ROF / Nature, Extent, Frequency will Change from Entity to Entity / Detailed Annually Vs Less Structures** Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. • **How it is relevant for Audit? – Makes us understand Control Environment / Example What if Mgt has not made assessment of risk of fraud.** The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control. The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. • **Unlikely to provide useful info for RMM -- Management ROF ≠ Auditor's RMM due to Fraud / Management themselves may be involved / Evaluate Responses with other information.** However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional scepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.	

QNO 13.000	Responsibility in Management Fraud UNIQUE	Old Course - (N09E, N12R, N15R, S17M, P17M, M17R, M17E, N18M) New Course- (S17M, S21M)
	Fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity. **In view of the above-mentioned circumstances of management fraud, explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from such Management Fraud.** **OR** **Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.**	

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statement.
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **As per SA 240**

- **Nature of Management Fraud – Overriding Controls / Complex Transactions to Misrepresent Financial Performance**
  Fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

- **Employee Fraud Vs Management Fraud**
  The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

- **TCWG & Management Responsibility to Prevent , Detect Fraud & Obtain Reasonable Assurance that FST are free from MMST.**
  The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity. Further, 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.

- **Auditor Objective – Reasonable Assurance regarding MMST.**
  Auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance, hence in an audit, the auditor does not guarantee that material misstatements will be detected.

- **Because of Inherent limitation in Audit some MMST may not be detected**
  Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

➢ **As per Sec 143 (12) - Reason to Believe – Fraud by of Officer or Employee on the company—report to CG (if fraud >=1 crore) or to Audit Committee , BOD (if fraud is less than 1 crore)**
Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, **has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees** of the company, he shall **immediately report the matter to the Central Government (in case amount of fraud is Rs 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs 1 crore)** within such time and in such manner as may be prescribed.

➢ **Clause (xi) of CARO 2020 - Report on fraud by/on the company noticed or reported.**
whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated.

➢ **Ability to Continue as Auditor- Resulting from fraud or expected fraud – encounters exceptional circumstances – not able to continue.**
If, as a result of a misstatement **resulting from fraud or suspected fraud**, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

➢ **Consider is it appropriate to withdraw.**

- **If it is appropriate to with draw – inform, discuss with management & TCWG with reasons / Report decision to persons, authorities as per legal & regulatory requirement.**

If the auditor withdraws:

- Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

QNO 14.000	Error in Valuation of Inventory UNIQUE	Old Course - (N11R, N13R, P17M)

As an auditor of public limited company for year ended 31.03.2013, you discovered an error in valuation of inventory, which has material effect on financial statements. Comment with reference to standards on auditing.

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements.
- SA 450, Evaluation of Misstatement Identified during the Audit
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

COMMON POINTS -- SA 240 & 450

➢ **As per SA 240**

- **Circumstances Indicates Possible Misstatement – Consider Potential Effect – If Effect could be Material – Perform Modified & Additional Procedures**

  SA 240, "The Auditor's Responsibilities Relating Fraud in an Audit of Financial Statements", requires that 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.

- **If actual Misstatement – Evaluate whether Indicative of Fraud – if such Indication – Implication on other aspects of audit, *E.g., Cannot be isolated occurrence, Reliability of WR.***

  SA 240 also requires that when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit.

➢ **As per SA 450 & 320**

After Misstatement Identified – Extend Audit Procedures to know materiality and Ask for Adjustment for Misstatements and Must for Material Items –Even after extension unable to conclude about materiality given or If rectification not done – give qualified or adverse opinion as the case may be

Further, SA 450, also requires that in such circumstances, the auditor should consider requesting the management to adjust the financial information or consider extending his audit procedures. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

COMMON POINTS -- ABILITY / SEC 143 / CARO

- **Ability to Continue as Auditor- Resulting from fraud or expected fraud – encounters exceptional circumstances – not able to continue.**
  If, as a result of a misstatement **resulting from fraud or suspected fraud**, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- **Consider is it appropriate to withdraw.**
  - **If it is appropriate to with draw – inform, discuss with management & TCWG with reasons / Report decision to persons, authorities as per legal & regulatory requirement.**
    If the auditor withdraws:
    - Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
    - Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

- **As per Sec 143 (12) -Reason to Believe – Fraud by of Officer or Employee on the company— report to CG (if fraud >=1 crore) or to Audit Committee , BOD (if fraud is less than 1 crore)**
  Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, **has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees** of the company, he shall **immediately report the matter to the Central Government (in case amount of fraud is Rs 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs 1 crore)** within such time and in such manner as may be prescribed.

- **Clause (xi) of CARO 2020 - Report on fraud by/on the company noticed or reported.**
  whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated.

Part III – Case Discussion

- Error is valuation of Inventory can be intentional or Intentional, so it can be suspected fraud or can be genuine error. Further it has material impact also.

Part IV -- Conclusion

- So, auditor should perform additional procedures, find out whether it is fraud or error. If it's a fraud consider impact on other aspects of audit and further ask management to rectify it.

Author's Note

In this question as per PM, reference of SA 320 is given along with SA 240 , but in Param SA 450 reference is given along with SA 240 because it SA 450 is more appropriate and relevant, other questions also refer SA 450 in such situation.

QNO 15.000	Difference in Control Accounts UNIQUE	Old Course - (M04E, M12R, N16M ,P17M)

In the books of accounts of M/s OPQ Ltd. huge differences are noticed between the control accounts and subsidiary records**. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year. As a Statutory Auditor, how would you deal?**

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements.
- SA 450, Evaluation of Misstatement Identified during the Audit
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

COMMON POINTS -- SA 240 & 450 - Refer QNO 14.0
COMMON POINTS -- ABILITY / SEC 143 / CARO- Refer QNO 14.0

Part III – Case Discussion

- Huge Difference Indicates Material Misstatement – Indicates no proper accounting system – it can be spread across many branches – it can be recurring – contention of chief accountant is not acceptable.

  The huge differences found between control accounts and subsidiary records in the books of M/s OPQ Ltd. indicate that there may be material misstatements. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon, or such reconciliation could not be done at a subsequent date. The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business.

Part IV -- Conclusion

- Auditor should perform detailed examination to find out is it a material misstatement and then further whether fraud or error and ask for rectification.

  Above circumstances indicate the possibility of some kind of material misstatements and require detailed examination by the auditor to ascertain the cause.

QNO 16.000	IOU UNIQUE	Old Course - (M09E, N12M, M13R, M13M, P17M)

While conducting statutory Audit of ABC Ltd, you come across IOUs amounting to Rs 2 crores as against a cash balance shown in books of Rs 2.10 crores You also observe that despite similar high balances throughout the year, small amounts of Rs 50,000 are withdrawn from the bank to meet day-to-day expenses

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements.
- SA 450, Evaluation of Misstatement Identified during the Audit
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

- Requirements of Guidance Note on Audit of C&B
  If Entity is Maintaining Unduly Large Cash Balance – Conduct Surprise Check – If Cash doesn't agree – Ask for explanation – If it is unsatisfactory – Consider effect on AR

  The Guidance Note on Audit of Cash and Bank balances also mentions that if the entity is maintaining an unduly large balance of cash, he should carry out surprise verification of cash more frequently to ascertain whether it agrees. If cash in hand is not in agreement with the book balance, he should seek explanations and if the same are not satisfactory should state the said fact appropriately in his Audit Report.

COMMON POINTS -- SA 240 & 450- Refer QNO 14.0
COMMON POINTS -- ABILITY / SEC 143 / CARO- Refer QNO 14.0

Part III – Case Discussion

- Very high cash balance of 2.10 crore, IOUs of 2 crores is unusual, further withdrawal of 50,000 in these circumstances is again weird.

Part IV -- Conclusion

- Auditor should perform detailed examination as explained above to find out is it a material misstatement and then further whether fraud or error and ask for rectification.

Author's Note
Sometimes cashiers of subsidiaries etc come to cashier of holding company and they ask for cash and in return they give a document containing all details and promise to give back cash in 1-2 days .

	Cashier keeps this document of acknowledgement in cash box and this document is call "I Owe You" or IOU. Now if instead of actual cash only these statements are appearing in cash box that indicates something is wrong.

QNO 17.000	**No Documentary or Other Evidence** **UNIQUE**	**Old Course - (N13E, N16R, P17M,M20M)** **New Course- (N18R ,M20M)**

Intelligent Ltd entered into an agreement with Mr Intellectual on 15th March, 2016, whereby it agreed to pay him Rs 2 lakhs per month as retainership fee for consultation in IT department However, no amount was actually paid and Rs 24 lakhs was provided in the Statement of Profit and Loss for the year ending on March 31st, 2016 Management of the company uttered that need-based consultation was obtained throughout the year However, on investigation, no documentary or other evidence of receipt of such service was found As the auditor of Innocent Ltd, what would be your approach?

OR

On 15thMarch, 2020, the directors of Phony Ltd. instructed their accountant to enter purchases amounting Rs. 1.02 crores from a company incorporated dated 11th March 2020. However, no amount was actually paid and Rs. 1.02 crore was provided in the books of account as purchases for the year ending on 31st March 2020.

On inspection, no documentary or other evidence of such purchases was found. As the auditor of Phony Ltd., what would be your approach regarding reporting of such bogus purchases?

Answer

Part I -- Relevant Standards & Laws

- SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements.
- SA 450, Evaluation of Misstatement Identified during the Audit
- Sec 143 (12) of Companies Act
- Clause (XI) of CARO 2020

Part II -- Requirements of Relevant Standards & Laws

NEW POINT

➢ **Fictitious Journal Entries at the end of the year are generally used to manipulate financial statements**

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

COMMON POINTS -- SA 240 & 450 - Refer QNO 14.0

COMMON POINTS -- ABILITY / SEC 143 / CARO - Refer QNO 14.0

Part III – Case Discussion

➢ **Entered into agreement with Consultant – Charged Fees of Rs 24 lakhs to P&L – No Evidence for receipt of services**

In the given case, Intelligent Ltd. has entered into an agreement with Mr. Intellectual, at year-end, for consultation in IT department. It also charged yearly fee of Rs 24 lakhs in the Statement of Profit and Loss, however, no documentary or other evidence of receipt of such service was found, on investigation.

Part IV -- Conclusion

➢ **Indicates Fictitious Journal Entry – Auditor should Perform Additional Detailed Examination**

It is clear that company has passed fictitious journal entries, near year-end, to manipulate the operating results.

QNO 18.000	**Special Audit Report Not Provided** **UNIQUE**	**Old Course - (M14E, P17M)** **New Course-(S17M , M18R, N18M, S21M)**

In the course of audit of K Ltd, its auditor Mr 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects Despite many reminders it was not provided In absence of the special audit report, Mr 'N' insisted that he be provided with at least a written

	representation in respect of fraud on/by the company For this request also, the management remained silent Please guide Mr 'N'.
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements ▪ SA 450, Evaluation of Misstatement Identified during the Audit ▪ SA 580, Written Representation ▪ Sec 143 (12) of Companies Act ▪ Clause (XI) of CARO 2020 **Part II -- Requirements of Relevant Standards & Laws** ➢ **As per SA 580** **No WR or Modification of WR as against expected – Indicates Significant Issues – Discuss Issue with management – at the same time Re-evaluate integrity and effect on reliability of WR, other audit evidence in general—take appropriate action – consider effect on opinion** As per SA 580 "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. The auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report. **COMMON POINTS -- SA 240 & 450 - Refer QNO 14.0** **COMMON POINTS -- ABILITY / SEC 143 / CARO - Refer QNO 14.0** **Part III – Case Discussion** ➢ **Special Audit by Client – Report not shared despite many reminders – No WR also given** In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent. **Part IV -- Conclusion** ➢ Auditor should perform detailed examination as explained above to find out is it a material misstatement and then further whether fraud or error and ask for rectification.

QNO 20.000	**Teeming & Lading** **UNIQUE**	**Old Course - (M05E, N09R, P17M)** **New Course - (M18M)**
	The Managing Director of the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company. As a Statutory Auditor, how would you deal?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 240, The Auditor's Responsibilities Relating to Fraud in audit of Financial Statements ▪ SA 450, Evaluation of Misstatement Identified during the Audit ▪ SA 580, Written Representation ▪ Sec 143 (12) of Companies Act ▪ Clause (XI) of CARO 2020 **Part II -- Requirements of Relevant Standards & Laws** **NEW POINT** ➢ **Communicate it to Chairman, BOD / Fraud is at highest level, it affects reliability of audit evidence previously obtained** The auditor should communicate the matter to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management.	

	COMMON POINTS -- SA 240 & 450 - Refer QNO 14.0 COMMON POINTS -- ABILITY / SEC 143 / CARO - Refer QNO 14.0
	Part III – Case Discussion
	➢ **Teeming & Lading Fraud by MD** Fraud Committed by Managing Director: The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements".
	Part IV -- Conclusion
	➢ Auditor should perform detailed examination as explained above to find out is it a material misstatement and then further whether fraud or error and ask for rectification.

SA 250

QNO 21.000	**Auditor's Responsibility (Compliance of Law)** **Bhaskar CNO - SA250.020**	**Old Course - (N04E,N14E)**
	What are the roles and responsibilities of the statutory auditors in relation to compliance with the laws and regulations **by the entity?**	
Answer	**Part I -- Relevant Standards & Laws**	
	SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",	
	Part II -- Requirements of Relevant Standards & Laws	

➢ **General Understanding –**

- **legal, regulatory framework applicable / how entity is complying with framework**

  As part of obtaining an understanding of the entity and its environment in accordance with SA 315, the auditor shall obtain a **general understanding of:**(List of laws applicable, Recent Changes, Big legal issue in past)
  - The **legal and regulatory framework applicable** (Banking Regulation Act / RBI Circulars etc.) to the entity and the industry or sector in which the entity operates; and
  - How the entity is **complying with that framework.** (Policies, Procedures, Registers, monitoring etc. as studied above)

➢ **Direct Effect- S&A evidence regarding COMPLAINCE of L&R having direct effect on material amounts & disclosure of FST.**

The auditor shall obtain sufficient appropriate audit evidence regarding **compliance** with the provisions of those laws and regulations **generally recognised to have a direct effect** on the determination of material amounts and disclosures in the financial statements. *(E.g., Sch II, Sch III / Sections of Company Act for loans, investments, expenses etc. / Income Tax Act/ Payment of Gratuity / Payment of Bonus etc.: - Sit with detailed checklist of laws and check though inquiry, observation & inspection whether compliance is done)*

➢ **Other Laws (May have Material Effect) – identify instances of NON-COMPLAINCE – through a. Inquiry with Mgt , TCWG b. Inspecting Correspondence with licensing or regulatory authority.**

The auditor shall perform the following audit procedures to help **identify instances of non-compliance** with **other laws and regulations** that **may have a material effect** on the financial statements: *(E.g., Factory Act, Industrial Dispute Act, Environment Act etc.)*

- **Inquiring of management and, where appropriate, those charged with governance**, as to whether the entity is in compliance with such laws and regulations; and
- **Inspecting correspondence,** if any, with the relevant licensing or regulatory authorities. *(Letters etc. exchanged with ministry, collector office, trade unions etc.)*

➢ **Remaining Laws which not expected to have Material Effect – Not required to perform audit procedures.**
In the absence of identified or suspected non-compliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in above paragraphs (Prevention of Terrorism Act / Defence Act etc.)

➢ **Alert – Remain alert, other audit procedures may bring instances of non-compliance or suspected non-compliance.**
During the audit, the auditor shall remain **alert** to the possibility that **other audit procedures** applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. (Procedures which are generally performed for other audit aspect can also tell you more about non-compliance for example correspondence with previous auditor, reading board minutes, meeting with internal & external legal counsel under SA 501, Substantive checking of legal expenses etc.)

➢ **Written Representation – Request WR all instances of non-compliances or suspected non-compliance disclosed to auditor.**
The auditor shall request management and, where appropriate, those charged with governance to provide **written representations** that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor

QNO 22.000	**Indicators of Non-Compliance** **Bhaskar CNO - SA250.040**	**Old Course - (M16E, N18R, N20E)** **New Course-** **(S17M,M18E,S21M,N21M,M23M)**

R & M Co wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd R & M Co seeks your guidance for identifying the indications of non-compliance with Laws and Regulations.

Answer

Part I -- Relevant Standards & Laws

- SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",

Part II -- Requirements of Relevant Standards & Laws

When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations:

➢ **Indicators of non-compliance (C2-PUPATE)**
Payment to Country other than source→Unusual Cash payment →Unspecified Payments to related party etc →Unauthorised transaction→Irrational Purchase price →Agents Fees / Commission →Transactions in tax haven→No Exchange documents

- Payments for goods or services made other than to the **C**ountry from which the goods or services originated. (Non-Compliance of Customs Act)
- Unusual Payments in **C**ash purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts. (May be bribe)
- **P**ayments for unspecified services or loans to consultants, related parties, employees or government employees. (Non-Compliance of Company Act)
- **U**nauthorised transactions or improperly recorded transactions. (Secrets payments against law E.g. No approval as per company law etc.)
- Purchasing at **P**rices significantly above or below market price. (Non-Compliance of Income Tax Act)
- Sales commissions or **A**gent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received. (Non-compliance of IRDA Regulations etc.)
- Unusual **T**ransactions with companies registered in tax havens. (Non-Compliance of Income Tax Act)
- Payments without proper **E**xchange control documentation. (Non-Compliance of FEMA)

	➢ **Post Non-Compliance Matters** **Investigations→ Unusual Legal Fees→Fails to provide audit trail→Adverse Media Comment** • Investigations by regulatory organisations and government departments or payment of fines or penalties. • Unusual payments towards **legal and retainer ship fees.** • Existence of an information system which **fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.** • **Adverse media comment.**

QNO 23.000	Non-Compliance Bhaskar CNO - SA250.060	Old Course -(N12E, M16R, N16M, P17M, M20M, M21M) New Course- (M18R, M20M, M21M,M22R,M23M)

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

OR

CA. Young has been appointed as an auditor of Rama Ltd., a textile entity. While going through the employee records of the company, CA. Young identified that most of the labourers employed are of the age between 11-12 years. On enquiring the same, the management argues that there is no such boundation with regard to employment of such lower age children and contends that it is out of the scope of audit as well to check such compliance. Comment in the context of relevant standard on auditing whether the contention of management is tenable.

Answer

Part I -- Relevant Standards & Laws

- SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",

Part II -- Requirements of Relevant Standards & Laws

➢ **Auditor should obtain S&A evidence regarding law having direct effect including tax & labour laws**

Compliance with Other Laws: As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

➢ **Non-Compliance may result in fines, litigations or other consequences**

Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements but are not considered to have a direct effect on the financial statements.

➢ **Auditor should understand Nature of act & circumstances→Possible effect on financial statement→Discuss with management→if not satisfied obtain legal advice→if still not able obtain sufficient & appropriate evidence→Modify as per SA 705→Impact on other areas**

If the auditor becomes aware of information concerning an instance of noncompliance or suspected non-compliance with laws and regulations, the auditor shall obtain: (Children working in factory premises, could be contravention of child labour act)

- An understanding of the **nature of the act and the circumstances** in which it has occurred (25 children were working in packing department under supervision of contractor without identity card & age proof); and
- Further information to evaluate the **possible effect on the financial statements**. *(Go through law, amendments, rule to determine penalty, impact on production license etc.)*

If the auditor suspects there may be non-compliance, the auditor **shall discuss the matter with management and, where appropriate, those charged with governance**. If management or, as appropriate, those charged with governance **do not provide sufficient information that supports that the entity is in compliance with laws and regulations** and, in the auditor's judgment, the effect of the Suspected non-compliance may be material to the financial statements, **the auditor shall consider the need to obtain legal advice.** *(Discuss with management if required obtain legal advice E.g., VODAFONE case).*

If sufficient information about suspected non-compliance **cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.** (Modify Opinion)

The auditor shall evaluate the **implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.** (MD / CFO both were aware & they also gave in writing there are no child labour in fire cracker factory, affects reliability of WR)

Part III – Case Discussion

- **Major Portion of Labour Employed was Child Labour / Contention of Management that it was outside scope of financial audit is not acceptable.**
  In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Part IV -- Conclusion

- **After performing audit procedures as given in SA 250, ensure that cost of fines l litigation etc. are properly accounted and disclosed / if not express qualified or adverse opinion as appropriate.**
  Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

QNO 23.100	Non-Compliance (Reporting) Bhaskar CNO - SA250.080	Old Course - (N6E, P17M)

State the reporting responsibility of an auditor in the context of non-compliance of Law and Regulation in an audit of Financial Statement.

Answer

Part I -- Relevant Standards & Laws

- SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",

Part II -- Requirements of Relevant Standards & Laws

According to SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", the reporting responsibilities of an Auditor may be divided into the following categories-

- **Reporting Non-Compliance to Those Charged with Governance:** Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential. If, in the auditor's judgment, the non-compliance referred above is believed to be intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable. If the auditor suspects that management or those charged with governance are involved in non-compliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

- **Reporting Non-Compliance in the Auditor's Report on the Financial Statements:** If the auditor concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall, in, inaccordance with SA 705 express a qualified or adverse opinion on the financial statements.

  If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to

	the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with SA 705. If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with SA 705. ➢ **Reporting Non-Compliance to Regulatory and Enforcement Authorities:** If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

23.500	**Policies and Procedures by management for prevention and detection of non-compliance** **Bhaskar CNO - SA250.080**	**New Course- (N20E)**
	PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations **that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, CA Jazz** wants to implement such policies and procedures **that can assist him in the** prevention and detection of non-compliance **with laws and regulations. Help CA Jazz by** citing examples of such policies and procedures.	
Answer	In PQ Ltd, listed entity, CA Jazz has been appointed as CFO. PQ Ltd is in the business o f manufacturing of specialty chemicals. CA Jazz is concerned about compliance with the provisions of Laws and regulations and wants to implement such policies and procedures that would assist him in prevention and detection of non-compliance with laws and regulations. CA Jazz is specifically wanting examples of types of policies and procedures that PQ Ltd may implement so that relevant laws and regulations are properly complied with. Such examples of policies and procedures are given in SA 250. As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", The following are examples of the types of policies and procedures PQ Ltd. may implement to assist in the prevention and detection of non-compliance with laws and regulations: **i.** Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements. **ii.** Instituting and operating appropriate systems of internal control. **iii.** Developing, publicizing and following a code of conduct. **iv.** Ensuring employees are properly trained and understand the code of conduct **v.** Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it. **vi**. Engaging legal advisors to assist in monitoring legal requirements. **vii.** Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.	

SA 260

QNO 24.000	**Matters to be Communicated to TCWG** **Bhaskar CNO - SA260.060**	**Old Course - (N07E,P17M)**
	"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity" Briefly state the matters to be included in such Communication**.**	

Answer

Part I -- Relevant Standards & Laws

- SA 260 - Communication with those charged with governance

Part II -- Requirements of Relevant Standards & Laws

(Just After Appointment)

➢ **The Auditor's Responsibilities in Relation to the Financial Statement Audit –**

- **forming and expressing opinion on FST prepared by management / doesn't relieve Mgt, TCWG of their responsibilities.**

  The auditor **shall communicate** with those charged with governance the **responsibilities of the auditor** in relation to the financial statement audit, including that:

  - The auditor is **responsible for forming and expressing an opinion** on the financial statements that have been prepared by management with the oversight of those charged with governance; and
  - The audit of the financial statements **does not relieve management or those charged with governance** of their responsibilities.

(Just before starting Audit work)

➢ **Planned Scope and Timing of the Audit – Overview of planned scope & timing including significant risks.**

The auditor shall communicate with those charged with governance an **overview of the planned scope and timing** of the audit, which includes communicating about the significant risks identified by the auditor.

(During the Audit)

➢ **Significant Findings from the Audit**

- **Significant difficulties**
  - **Significant matters discussed or subject to correspondence with Mgt**
  - **Request of WR**
- **Significant Qualitative Aspects including Accounting Policies, Estimates, Disclosures**

  The auditor shall communicate with those charged with governance:
  - **Significant difficulties**, if any, encountered during the audit;
  - Unless all of those charged with governance are involved in managing the entity:
    - **Significant matters** arising during the audit that were discussed, or subject to correspondence, with management; and
    - **Written representations** the auditor is requesting;
  - The auditor's views about **significant qualitative aspects** of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. *(E.g., Whether Accounting Policies are Conservative or Aggressive, Are they in line with industry practices etc.) When* applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;*(SLM & WDV are acceptable & popular in FRF but machine hour method of depreciation is more appropriate);*

(Before signing audit report)

➢ **Circumstances that affect form & content of AR**

Circumstances that affect the form and content of the auditor's report, if any; and
(Key Audit Matters under SA 701 / Modifications Under SA 705 / EMP or OMP under SA 706)

(Others)

➢ **Any Other Significant Matter**

Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process. *(E.g., Safety & Security of financial data)*

(Only in Listed Companies)

➢ **Auditor Independence:-**

- **Statement that team & other in firm complied with relevant ethical requirements regarding independence**

	• All relationships & other matters / audit & non-audit fees
	• Safeguards to eliminate identified threats.
	In the case of **listed entities**, the auditor **shall communicate** with those charged with governance:
	  • A statement that **the engagement team and others in the firm** as appropriate, the firm and, when applicable, network firms have **complied with relevant ethical requirements regarding independence**; and
	  • **All relationships and other matters** between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This **shall include total fees charged** during the period covered by the financial statements for **audit and non-audit services** provided by the firm and network firms to the entity and components controlled by the entity. These **fees shall be allocated to categories** that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
	  • The **related safeguards that have been applied** to eliminate identified threats to independence or reduce them to an acceptable level.

	Author's Note
	Examples of significant matters arising during the course of audit.
	• **Significant Matters means**
	  ○ Significant Risk (CEO & CFO resigned suddenly and no appoints for made for 9 months till year-end)
	  ○ Significant Internal Control Deficiency (Directors sign blank cheques and give to employees for expenses)
	  ○ Significant Difficulty (Management gives information after delays of 2-3 weeks)
	  ○ Material Misstatement (Investment not valued as per AS 13)
	• **Significant Difficulty**
	  ○ Given less time for audit.
	  ○ Not giving access to certain records and people
	  ○ Basic schedules not ready
	  ○ Delay in giving information
	  ○ Extraordinary effort required to gather information

QNO 24.050	**Significant Difficulties During Audit** **Bhaskar CNO - SA260.080**	**New Course - (M22R)**
	M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260.	
Answer	As per SA 260, "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as: (i) Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures. (ii) An unreasonably brief time within which to complete the audit. (iii) Extensive unexpected effort required to obtain sufficient appropriate audit evidence. (iv) The unavailability of expected information. (v) Restrictions imposed on the auditor by management. (vi) Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested. In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.as per SA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report.	

QNO 24.100	Importance of Key Audit Matter Bhaskar CNO - SA260.100	Old Course - (N18R)
	SA 260 requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications about key audit matters will vary with the Circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance. Explain in detail why it is important to communicate key audit matters to those charged with governance.	
Answer	➢ **Preliminary Views Communication** However, the auditor may communicate **preliminary views** about key audit matters when discussing the **planned scope and timing** of the audit and may further discuss such matters when communicating **about audit findings**. • **Robust Communication** Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance. • **Opportunity to TCWG** Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report and provides them with an opportunity to obtain further clarification where necessary. ➢ **Draft of Auditor's Report** The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. ➢ **Conclusion** Communication with those charged with governance recognizes their important role in overseeing the financial reporting process and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.	

QNO 25.000	Communication to Shareholders Vs TCWG UNIQUE	Old Course - (N14E, P17M, M17R) New Course (M18R, S20M)
	Reporting to Shareholders vs Reporting to those Charged with Governance.	

Answer

Shareholder Vs TCWG Reporting

Report	
Reporting to Shareholders	**Reporting to those Charged with Governance**
(Applicability) ➢ **Sec 143 makes it mandatory** Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	➢ **SA 260 makes it mandatory** Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.
(Objective) ➢ **True & Fair View** Statutory Audit Report is on true and fair view and as per prescribed Format.	➢ **Responsibilities, Planning, Significant Difficulties, Significant Matters, Content of AR**

		It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
	(Confidentiality) ➢ **Public Document** Statutory Audit Reports are in public domain.	➢ **Private Document** Reporting to those Charged with Governance is an internal document i.e. private report.

SA 299

QNO 27.100	No Division of Work Bhaskar CNO - SA299.020	Old Course - (N11E, P17M) New Course- (M19E)

ABC & Co. and DEF & Co, Chartered Accountant firms were appointed as joint auditors of Good Health Care Ltd. for 2009-10. A special audit was conducted during March 2011 and observed gross understatement of Revenue.
The revenue aspects were looked after by DEF & Co, but there was no documentation for the division of work between the joint auditors.

OR

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March , 2019.
In the course of audit, it has been observed that there is a major understatement in the value of inventory The inventory valuation % work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors. Comment on the above situation with regard to responsibilities among joint auditors.

Answer

Part I -- Relevant Standards & Laws

- SA 299 on, "Responsibility of Joint Auditors"

Part II -- Requirements of Relevant Standards & Laws

➢ **Documentation for Division of Work between the Joint Auditors:**
As per SA 299 "Responsibility of Joint Auditors", where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves.

Division of audit areas

By Mutual Discussion
1. Business Units
2 .Specified Areas.
3 .Assets or Liab.
4 .Inc or Exp

The division of work would usually be in terms of audit of identifiable units or specified areas.

In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time.

Common audit areas

Due to:
1. Their imp .
2. Nature.
Would not be divided & Covered by all JA

Certain areas of work, owing to their importance or owing to the nature of the work involved, would not be divided and would be covered by all the joint auditors.
The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

Further, each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work in accordance with the generally accepted audit procedures. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.

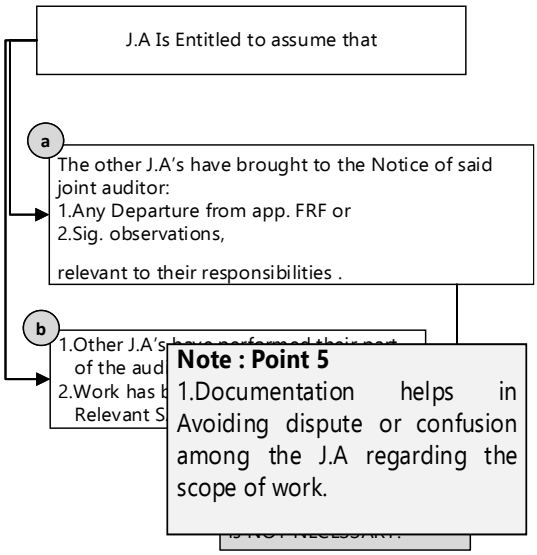
Each joint auditor is entitled to rely upon the other joint auditors for bringing to his notice any departure from generally accepted accounting principles or any material error noticed in the course of the audit.

Part III -- Facts

- In the present case, there was no documentation for the division of work and the responsibility of revenue aspect was delegated to DEF & Co., in which gross understatement of revenue has been observed. ABC & Co. has not reviewed the work as they have put their reliance on the orc performed by DEF & Co.

Part IV -- Conclusion

- Hence, there is a violation of SA 299 as the division of work has not been documented. In the normal course DEF & Co. will be held liable for negligence. If DEF & Co. refuses to accept sole responsibility for the fault, ABC & Co. have to prove by other ways and means of evidence that the particular area of audit was exclusively done by DEF & Co. only.



Author's Note :
Second Question of Dice Ltd is similar to 1st question i.e. ABC & Co. and DEF & Co. They both mention that "there was no documentation for the division of work between the joint auditors" , however the answer of Dice LTD also speaks about Responsibility of Joint Auditors as the question of Dice LTD also asks for "Comment on the above situation with regard to responsibilities among joint auditors. So the answer of DICE Ltd will be a combination of QNO 27.100 & 28.100.

QNO 28.100	Responsibility of Joint Auditors & Difference of opinion amongst Joint Auditor Bhaskar CNO - SA299.040	Old Course – (N04E, M15R, N15E, P17M, N17M, N18E, N18M, N19E) New Course (S17M, M18M, S21M)

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2015-16. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries.

Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.

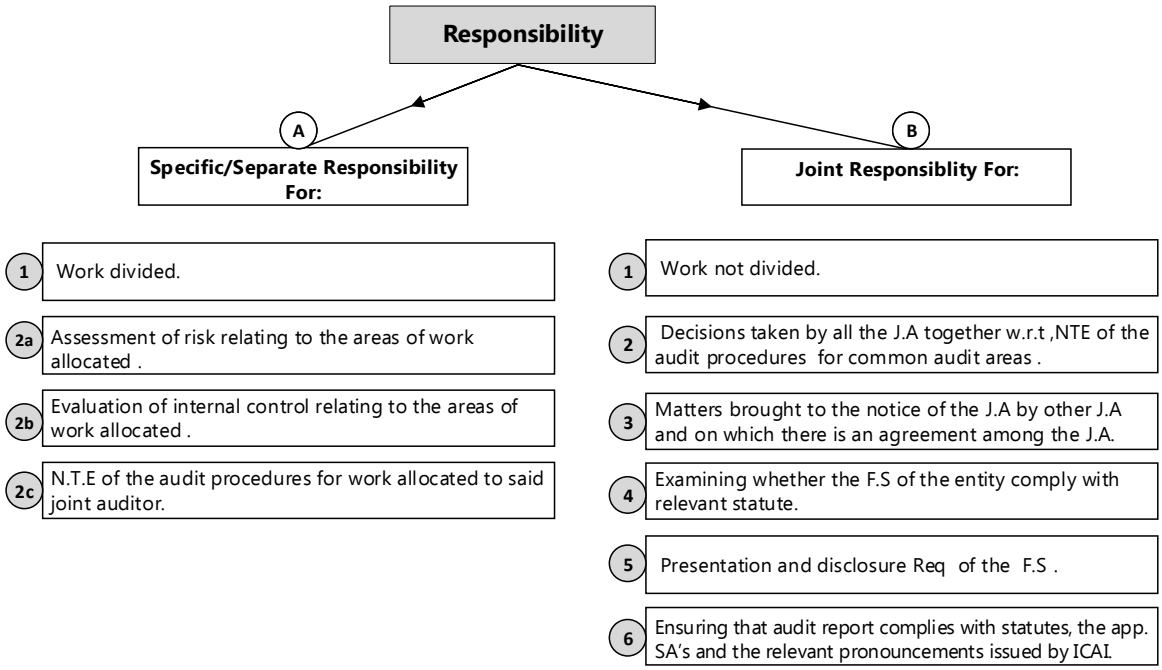
OR

Excellent Bank Ltd. is a Public Limited Company.. The Bank appoints 3 Joint Auditors for the financial year ending 31/03/2019. All the 3 Joint Auditors divide the work with mutual consent. Verification of Consolidation, however, remained undivided.
All branches and zones were divided amongst the 3 Joint Auditors" During audit of zones, CA. Z, one of the joint auditors expressed a concern about internal control in one of the large corporate branches situated in his zone.
The irregularity was net reported, in the final accounts as the other 2 Joint Auditors were not in favour of reporting and decision of not reporting the same was taken on the basis of majority. Subsequently, fraud has been detected in the said branch which was audited by CA. Z.
Bank seeks your advice about the responsibility of the 3 Joint Auditors in the above situation.

Answer

Part I -- Relevant Standards & Laws

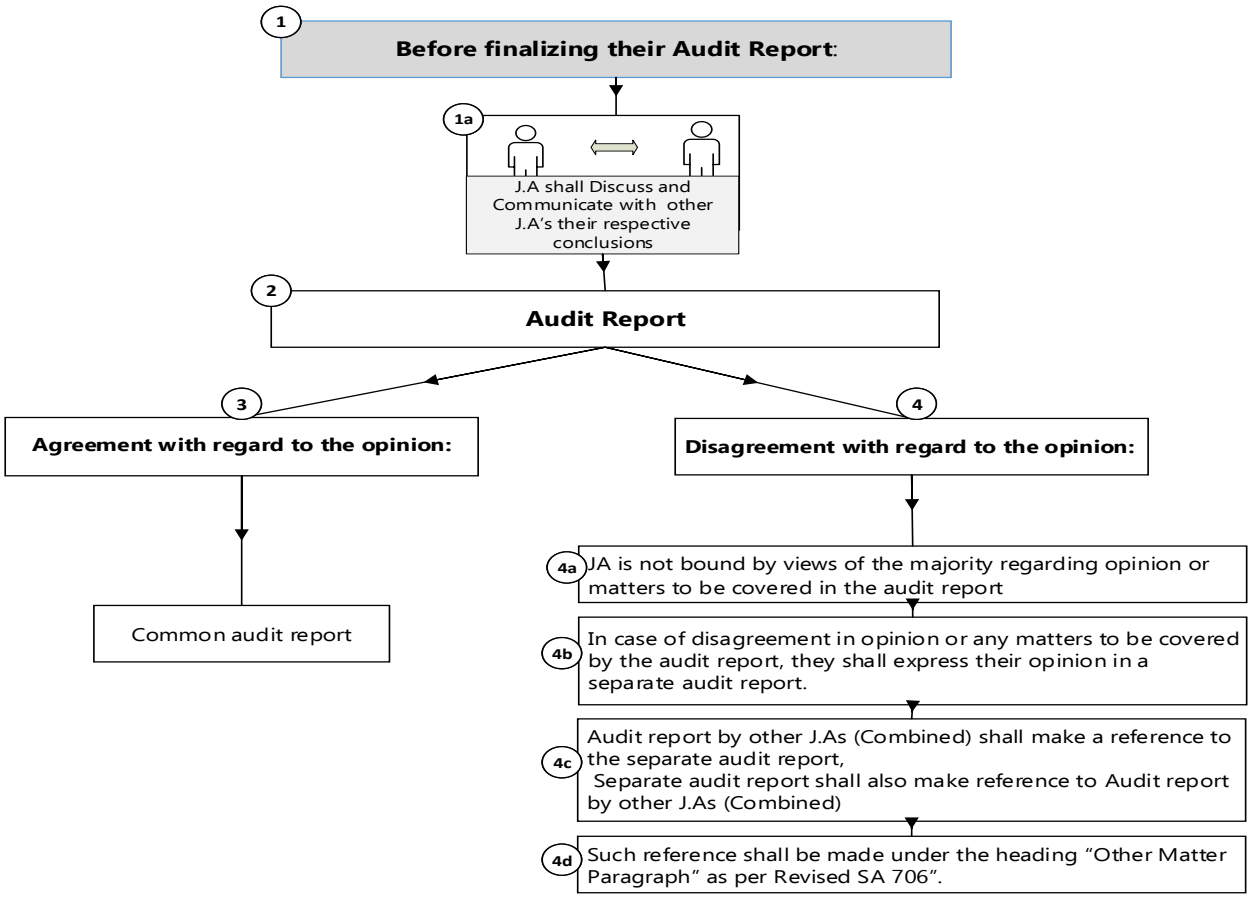
- SA 299 on, "Responsibility of Joint Auditors"



➢ **Difference of Opinion Among Joint Auditors:**

SA 299 on, "Responsibility of Joint Auditors" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand, the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;
- in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute.
- for ensuring that the audit report complies with the requirements of the relevant statute.
- it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
- the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;
- each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.



SA Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express their own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Case I

Part III -- Facts

- In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditors) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.

Part IV -- Conclusion

- Hence, as per SA 299, Mr. Z is suggested to express his own opinion through a separate report whereas Mr. X and Mr. Y may provide their joint report for the same.

Case II (Excellent Bank Ltd)

Part III -- Facts

- In the instant case, Excellent Bank Ltd. Appoints 3 joint auditor for the financial year ending 31.03.2019. All the joint auditors divided the work with mutual consent. The only work which remained undivided was verification of Consolidation. In accordance with SA 299, all the joint auditors are responsible for the same.

  Further, during audit of zone, CA Z, one of the joint auditors expressed a concern about internal control in one of the large corporate branches situated in his zone, however, this irregularity was not reported as 2 of the joint auditors (i.e. majority of the joint auditors) were not in favour of the same. Later on, fraud has been detected in the same branch which was audited by CA. Z

Part IV -- Conclusion

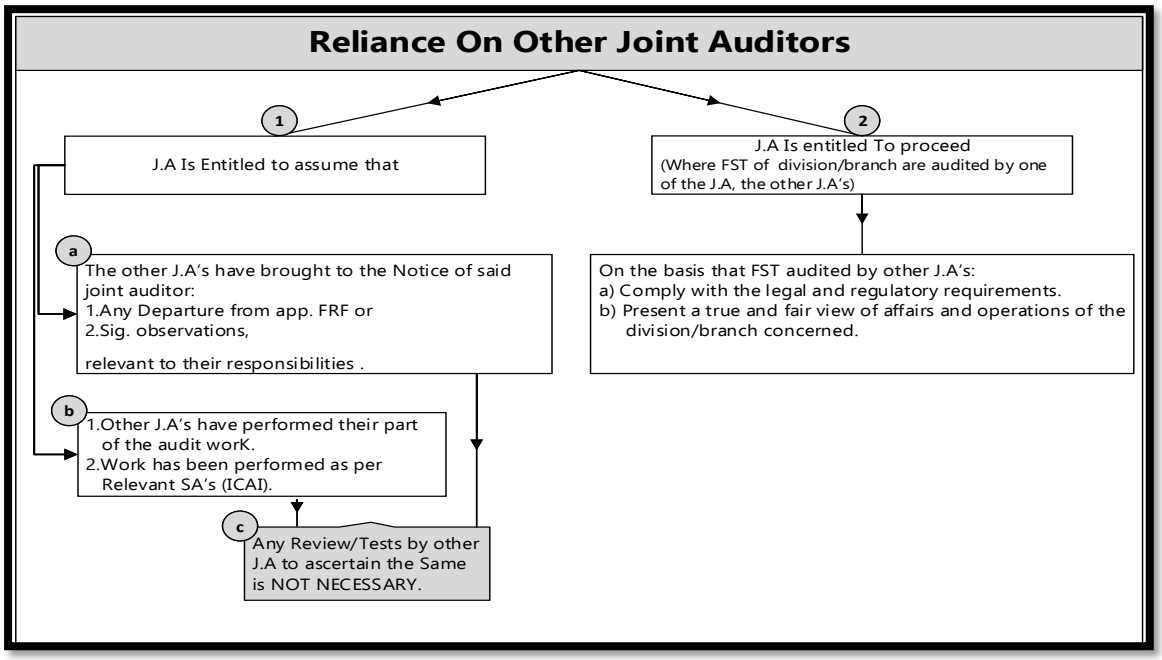
- In the present scenario, CA. Z brought this matter in the notice of the other 2 joint auditors and the decision for not reporting was taken on majority basis and no separate opinion was expressed through

	separate audit report pointing out irregularity. Thus, all the 3 joint auditors will be held responsible for the fraud detected in the branch audited by CA. Z as per SA 299

QNO 28.200	Reliance on other Joint Auditor and reporting Bhaskar CNO - SA299.060/ SA299.080	(M19M)
	NMN & Co LLP and ABC & Associates LLP are the joint statutory auditors of BHS Ltd. BHS Ltd. is a listed company and has been in existence for the last 50 years. Since beginning this company was audited by MQS & Associates but due to audit rotation, the company had to bring in new auditors. Considering the size of the company, two auditors were appointed as joint auditors. Since the company is new to these auditors and the concept of joint auditors to whom audit work has been divided, management had a discussion and understood that each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. Advise.	

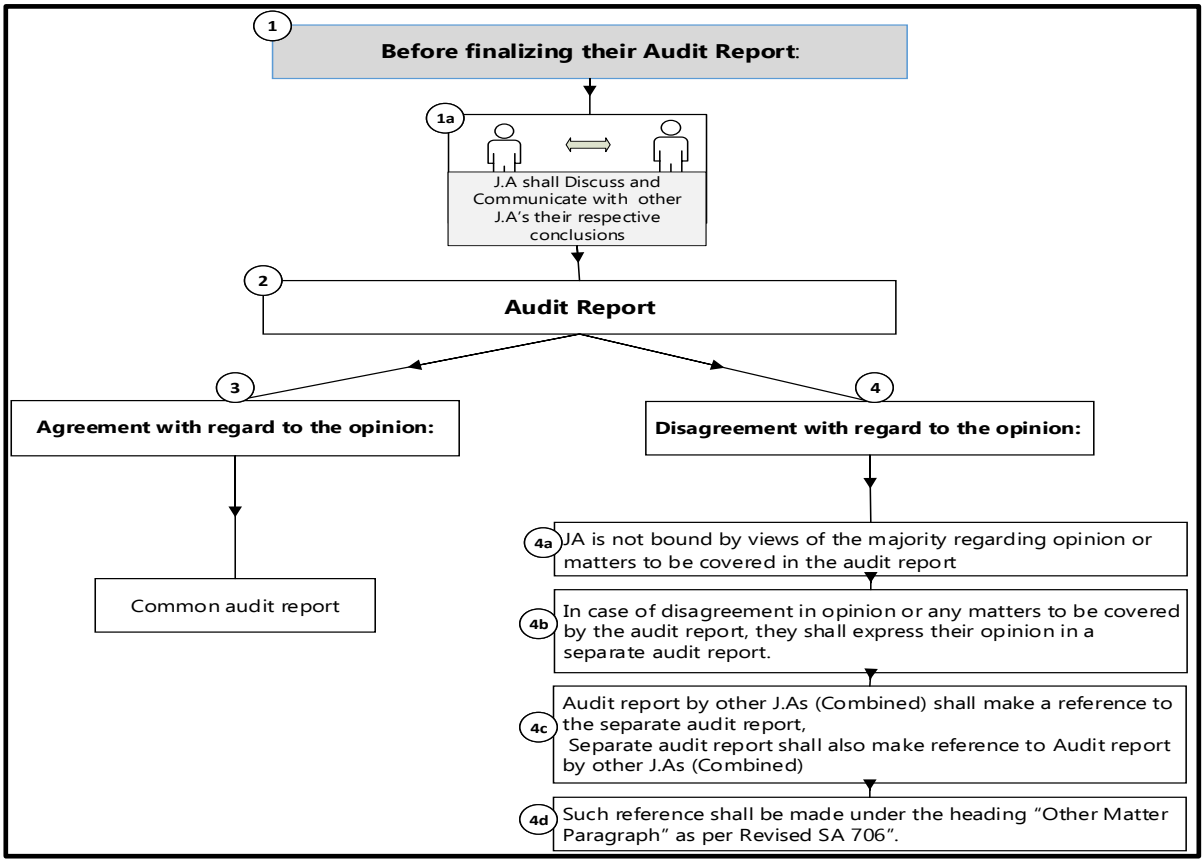
Answer

➢ **Reliance on other Joint Auditor**



- Each joint auditor is entitled to assume that:
  - The other joint auditors have carried out their part of the audit work and the work has actually been performed in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.
  - The other joint auditors have brought to said joint auditor's notice any departure from applicable financial reporting framework or significant observations that are relevant to their responsibilities noticed in the course of the audit.
- Where financial statements of a division/branch are audited by one of the joint auditors, the other joint auditors are entitled to proceed on the basis that such financial statements comply with all the legal and regulatory requirements and present a true and fair view of the state of affairs and of the results of operations of the division/branch concerned.
- Before finalizing their audit report, the joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report.

➢ **Reporting**



- SA 299 "Joint Audit of Financial Statements" deals with the professional responsibilities which the auditors undertake in accepting appointments as joint auditors. The joint auditors are required to issue common audit report, however, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.
- A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s).

  Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

Author's Note

Question is asking to explain two things.

1st Responsibilities of Joint Auditor & 2nd Reporting by Joint Auditor's.

But ICAI in its answer explains concept of "Reliance on other Joint Auditor, instead of "Responsibility of Joint Auditor". We advise to give answer as per what is asked, ICAI answer is inappropriate.

SA 320

QNO 42.000	Benchmark BHASKAR CNO—SA320.020	Old Course – (N13E, N17R, P17M, N18M, N20E,N22E) New Course – (N18M)

CA. B was appointed as the auditor of SRT Limited for the financial year 2021-22. During the course of planning for the audit, CA. B intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.

What benchmark should be adopted by CA. B, if SRT Limited is engaged in:
(i) the manufacture and sale of air conditioners and is having regular profits.
(ii) the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic

OR

Mr X was appointed as the auditor of M/s Easygo Ltd and intends to apply the concept of materiality for the financial statements as a whole Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose.

OR

You are being appointed as the auditor of X Ltd. for the first time You want to determine them materiality level and for that have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of materiality while auditing?

Answer

Part I -- Relevant Standards & Laws

- SA 320, Materiality in Planning and Performing an Audit

Part II -- Requirements of Relevant Standards & Laws

➢ **Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole:**
As per SA 320 prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

➢ **Factors Affecting Identification of Benchmark (Apple LOVE)**
Factors that may affect the identification of an appropriate benchmark include the following:
A- Attention of the users/ L- Life Cycle & Industry & Economic Environment / O- Ownership Structure & Financing / V- Volatility / E- Elements of Financial Statements

	Examples
• The **elements** of the financial statements	• *assets, liabilities, equity, revenue, expenses);*
• Whether there are items on which the **attention of the users of the particular entity's financial statements tends to be focused**	• *for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);*
• The nature of the entity, • where the entity is at in its **life cycle &** • the **industry and economic environment** in which the entity operates	• *Business Entity / Government Entity / Non-Profit* • *Initial Vs Established* • *Recession / Boom*
• The entity's **ownership structure** and the way it is financed	• *if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings*
• The **relative volatility of the benchmark**	• *(NP Vs GP Vs Turnover)*

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

In case if SRT Limited is engaged in manufacture and sale of air conditioner, and is having regular profits: CA. B, the auditor may consider profit before tax /Earnings.

In case if SRT Limited is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA. B, the auditor may consider Revenue or Gross Profit as benchmarking. Alternatively, CA B, the auditor may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity. Where an entity has custody of the assets, assets may be an appropriate benchmark.

QNO 43.000	**Revision of Materiality** **BHASKAR CNO—SA320.080/ SA320.0400**	**Old Course – (N09R, M15E,N16M,S17M,P17M,N17R, M19M)** **New Course – (S17M, M18E,S20M,S21M)**
	As an auditor of BRK Ltd Mr Preet applied the concept of materiality for the financial statements as a whole on the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept Please guide him. **OR** **"Auditor's assessment of materiality may be different at the time of planning the engagement than at the time of evaluating the results of his audit procedures" Discuss.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 320, Materiality in Planning and Performing an Audit **Part II -- Requirements of Relevant Standards & Laws** ➢ **Types of Materiality: -**	

Determine Overall Strategy / While Determining Overall Strategy Determine FST Level Materiality / Determine lower amount for TBD level if it's affecting economic users / Also determine performance materiality at FST level and TBD Level.

As per SA 320 **while establishing the overall audit strategy**, the auditor shall **determine materiality** for the **financial statement as a whole**. He should **set the benchmark** on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of **lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels** to be applied to those particular classes of transactions, account balances or disclosures.

- **Uses of Materiality: -**

  Planning / Performing / Evaluating Misstatements / Uncorrected Misstatements / Opinion on Audit Report

  SA 320 recommends that the concept of materiality is applied by the auditor both in **planning and performing the audit,** and **in evaluating the effect of identified misstatements** on the audit and of **uncorrected misstatements**, if any, on the financial statements and in forming the opinion in the auditor's report.

- **Revision of Materiality: -**

  Auditor shall revise financial statement materiality / TBD level materiality if auditor gets information which was not available initially

  The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) **in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.**

- **What if materiality level is Lowered? -**

  If lower materiality is determined than initial, then think whether it is necessary to revise performance materiality and NTE of further audit procedures

  If the auditor concludes that a **lower materiality** for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether **it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate**

- **Reasons for change: -**

  Change in Circumstances / New Information / Change in Understanding of The Entity & its Operation after performing further audit procedures

  Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit ***(for example, a decision to dispose of a major part of the entity's business)*,** new information *(Ongoing Fraud by MD in Purchases)*, or a change in the auditor's understanding of the entity and its operations *(Bonus is much complicated than thought)* as a result of performing further audit procedures.

- **Example: -**
  - **Actual Financial Results are substantially different from anticipated period end financial results.**

    For example, if during the audit, it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

	Part III – Case Discussion ➢ **Mr Preet determined FST level materiality / Got additional information on contractual arrangements on Particular Aspect of Business** In the instant case, Mr. Preet, as an auditor of BRK Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept **on the basis of additional information of significant contractual arrangements** which draws **attention to a particular aspect of the company's business.** **Part IV – Conclusion** ➢ **If auditor concludes revision is necessary, then revise materiality and also NTE of further audit procedures.** **If the auditor concludes a lower materiality for the same,** then he should consider the fact that whether it is **necessary to revise performance materiality** and whether the **nature, timing and extent of the further audit procedures remain appropriate.** Thus, Mr. Preet can re-evaluate the materiality concepts after considering the necessity of such revision.

SA 330

QNO 47.000	**Compliance Procedures/ Test of Controls** **BHASKAR CNO—SA340.040**	**Old Course – (N08R, P17M)**
	Briefly discuss the compliance procedures and their use in evaluation of internal controls.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 330, 'The Auditor's Responses to Assessed Risks **Part II -- Requirements of Relevant Standards & Laws** ➢ **Definition: -** **Audit Procedures to evaluate operating effectiveness of controls in preventing, detecting and correcting material misstatements at assertion level.** Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. ➢ **Which Controls Should be Tested: -** • **While determining RMM it was expected that the control will operate effectively / Where substantive procedures alone are not sufficient. Higher level of assurance regarding operating effectiveness will be required in such cases.** **The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:** ○ **The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (*i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or (Rate of goods purchased is approved by purchase manager (who is new to organisation), latter system checks it with rates in agreements and average of past 3 / 6 months. Software based control is expected to function effectively so let's check it)*** ○ **Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.** **A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. *(In banks interest and other charges are automated, they are system generated entries in such situations test of***

controls are must they cannot be ignored, in fact we will check them in greater details)

➢ **Nature of test of controls: -**

- **Perform audit procedures in combination of inquiry to obtain audit evidence about operating effectiveness, which includes 1. By whom & what means they are applied / 2. Consistency of their application / 3. How controls are applied during the year / 4. Determine whether other controls (indirect controls) need to be tested**

  In **designing and performing tests of controls, the auditor shall:**

  - **Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:**
    - **How the controls were applied at relevant times during the period under audit.** ***(Are there any changes during the year, if yes have separate evaluation)***
    - **The consistency with which they were applied.** ***(Whether every transaction is evaluated carefully, automated controls are consistent but human based controls can be more or less depending on people or product involved, MD related purchases may be compromised in rates)***
    - **By whom or by what means they were applied.** ***(By Purchase Manager by Signing PO, By Software by matching customer code and rejecting un registered names)***
  - **Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.** ***(Software based controls may depend on general IT / EDP controls of access controls, development controls etc so we will have to check them also)***

➢ **Inquiry alone not sufficient: -**

Observation / Inspection / Reperformance. Inquiry + Inspection or Reperformance is better than Inquiry + Observation / As Observation gives evidence only for point of time. Nature of checking depends on type of control we are checking. E.g. If documents are important inspection should be done.

Further explanation of point above

Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.

The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness.

Author's Note

Answer for this question is changed to bring it in line with SA 330. This question was asked in N09 when standards on auditing were not fully incorporated in ICAI material hence had old outdated answer. It is better to go with SA based better answer.

QNO 47.500	Test of Control Interim Period -- Identifying & Disclosing Related Party UNIQUE	Old Course – (N21R) New Course – (N21R)
	While formulating the audit plan and responding to the risks of material misstatement identified and assessed in related party transaction and relationships, Ms. K the engagement manager of the audit team of ABC Limited, decided to rely upon the internal controls placed for identification and disclosure of	

	related party relationships **and transactions in accordance with the applicable financial reporting framework.** **You are requested to** guide Ms. K regarding the necessity to test the controls to obtain sufficient and appropriate audit evidence**. Also guide,** whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification and disclosure of related party relationships and transactions, in the interim period.
Answer	➢ **SA 550 FAP** As per SA 550, "Related Parties", according to para on "Responses to the risks of material misstatement associated with related party relationships and transactions", the auditor should design and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. ➢ **SA 330--which Controls/NTE** Further, as per SA 330, "The Auditor's Responses to Assessed Risks", the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when: (a) the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. Moreover, the auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls. ➢ **Interim Period** When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall: (a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and (b) Determine the additional audit evidence to be obtained for the remaining period. In the current case, Ms. K shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls as she intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures. Further, she is also required to obtain the audit evidence about significant changes to those controls subsequent to the interim period along with the additional audit evidence to be obtained for the remaining period in accordance with the requirements of Standards on Auditing as discussed above.

QNO 49.000	**Relying on previous year test of controls.** **BHASKAR CNO—SA330.060**	**Old Course – (M13E, N16R, P17M, N19M)** **New Course – (N18R , N19M,M22R)**
	In the course of audit of Z Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 330, 'The Auditor's Responses to Assessed Risks	

	Part II -- Requirements of Relevant Standards & Laws
	➢ **Retesting Controls: - Its matter of professional judgement to decide whether to retest controls and what should be length of time between retesting / Even if there are no changes auditor should test controls once in every third audit. Shall test some controls each audit to avoid possibility of testing all controls in one audit.** **As per** SA 330 **changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.** **If there have not been such changes, the auditor shall test the controls at least once in every third audit and shall test some controls each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods.** ➢ **Factors affecting retesting on controls: -** **Factors that may warrant a re-test of controls are-** **Retesting should be done if there are three Deficiencies in PM's Computer Deficient Control Environment / Deficient General IT Controls / Deficient Monitoring on Controls / Personnel Changes / Manual Controls are Significant / Changing Circumstances.** • **D- Deficient Monitoring of controls.** ***(Purchases not covered in scope of Internal Audit)*** • **D- A Deficient Control environment.** ***(Poor attitude of management towards internal control system is encouragement to wrong doers)*** • **D- Deficient General IT-controls.** ***(Purchase entries are ID restricted, but people use each other's computer, and they know username passwords)*** • **P- Personnel changes that significantly affect the application of the control.** ***(Purchase & Store Manager Retired at the beginning of the year, they were replaced my new comers)*** • **M- A significant Manual element to the relevant controls.** ***(Quotation Selection & Issuing PO is subjective matter and depends on approving authority, behaviour can change over period of time)*** • **C- Changing circumstances that indicate the need for changes in the control.** ***(GST)***

QNO 50.000	**Substantive Procedures** **BHASKAR CNO—SA330.100**	**Old Course – (N12E, P17M)**
	While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 330, 'The Auditor's Responses to Assessed Risks **Part II -- Requirements of Relevant Standards & Laws** ➢ **Substantive Procedures for Material Items: - Irrespective of RMM design and perform SP for each material TBD / Reason being RMM is judgement based and some RMM may not be identified & Inherent Limitation of ICS.** **Designing and Performing Substantive Procedures Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.** **This requirement reflects the facts that:** • **The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and** • **There are inherent limitations to internal control, including management override.**	

- **Effect of Test of Controls: - If test of controls are unsatisfactory then assessed RMM will increase which will lead to increase in substantive procedures / extent will increase / extent ordinarily means increase in sample size / may also include other means of testing.**
  Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory.
  In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

- **Types of Substantive Tests: -**
  - **Only SAP / Only TOD / Combination of Both.**
    Depending on the circumstances, the auditor may determine that:
    - **Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls. *(Electricity bills payments)***
    - **Only tests of details are appropriate. *(Legal Expenses)***
    - **A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks *(Salary)***
- **Substantive Analytical Procedures: - Suitable for Large Volumes of Transactions & Predictable / More details in SA 520.**
  Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, "Analytical Procedures" establishes requirements and provides guidance on the application of analytical procedures during an audit.

- **Test of Details: - Depending nature of risk design test of details / example of existence or occurrence vs completeness.**
  The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. *(List to actual stock → Existence and actual stock to list → Completeness)*

- **External Confirmation: - Shall consider while performing substantive procedures.**
  The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.
- **Closing Process: -**
  - **Shall have SP for Agreeing, Reconcile FST to underlying records / Examine material journal entries & other adjustments while preparing FST / NTE depends on nature and complexity of financial reporting process & RMM.**
    The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:
    - **Agreeing or reconciling the financial statements** with the underlying accounting records; and
    - Examining **material journal entries and other adjustments** made during the course of preparing the financial statements.

    The **nature, and also the extent, of the auditor's examination of journal entries and other adjustments depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement**

QNO 50.500	**Factors to be considered while deciding whether to go for external confirmation** **BHASKAR CNO—SA330.120**	**New Course – (N21E)**
	Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures	
Answer	**Factors that may assist Mr. Agarwal, the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:** (i) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed. (ii) The ability or willingness of the intended confirming party to respond – for example, the confirming party: • May not accept responsibility for responding to a confirmation request; • May consider responding too costly or time consuming; • May have concerns about the potential legal liability resulting from responding; • May account for transactions in different currencies; or • May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations. In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response. (iii) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.	

QNO 52.000	Understanding Services Given by SO BHASKAR CNO--SA402.020/SA402.040	Old Course – (M06E, M11E, M12M, N12R, N13E, N14R, M16R, P17M, M17R,N19M) New Course – (N18R, N18M,N19M,M23M)

In the course of audit of Raja and Rank Ltd, the audit manager of Sharma & Co observed that Raja and Rank Ltd has outsourced certain activities to an outsourcing agency.

(a) As the engagement partner, guide the audit manager in the assessment of services provided by the outsourcing agency in relation to the audit

(b)What are sources of information for understanding SO services.

(c) Discuss the procedure to be applied in case the user auditor is unable to obtain a sufficient understanding from the user entity?

OR

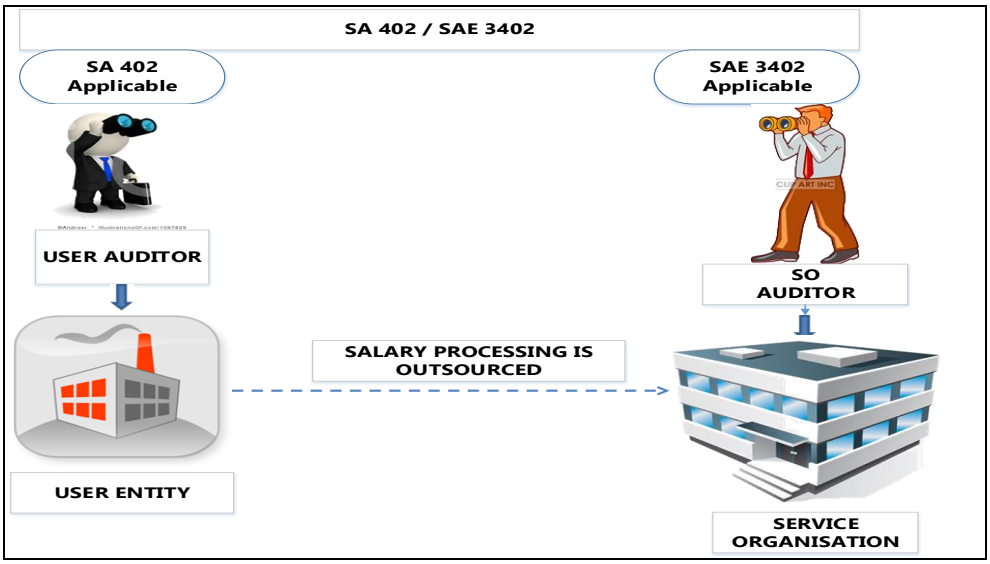
In the course of audit of FIN Limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. FIN Limited used a service organisation to record transactions and process related data. As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

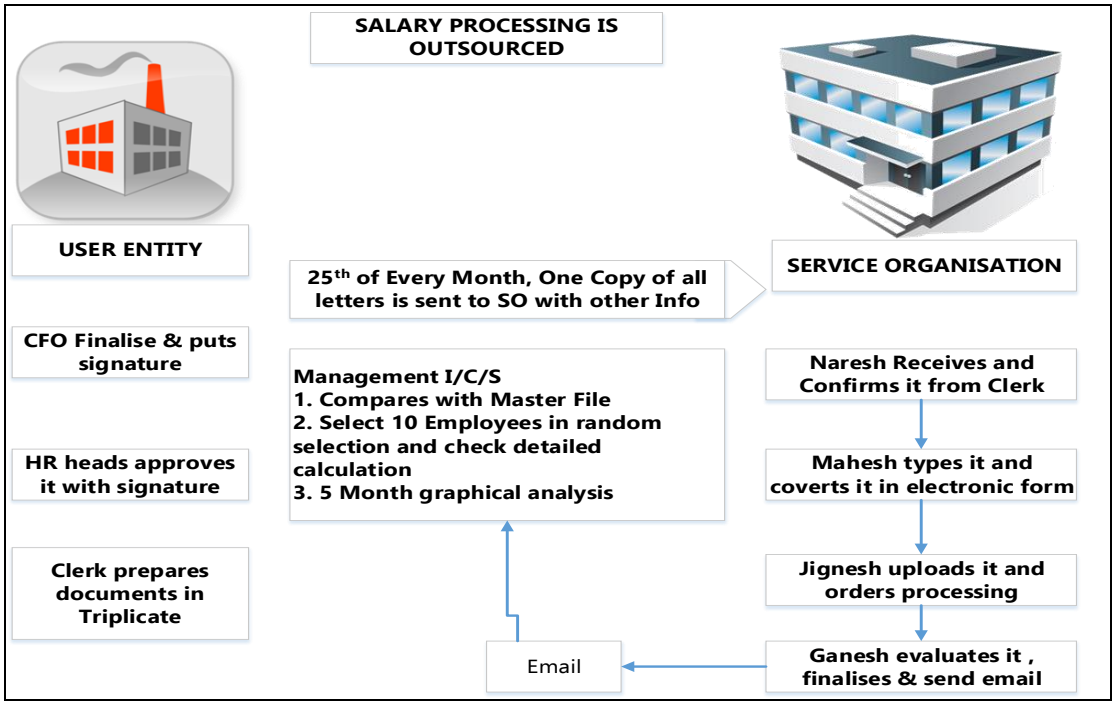
Answer

Part I -- Relevant Standards & Laws

- SA 402, Audit Considerations relating to an Entity Using a Service Organisation

Part II -- Requirements of Relevant Standards & Laws





a)

- **Obtaining Understanding: - Obtaining understanding of entity & its environment is covered under SA 315 / SA 402 further explains which information should be obtained if services of SO is used.**

  As per SA 402 for obtaining understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operation including:

- **Four Information points are Related to Services.**
  - **Nature of Services / Significance of Services / Effect of Services on ICS / Nature & Materiality of TBD affected by Service.**
    - The **nature of services** provided by the service organisation and the **significance of such services** to the user entity, including its **effect on the internal control of user entity.**
    - The **nature and materiality** of the transactions processed, or accounts or financial reporting processes affected by the service organisation.

- **Three Information Points are Related to SO**
  - **Nature of Relationships with SO / Degree of Interaction with SO / Relevant Controls applied on transactions processed by SO**
    - The nature of the **relationship between the user entity and the service organization** including the relevant contractual terms for the activities undertaken by the service organisation.
    - The **degree of interaction** between the activities of the service organization and those of user entity and

  When obtaining an understanding of internal control relevant to the audit in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", **the user auditor shall evaluate the design and implementation of relevant controls** at the user entity that relate to the services provided by the service organisation, **including those that are applied to the transactions processed by the service organisation.**

(b)

- **Sufficient Understanding should be obtained Services Received & SO, so that auditor can go for Identification & Assessment of RMM.**

  The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal

control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

Sources of Information –

Information on the nature of the services provided by a service organisation may be available from a wide variety of sources, such as **1.** the contract or service level agreement **between the user entity and the service organisation; 2.** system overviews**; 3.** technical manuals**; 4.** user manuals**; 5.** reports by service organizations**; 6.** reports by the service auditor**; 7.** internal auditors or regulatory authorities on controls **at the service organisation; 8. including** management letters, **if available.**

Knowledge obtained through the user auditor's experience with the service organisation, for example through experience with other audit engagements, may also be helpful in obtaining an understanding of the nature of the services provided by the service organisation. This may be particularly helpful if the services and controls at the service organisation over those services are highly standardized.

(c)

- **If Sufficient understanding is not obtained from User Entity, then following procedures can give auditor better understanding. *(In sequence of ease of doing procedures)***
  - **Type 1 or Type 2 Report / Contact SO through UE / Using Another Auditor / Visiting SO**

    If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:
    - Contacting the service organisation, through the user entity, to obtain specific information;
    - Obtaining a Type 1 or Type 2 report, if available;
    - Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organisation.
    - Visiting the service organisation and performing procedures that will provide the necessary information about the relevant controls at the service organisation;

Author's Note: -
It is a Kind of Master answer for SA 402 covering more than a single topic. Please consider the question asked and don't just write the entire answer.
Choose the relevant part of answer on the basis of question asked.

QNO 52.100	Factors to decide relevance of SO Services BHASKAR CNO--SA402.060	Old Course – (M18E) New Course – (N21E)

Durafone Mobile Co. Ltd. have pan India presence and market leader in mobile operation. It has outsourced all its revenue operation including accounting functions to Set Solutions (P) Ltd. As an Auditor of the mobile company, enumerate the factors to be taken into consideration related to its financial reporting.

Answer

- As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", services provided by a service organisation are **relevant to the audit of a user entity's financial statements** when those services, and the controls over them, are **part of the user entity's information system, including related business processes, relevant to financial reporting.** *(E.g. Security, Cleaning services outsourcing may not be relevant for auditor)*

  Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services **affect any of the following:**

  Most relevant service is given by **ESCAPE** button.
  - **Estimates**-The financial reporting process used to prepare the user entity's financial statements, **including significant accounting Estimates and disclosures**; *(E.g. Useful life of assets, inventory valuation etc)*

- **Significant** -The **classes of transactions** in the user entity's operations that are **Significant to the user entity's financial statements**; *(E.g. online sales occur from third party websites like amazon / flipkart etc)*
- **Captures** -How the user entity's information system **Captures events and conditions, Other than transactions, that are significant to the financial statements**; *(E.g. Impairment testing of plant, goodwill, financial instruments are outsourced to ca firm)*
- **Accounting -The related Accounting records, either in electronic or manual form,** supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger; *(E.g. Creditor ledger accounting outsourced)*
- **Procedures -The Procedures, within both information technology (IT) and manual systems,** by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements; *(E.g. Raw material price collection, party evaluation, quality check is outsourced)*
- **Entries -Controls surrounding journal Entries,** including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. *(E.g. Year end journal entries are passed by specially hired CA Firm)*

QNO 53.000	Sub Service Organisation BHASKAR CNO--SA402.100	Old Course – (M15E, P17M) New Course –(S17M, S21M)

When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls **The service organization determines which method will be used As a user auditor what information would you obtain about controls at a sub-service organization?**

Answer

Part I -- Relevant Standards & Laws

- SA 402, Audit Considerations relating to an Entity Using a Service Organisation

Part II -- Requirements of Relevant Standards & Laws

- **Use of Subservice Organisation: - It may happen that UE is taking services from, SO which are in turn given by SSO. SSO can be related to SO or sperate entity all together.**
  In accordance with SA 402 a **user entity may use a service organisation that in turn uses a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting.** The sub-service organisation may be a **separate entity from the service organisation or may be related to the service organisation.**

- **Controls at SSO: - Auditor needs to consider controls at SSO. Two important factors Interactions / Nature & Materiality of Transactions in determining significance of SO & SSO controls. Interaction will include interaction between UE / SO / SSO**
  A user auditor may need to **consider controls at the sub-service organisation.** In situations where one or more sub-service organisations are used, **the interaction between the activities of the user entity and those of the service organisation is expanded to include the interaction between the user entity, the service organisation and the sub-service organisations.** The degree of this interaction, as well as the **nature and materiality of the transactions processed by the service organisation and the sub-service organisations** are the most important factors for the user auditor to consider in determining the **significance of the service organisation's and sub-service organisation's controls to the user entity's controls.**

- **Sufficient Understanding: - Nature of Services / Significance of Services / Effect of Services on ICS**
  Further, the user auditor shall determine whether **a sufficient understanding of the nature and significance of the services provided by the service organisation** and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

- **If Sufficient understanding is not obtained from User Entity, then Type 1 / Type 2 can give auditor better understanding.**

Two Methods of Reporting: - SO Auditor may either include or exclude control objectives & controls of SSO. These 2 methods of reporting are called inclusive & carve out method respectively.

It is mandatory for SO to include description of controls at SSO in its description of controls. If carve out method of reporting is used and controls at SSO are relevant then auditor needs to apply requirements of SA 402 in respect of SSO

If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding by application of the following two methods of presenting description of internal controls i.e. (i) Type 1 report; or (ii) Type 2 report.

If a service organisation uses a subservice organisation, the service auditor's report may either include or exclude the subservice organisation's relevant control objectives and related controls in the service organisation's description of its system and in the scope of the service auditor's engagement.

These two methods of reporting are known as the inclusive method and the carve-out method respectively.

In either method, the service organisation includes in its description of controls a description of the functions and nature of the processing performed by the subservice organisation. If the Type 1 or Type 2 report excludes the control at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of the SA 402 in respect of the subservice organization. The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organization depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

QNO 53.050	Giving Reference of Type 1 & Type 2 report BHASKAR CNO--SA402.120	Old Course – (N20R,M21M) New Course–(N20R,N21M,M21M,N22M)

ENN Limited is availing the services of APP Private Limited for its payroll operations. Payroll cost accounts for 65% of total cost for ENN Limited. APP Limited has provided the type 2 report as specified under SA 402 for its description, design and operating effectiveness of control.

APP Private Limited has also outsourced a material part of payroll operation M/s SMP & Associates in such a way that M/s SMP & Associates is sub-service organization to ENN Limited. The Type 2 report which was provided by APP Private Limited was based on carve-out method as specified under SA 402.

CA Raman while reviewing the unmodified audit report **drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence** asked his assistant to remove such reference and modify report accordingly.

Comment whether CA Raman is correct in removing the reference of the work done by service auditor?

Part I -- Relevant Standards & Laws

- SA 402, Audit Considerations relating to an Entity Using a Service Organisation

Part II -- Requirements of Relevant Standards & Laws

- **Reporting by the User Auditor:**

  As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organization", the user auditor shall modify the opinion in the user auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements.

  The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.

Part III – Case Discussion

- CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor.

Part IV – Conclusion

	➢ Thus, in view of above, contention of CA. Raman in removing reference of the work done by service auditor is in order as in case of unmodified audit report, user auditor cannot refer to the work done by service auditor.

SA 450

QNO 54.000	Sources of Misstatement BHASKAR CNO--SA450.020	Old Course – (M12M, N12R, M13E, P17M, M18M) New Course – (N18R,M22R)
	In audit plan for T Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them Identify the sources of misstatements.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 450, Evaluation of Misstatements identified during the Audit **Part II -- Requirements of Relevant Standards & Laws** ➢ According to SA 450, the following are the sources of misstatements arising from other than fraud ➢ **omission / Inaccurate Gathering of Data / Inappropriate selection & application of AP / Inaccurate Processing / Unreasonable Estimates by Mgt / Incorrect Estimate because of Overlooking or Misinterpretation** • An **omission** of an amount or disclosure; • An **inaccuracy in gathering** or **processing data** from which the financial statements are prepared; • **Judgments of management** concerning accounting estimates that the auditor considers **unreasonable** or the **selection and application of accounting policies that the auditor considers inappropriate.** • An **incorrect accounting estimate** arising from **overlooking**, or **clear misinterpretation of facts**; and	

QNO 55.000	Impact of Uncorrected Misstatement BHASKAR CNO--SA450.040	Old Course – (N14E, P17M, N17E)
	The auditor of XY & Co Ltd has intimated the management that certain misstatements identified during the course of audit need to be corrected as an auditor, discuss the impact of such misstatements in case the management does not carry out the said corrections.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 450, Evaluation of Misstatements identified during the Audit **Part II -- Requirements of Relevant Standards & Laws** *(In this particular question points 1 to 4 were not required, but it is good to write them and easier to remember only one full 10 points answer, so if you are short of time only write 5 to 10)* ➢ **Accumulate misstatements unless clearly trivial.** The auditor shall **accumulate misstatements** identified during the audit, other than those that are **clearly trivial.** ➢ **Revision of Overall Audit Strategy & Audit Plan: -** ➢ **if aggregate misstatement reaches materiality or if aggregate misstatements & other misstatements which may exist together reaches materiality.** The auditor shall determine whether the **overall audit strategy and audit plan need to be revised if**: • The nature of identified misstatements and the circumstances of their occurrence **indicate that other misstatements may exist** that, when aggregated with misstatements accumulated during the audit, could be material; or • The **aggregate of misstatements accumulated during the audit approaches materiality** determined in accordance with SA 320. ➢ **Communicate on timely basis all misstatements and request to correct them.**	

The **auditor shall communicate on a timely basis all misstatements** accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation**. The auditor shall request management to correct those misstatements.**

- **Additional Audit Procedure to check corrections.**
  If, at the auditor's request, **management has examined a class of transactions, account balance or disclosure and corrected misstatements** that were detected, the auditor **shall perform additional audit procedures** to determine whether misstatements remain.

- **Mgt Refusal / Uncorrected Misstatement: - If Mgt refuses understand reasons & evaluate whether FST are materially misstated**
  If management **refuses to correct some** or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of **management's reasons for not making the corrections** and shall take that understanding into account when **evaluating whether the financial statements as a whole are free from material misstatement.**

- **Reassesses materiality before evaluating impact of uncorrected misstatements.**
  Prior to evaluating the effect of uncorrected misstatements, **the auditor shall reassess materiality determined in accordance with SA 320** to confirm whether it remains appropriate in the context of the entity's actual financial results.

- **While Evaluation impact of misstatements consider them individually or in aggregate.**
  - **Consider size as well as nature of misstatement at TBD level and FST level/ Also consider effect of uncorrected misstatements of prior periods while aggregating misstatements.**
    The auditor **shall determine whether uncorrected misstatements are material, individually or in aggregate.**
    In making this determination, the auditor shall consider:
    - The **size and nature of the misstatements**, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
    - The **effect of uncorrected misstatements related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

- **Communicate to TCWG all uncorrected misstatements. Identify material misstatements individually, also uncorrected misstatements of previous period. Explain effect on opinion. And request them to correct all misstatements.**
  The auditor **shall communicate with those charged with governance uncorrected misstatements** and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. **The auditor shall request that uncorrected misstatements be corrected.** The auditor shall also **communicate with those charged with governance the effect of uncorrected misstatements related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

- **WR from Mgt / TCWG on whether they believe effects of misstatements in individual or aggregate is immaterial. WR should have attached list of such misstatements.**
  The auditor shall request a **written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial,** individually and in aggregate, to the financial statements as a whole. **A summary of such items shall be included in or attached to the written representation.**

- **Consider effect on Audit Opinion as per SA 705**
  Consider effect of uncorrected misstatements on Audit Opinion as per SA 705.

QNO 57.000	Inquiry BHASKAR CNO--SA500.040	Old Course – (P17M, M17E,M21E)
	'Inquiry' as one of the methods of collecting audit evidence. OR During the course of audit of a Limited company, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence.	
Answer	• **Definition** Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. • **Written or Oral** Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. • **Responses** Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide the auditor with information **not previously possessed** or with **corroborative audit evidence.** Alternatively, responses might provide information that **differs significantly from other information** that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to **modify or perform additional audit procedures.** • **Evidence about Management's Intent** Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.	

QNO 58.000	Evaluating work of Management's Expert BHASKAR CNO--SA500.100	Old Course – (M04E, M09E, M11E, N11E, M12R, N12M, M13M, N15R, M16E, P17M, N18M,M18E,N20E) New Course – (M18E,M18M, N20M)
	CA. Needle had been appointed as an Auditor of M /s Fahric Ltd In the course of audit, it had been observed that inventory including work -in¬ process had been valued by Management by using experts hired by them. Analyse relevant factors to decide as to whether or not to accept the findings from the work of Management expert in valuation of inventories**.** **OR** **The auditor of CROX Ltd. accepted the** gratuity liability valuation based on the certificate issued by a qualified actuary**. However, the auditor noticed that the** retirement age adopted is 65 years **as against the** existing retirement age of 60 years**. The company is** considering a proposal to increase the retirement age to 65 years. Comment. **OR** **Explain the** responsibility of auditors**, in case,** report made by Mr Y's actuary, found faulty **OR** **PDJ Ltd. has engaged an actuary to ascertain actuarial valuation of defined benefit obligations viz. Gratuity and Leave Encashment liabilities. As an auditor of PDJ Ltd. you would like to use the report of the actuary as audit evidence.** How would you evaluate the work of the actuary?	

Answer

Part I -- Relevant Standards & Laws

- SA 500 "Audit Evidence"

Part II -- Requirements of Relevant Standards & Laws

➢ **Three Steps before relying on Management's Expert: -**

- **Evaluate Competence, Capabilities, Objectivity/ Understand field of Expert/ Evaluate appropriateness of Work.**

  The auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes.
  - Evaluate the **competence, capabilities and objectivity** of that expert.
  - Obtain an **understanding of the work** of that expert; and
  - Evaluate the **appropriateness of that expert's work** as audit evidence for the relevant assertion.

➢ **Competence, Capabilities and Objectivity- Obtain information from sources / qualification, published papers & books, previous work with expert, discussion with expert, discussion with other who are familiar with expert.**

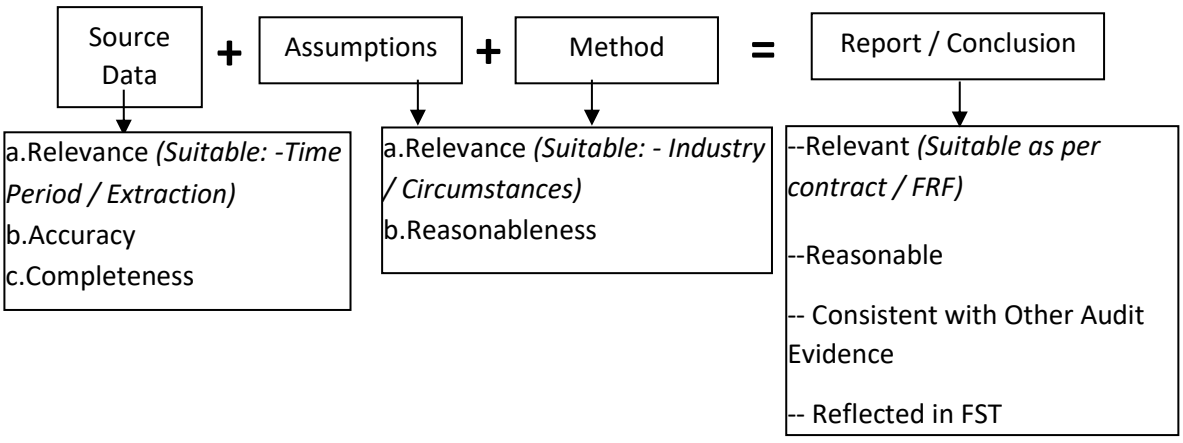
The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as
- **knowledge of that expert's qualifications**;
- **published papers or books** written by that expert.
- **personal experience** with previous work of that expert;
- **discussions** with that expert;
- **discussions with others** who are familiar with that expert's work;

➢ **Understanding Work of Expert: - Understand aspects of expert's field including assumption and methods.**

Aspects of the management's expert's field relevant to the auditor's understanding may include what **assumptions and methods** are used by the management's expert, and whether **they are generally accepted within that expert's field and appropriate for financial reporting purposes.**

➢ **Evaluating Work of Expert: -**

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:
- If that expert's work involves **significant use of source data**, the relevance, completeness, and accuracy of that source data.
- If that expert's work involves use of **significant assumptions and methods**, the relevance and reasonableness of those assumptions and methods; and
- The **relevance and reasonableness** of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;



Author's Note

If question is silent, we can assume its management expert and such assumption should be clearly written

QNO 58.500	Expert report inconsistent with other audit evidence BHASKAR CNO--SA500.100	Old Course – (N11R, N16R, P17M, M19R) New Course – (S17M, M19R, S21M)
	Based upon the legal opinion of a leading advocate, X Ltd made a provision of Rs 5 crores towards Income Tax liability The assessing authority has worked out the liability at Rs 50 crores It is observed that the opinion of the advocate was inconsistent with legal position with regard to certain revenue items **OR** **Based upon the legal opinion of a leading advocate, X Ltd. made a provision of ` 3 crores towards Income Tax liability. The assessing authority has worked out the liability at ` 5 crores. It is observed that the opinion of the** advocate was inconsistent with legal position with regard to certain revenue items**.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 500 "Audit Evidence" **Part II -- Requirements of Relevant Standards & Laws** ➢ **SA 500** SA 500 on "Audit Evidence" discusses the auditor's responsibility in relation to and the procedures the auditor should consider in, using the work of an expert as audit evidence. ➢ **Use of Expert** During the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert, e.g., legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc. ➢ **Responsibility** Before relying on advocate's opinion, the auditor should have seen that opinion given by the expert is prima facie dependable. The question states very clearly that the opinion of the advocate was inconsistent with legal position with regard to certain items. It is, perhaps, quite possible that auditor did not seek reasonable assurance as to the appropriateness of the source data, assumptions and methods used by the expert properly. ➢ **Case Discussion** In fact, SA 500 makes it incumbent upon the part of the auditor to resolve the inconsistency by discussion with the management and the expert. In case, the experts' work does not support the related representation in the financial information the inconsistency in legal opinions could have been detected by the auditor if he had gone through the same. ➢ **Conclusion** This seems apparent having regard to wide difference in the liability worked out by the assessing authority. Under the circumstance, the auditor should have rejected the opinion and insisted upon making proper provision.	

SA 501

QNO 59.000	Physical Verification on different date BHASKAR CNO--SA501.060	New Course – (N20E)
	Moon Ltd. is a dealer in electronic appliances. The Company has a centralized warehouse at the outskirts of Mumbai. The Auditors of the company M/s JK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month. **In the light of the above facts:** **Enumerate the audit procedures to be** considered by M/s JK Associates if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing.	

As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor, JK Associates, shall perform the following procedures:

- **Physical Verification**
  - Attendance at physical inventory counting, unless impracticable, to:
    - Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
    - Observe the performance of management's count procedures;
    - Inspect the inventory; and
    - Perform test counts; and
  - Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
- **Reconciliation**

  In addition to above, auditor shall also perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

  Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
    - Whether the perpetual inventory records are properly adjusted.
    - Reliability of the entity's perpetual inventory records.
    - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

QNO 60.000	Physical Verification & Cases it is Impractical BHASKAR CNO--SA501.040/SA501.080	Old Course – (M13M, M15R, N15E, M16M, P17M, M17M, M18M, M18E, M20R) New Course – (M18R, M20R, S21M, N22M)

XYZ Ltd supplies navy uniforms across the country The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders The major stocks are generally supplied from the borders XYZ Ltd appointed M/s MNO & Co to conduct its audit for the financial year 2016-17 Mr O, partner of M/s MNO & Co, attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s MNO & Co,

(a) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

(b) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

OR

"RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment.

You are the auditor of RIM Private Ltd. The inventory as at the end of the year was ` 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?"

OR

The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period. As a result, the engagement Partner decided not to perform any physical count of inventory as it will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement. In the light of SA 501, evaluate whether the decision taken by the Engagement Partner is appropriate or not.

Answer

Part I -- Relevant Standards & Laws

- **SA 501, Audit Evidence- Specific Considerations for Selected Items**

Part II -- Requirements of Relevant Standards & Laws

a)

➢ **Sufficient & Appropriate Evidence: - When inventory is material obtain S&A evidence for Existence & Condition**

As per SA 501 When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the **existence and condition of inventory** by:

➢ **Two steps to obtain evidence**

- **Step 1: - Attend physical verification and perform following Evaluate Mgt instructions & procedures, obtain evidence foe reliability of procedures / Observe counting / Inspect inventory / Perform test counts**

  Attendance at physical inventory counting, unless impracticable
  - Evaluate **management's instructions and procedures** for recording and controlling the results of the entity's physical inventory counting; Obtaining audit evidence as to the reliability of management's count procedure
  - Observe the **performance of management's count procedures**
  - **Inspect the inventory**; and
  - Perform **test counts**; and

- **Step 2: - Performing audit procedures on final inventory records and comparing them with actual inventory count results**

  Performing audit procedures over the entity's **final inventory records to determine whether they accurately reflect actual inventory count results.**

- **Suitable for both as Test of Controls or Substantive Procedures**

  These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

(b)

➢ **Reasons for Impractical Inventory Counting: - Nature & Location of Inventory**

In some cases, attendance at physical inventory counting may be impracticable.

This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable.

➢ **Example of Alternative Procedures: - Verify Subsequent Sale**

In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

➢ **Alternative Procedures Doesn't Give S&A Evidence – Modify Opinion as per SA 705**

In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In

	such cases, SA 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. ➢ **SA 501 Specific Principle: - If impractical Perform Alternative Procedures / If not possible then modify as per SA 705** If attendance at physical inventory counting is impracticable, the auditor shall perform **alternative audit procedures** to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. **If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.** ➢ **SA 200 General Principle: - Difficulty / Time / Cost is no itself valid basis to omit audit procedure for which there is no alternative or evidence available is less than persuasive** In SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

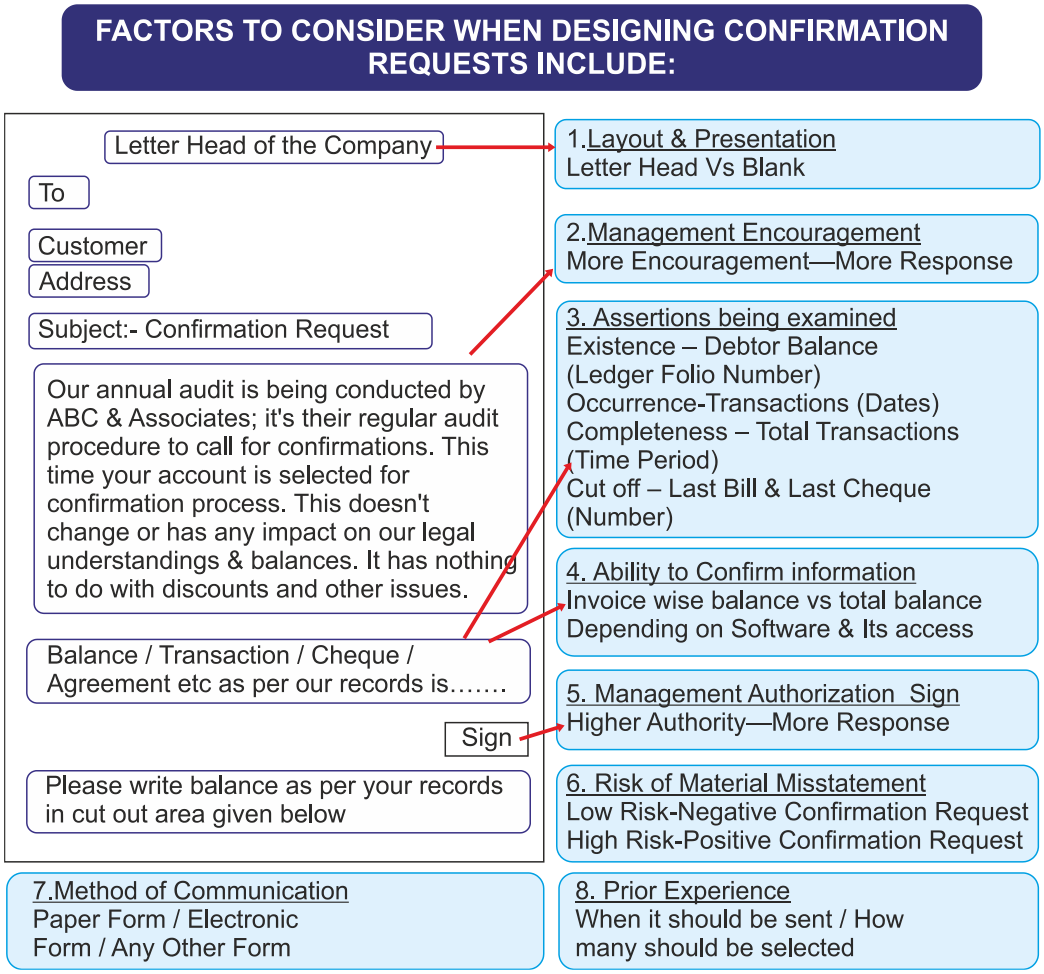
QNO 60.050	**Inventory under the Custody and Control of a Third Party** **BHASKAR CNO--SA501.100**	**(N19R)**
	Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2018-19. While verification of company's inventories as on 31st March 2019, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them?	
Answer	➢ **Basic Principle** **Basic Principle – If Custody & Control of Third Party then Request Confirmation or Other Audit Procedures** When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: • Request **confirmation from the third party** as to the quantities and condition of inventory held on behalf of the entity. • Perform **inspection or other audit procedures** appropriate in the circumstances. ➢ **Confirmation** SA 505 establishes requirements and provides guidance for performing external confirmation procedures. ➢ **Other Audit Procedures** Depending on the circumstances, for example where information is obtained **that raises doubt about the integrity and objectivity of the third party,** the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include: • **Inspecting documentation regarding inventory held by third parties,** *for example, warehouse receipts.* • Requesting confirmation from **other parties when inventory has been pledged as collateral.** *(Warehouse Owner)* • Obtaining **another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control** for ensuring that inventory is properly counted and adequately safeguarded. • **Attending, or arranging for another auditor to attend,** the third party's physical counting of inventory, if practicable.	

QNO 60.060	Understanding methods used by management for determining segment information BHASKAR CNO--SA501.160	New Course – (N20E)
	GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.	
Answer	The auditors, GHK Associates wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include: (i) Sales, transfers and charges between segments, and elimination of inter-segment amounts. (ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales. (iii) The allocation of assets and costs among segments. (iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.	

SA 505

QNO 61.000	External Confirmation (Uses) BHASKAR CNO--SA505.020	Old Course – (N07E, M09R, N09E, P17M)
	Write a short note on Situations where external confirmations can be use.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 505 "External Confirmation" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Situations where external confirmations can be obtained (In sequence of balance sheet, First Asset Side and then Liability Side)** • **Property title deeds held by third parties | Investments purchased but delivery not taken | Stock held by third parties | Debtor balances | Bank Balance and other information from bankers | Bank loans | Creditor balances | Transactions & related details | Terms of agreement or transactions with third parties** • Bank balance from bankers • Account receivable balances • Inventories held by third parties • Property title deeds held by third parties • Investments purchased but delivery not taken • Loan from lenders (vii) Account payable balances • Long outstanding share application money.	

QNO 62.000	Designing Confirmation Request BHASKAR CNO--SA505.040	Old Course – (M16E, N17M, N18R) New Course – (S17M, S21M)
	Mr H who is appointed as auditor of EXL Co Ltd wants to use confirmation request as audit evidence during the course of audit What are the factors to be considered by Mr H when designing a confirmation request? Also state the effects of using positive external confirmation request by Mr H.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 505, External Confirmation **Part II -- Requirements of Relevant Standards & Laws** ➢ As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include: • The **assertions being addressed**. • Specific identified **risks of material misstatement, including fraud risks.** • The **layout and presentation** of the confirmation request. • **Prior experience** on the audit or similar engagements. • **The method of communication** *(for example, in paper form, or by electronic or other medium)* • **Management's authorisation or encouragement** to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation. • The **ability of the intended confirming party to confirm or provide the requested information** *(for example, individual invoice amount versus total balance).* ➢ **Positive Confirmation Request: - Requests reply in all cases irrespective of whether confirming party agrees to info given or by directly asking information. There is risk that party responds without verifying hence its better don't state info / amount simply ask for it** **A positive external confirmation request** asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. **There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request and ask the confirming party to fill in the amount**	



or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

QNO 62.100	**Factors to be considered before using negative confirmation** BHASKAR CNO--SA505.040/ SA505.060	**Old Course – (M19E)**
	ABC & Co, LLP are appointed auditors of Sharp Company Ltd for the year ended 31St March 2019. As part of the audit process, they want to use confirmation procedures as audit evidence during the Course of audit. In view of the fact that positive confirmations are not responded favourably , the firm also intends to use negative confirmation requests. What are the factors to be considered for the same?	

Answer

➢ As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:

- Refer QNO 62.0

➢ **Factors to be considered for Negative Confirmation requests:**

- **Definition**
  - **Negative confirmation request –**
    A request that the confirming party respond directly to the auditor **only if the confirming party disagrees with the information provided in the request.**
- **Situations**
  Negative confirmations **provide less persuasive audit evidence than positive confirmations.** Accordingly, the auditor **shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:**
  - The auditor has **assessed the risk of material misstatement as low** and has obtained sufficient appropriate audit evidence regarding **the operating effectiveness of controls relevant to the assertion.**

- The population of items subject to negative confirmation procedures **comprises a large number of small, homogeneous, account balances, transactions or conditions.**
- **A very low exception rate is expected;** and
- **The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation** requests to disregard such requests.

➢ Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.
- Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

QNO 63.000	**External Confirmation (Use of Negative Confirmation Request Inappropriate)** **BHASKAR CNO--SA505.060**	**Old Course – (M14E, P17M) New Course – (S17M, M18R, S21M,N22E)**
	During the course of audit of Moon Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one old outstanding of Rs 25 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.	

Answer

Part I -- Relevant Standards & Laws

- SA 505 "External Confirmation"

Part II -- Requirements of Relevant Standards & Laws

➢ **Negative Confirmation Definition: - Confirming party should response only if they disagree with info given in EC request.**

As per SA 505, Negative Confirmation is a request that the **confirming party respond directly to the auditor only if the confirming party disagrees** with the information provided in the request.

➢ **Less Persuasive: - In NCR there is no response if TP agrees to Info. In PCR there is response with confirmation if info agrees. NCR provides less persuasive evidence because if there is no response, it may be because request is not received, Or they may not have replied because information disagreement may be favourable for them. Or they were just careless to reply. Hence no response is not explicitly indicating accuracy of information. NCR should be used for large number of small homogenous balances. It should not be used for big balances.**

Negative confirmations **provide less persuasive audit evidence than positive confirmations. The failure to receive a response** to a negative confirmation request **does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request**. Accordingly, a **failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request**. Confirming parties also **may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.**

➢ **No Response: - No response in NCR does not means misstatement / As NCR requires to respond only if there is disagreement / if Auditor has doubt he can examine subsequent cash disbursements / correspondence with TP / Examine other documents such as GRN etc**

Further non-response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request**. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.**

Part III – Case Discussion

➢ **Use of NCR: - Auditor has used NCR. There are many small credit balances, but one balance is of 25 lakhs and it is old outstanding.**

	In the instant case, the auditor sent the **negative confirmation requesting the trade payables** having outstanding balances in the balance sheet while doing audit of Star Limited. **One of the old outstanding of Rs 25 lacs has not sent the confirmation on the credit balance.**
	Part IV -- Conclusion
	➢ Doubts: - After using NCR, if auditor still has doubts and need more evidence. He should perform further audit procedures. Specially for old outstanding 25 lakh balance. He can go for PCR such balance. But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

QNO 65.000	**External Confirmation (Refusal)** **BHASKAR CNO--SA505.100**	**Old Course – (M05E, M11E, M12M, N12R, M13M, M13E, P17M, M17M, M20R)** **New Course – (M18E, M20R,S21M)**
	The accountant of V Ltd has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are under dispute and the matter is pending in the Court as a Statutory Auditor, how would you deal?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 505 "External Confirmation" **Part II -- Requirements of Relevant Standards & Laws** ➢ Refusal to send a Confirmation Request: - Inquire as to management's reasons & Seek audit evidence as to their validity / Evaluate the implications (RMM / ROF) / Perform alternative audit procedures. **If management refuses to allow the auditor** to send a confirmation request, the auditor shall: • **Inquire as to management's reasons** for the refusal, and seek audit evidence as to their validity and reasonableness; • **Evaluate the implications** of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and • **Perform alternative audit procedures** designed to obtain relevant and reliable audit evidence. ➢ Refusal is unreasonable & unable to obtain relevant and reliable audit evidence:- Modify opinion as per SA 705 If the auditor concludes that management's refusal to allow the auditor to send **a confirmation request is unreasonable**, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260. **The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.**	

SA 510

QNO 66.000	**Audit Procedures for Opening Balance** **BHASKAR CNO--SA510.020/SA510.040**	**Old Course – (N04E, N09E, N13R, N14R, M15E, M16M, N16M P17M, N17R, M18M, N18R, N19M, N19E)** **New Course – (S17M, N18R, N18M, M18M, N19M, N19E, S21M)**
	a) What are 'Initial Audit Engagements'**?** **(b) In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements**. Lay down the audit procedure, you will follow in cases: - **(i) when the financial statements** are audited for the preceding period by another auditor**; and** **(ii) when financial statements** are audited for the first time.	

(c) If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances'; what approach you will adopt in drafting your audit report in two situations mentioned in (b) above?

OR

You have been appointed as the auditor of Top Health Ltd. for 2017-18 which was audited by CA Trustworthy in 2016-17. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2016-17 have been brought to account in 2017-18 as Opening Balances and the Opening Balances do not contain misstatements.

Answer

Part I -- Relevant Standards & Laws

- SA 510 "Initial Audit Engagements – Opening Balances

Part II -- Requirements of Relevant Standards & Laws

➢ **Initial Audit Engagement: - Prior period FST Not Audited or Audited by Predecessor Auditor**

As per SA 510 "Initial Audit Engagements - Opening Balances", initial audit engagement is an engagement in which either:

- The financial statements for the prior period were not audited; or
- The financial statements for the prior period were audited by a predecessor auditor.

➢ **Audit Procedures: -**

- **Check whether closing balances have been correctly brought forward from last year ledger. / Agree opening balance with the most recent financial statements / Read predecessor audit report if any. *(If any modification it should be marked as RMM)* / If any adjustment is shown as prior period item, trace to previous period documents. / Whether audit procedures performed in the current period provide evidence relevant to the opening balances**

  The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

  - Determining whether the prior period's **closing balances have been correctly brought forward** to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
  - The auditor shall **read the most recent financial statements**, if any, and **the predecessor auditor's report thereon**, if any, for information relevant to opening balances, including disclosures.
  - Performing one or more of the following:
    - Where the prior year financial statements were audited, perusing the **copies of the audited financial statements** including the other relevant documents relating to the prior period financial statements;
    - Evaluating whether **audit procedures performed in the current period provide evidence relevant to the opening balances**; or
    - Performing **specific audit procedures** to obtain evidence regarding the opening balances.
  - Determining whether the opening balances reflect the **application of appropriate accounting policies;** and

➢ **Current Audit Procedures to give evidence about opening balance: -**

- **For CA & CL: - Collection or Payment of Op balances will give evidence about existence, completeness, valuation, rights & obligation.**

  For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection/ payment of opening accounts receivable/ accounts payable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

- **For other Assets & Liabilities: - Documentary evidence regarding opening balance / Confirmation from third parties**

In respect of other assets and liabilities such as property plant and equipment, investments, long term debts, the auditor will examine the records relating to opening balances. The auditor may also be able to get the confirmation from third parties (e.g., balances of long-term loan obtained from banks can be confirmed from the Bank Loan statement).

- If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.
- **Drafting Audit Report**: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

QNO 66.100	No Change, Opening Balance Case BHASKAR CNO--SA510.020	Old Course – (N15R, N17M, P17M, N18M, M20M) New Course – (N18M, M20M)

CA. Jack, a recently qualified practicing Chartered Accountant got his first audit assignment of Futura (P) Ltd. for the financial year 2017-18. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Jack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs. 150 lakhs continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Jack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment.

OR

CA. Mack, a recently qualified practicing Chartered Accountant got his first audit assignment of Captura (P) Ltd. for the financial year 2017-18. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Mack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs. 145 lakhs continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Mack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment

Answer

Part I -- Relevant Standards & Laws

- SA 510 "Initial Audit Engagements – Opening Balances

Part II -- Requirements of Relevant Standards & Laws

- **Opening Balance Procedures**

As per SA 510 "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether –

- Opening balances contain misstatements that materially affect the current period's financial statements; and
- Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

➢ **Written representation**

In addition, according to SA 580 "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Part III – Case Discussion

➢ In the given case, the management of Futura (P) Ltd. has restrained CA. Jack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Jack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Part IV -- Conclusion

➢ Thus, CA. Jack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme. Consequently, CA. Jack shall also be held guilty for professional misconduct for not exercising due diligence, or grossly negligence in the conduct of his professional duties as per the Code of Ethics.

SA 520

QNO 68.000	**Analytical Procedures** **BHASKAR CNO--SA520.020/SA520.040**	**Old Course – (M07E, M08R, N09R)**
	Explain analytical review procedures as some audit techniques. **OR** **Indicate briefly the purposes for which the analytical procedures are applied by the auditor.**	

Answer

Part I -- Relevant Standards & Laws

- SA 520, "Analytical Procedures"

Part II -- Requirements of Relevant Standards & Laws

➢ **Definition: -**

Evaluation of financial information *(TBD)*
Through analysis of plausible relationships among financial & non-financial data
(Step 1 Studying interrelationships in financial and non-financial data,
Step 2 Then Collecting Data, performing calculations, computing ratios percentages etc
Step 3 *Then comparing them with relevant data or expected values and investigating unusual differences)*

The term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such **investigation** as is necessary of identified **fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values** by a significant amount. Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.

➢ **Examples of Relationships –**

- **Among Elements of Financial Info / Between Elements of Financial & Non-Financial Info**

  Analytical procedures also include consideration of relationships, for example:

  - Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
  - Between financial information and relevant non-financial information, such as payroll costs to number of employees.

➢ **Simple Comparisons to Complex Analysis**

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. *(Correlation & Regression)* Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

➢ **Examples of various comparisons: -**

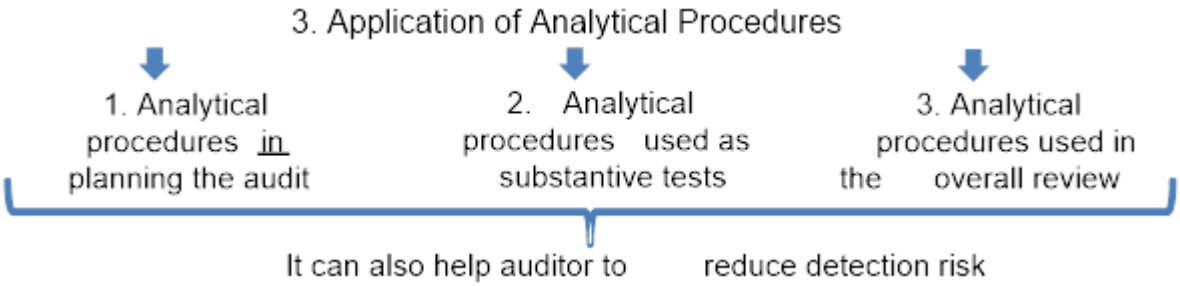
- **Prior Period, Trend Analysis / Budgets, Comparative Analysis / Auditor's Estimate, Predictive Analysis / Others in Industry, Inter Firm Analysis)**

  Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

  - Comparable information for prior periods. *(Trend Analysis)*
  - Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation. *(Comparative Analysis)*
  - Auditor's own estimate *(Predictive Analysis)*
  - Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry. *(Intern Firm Analysis)*

➢ **4 types of Comparisons as explained above**

Thus, we can say that Analytical Procedures may be segregated into these major types as comparison of client and industry data, comparison of client data with similar prior period data, comparison of client data with client-determined expected results, comparison of client data with auditor-determined expected results and comparison of client data with expected results, using non-financial data.



➢ **Purpose**

Analytical procedures are used for the following purposes:

- To assist the auditor in planning the nature, timing and extent of other auditing procedures.
- As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions.
- As an overall review of the financial information in the final review stage of the audit.

Analytical procedures should be applied to some extent for the purposes referred to in (1) and (3) above for all audits of financial statements. In addition, in some cases, analytical procedures can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions.

QNO 70.000	Analytical Procedures (Rental Income & Payroll) BHASKAR CNO--SA520.100	Old Course – (N13E, P17M, M19E)
	In the audit of Hotel Great Stay Ltd, its auditor wants to use the analytical procedure as substantive procedure in respect of room rental income as well as payroll costs Guide him as to how it can be done.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 520, "Analytical Procedures" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Predictive Model: - Unsophisticated predictive models can be effective** As per SA 520 in some cases, even an unsophisticated predictive model may be effective as an analytical procedure. ➢ **Payroll Cost: - If numbers of employees are known and there is fixed rate of pay, auditor can predict total payroll cost and compare it with actual payroll cost as presented in P&L. Reducing need to perform test of details.** **In case of Payroll cost-** Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. ➢ **Room Rental Income: - Predicted Total Room Rental Income = Total Rooms (1-Vacancy Rates) x Room Tariff / If actual room rental are near to this predicted rentals then it gives lot of assurance about room income / this can reduce test of details on room rental / different analytical procedures give different level of assurance for e.g. comparing growth of room rentals with nearby property will give less assurance as it may different circumstances all together** **In case of Room Rental Income of Hotel-** Different types of analytical procedures provide different levels of assurance. Analytical procedures involving the prediction of total rental income in case of Hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.	

QNO 71.000	Analytical Procedures (Considerations) BHASKAR CNO--SA520.080	Old Course – (M09E, N13R, P17M)
	What are the considerations to be kept in mind while performing substantive analytical procedures on data prepared by the client?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 520, "Analytical Procedures" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Factors to be kept in mind while performing analytical procedures** • **Suitability of particular substantive analytical procedures for given assertions / Reliability of data to be used to develop expectations / Develop expectations sufficiently precise /Determine differences from recorded values and evaluate whether investigations are required. Inquiry & Other Audit procedures can be used for investigations** As per "SA 520 (Revised) Analytical Procedure", when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following: • Determine the suitability **of particular substantive analytical procedures** for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; • Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; • Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually	

	or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and • **Determine the amount of** any difference of recorded amounts from expected **values** that is acceptable without further investigation and if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by: o Inquiring **of management** and **obtaining appropriate audit evidence relevant to management's responses**; and o Performing other audit procedures **as necessary in the circumstances.**

QNO 73.000	**Analytical Procedures (Data Reliability)** **BHASKAR CNO--SA520.120**	**Old Course – (N08R, N09R, N15E, M17M)**
	Relevant Criteria for determining Reliability of Data as per SA 520 **'Analytical Procedures'** **OR** **"The** extent of reliance on analytical procedures **depends on several** factors**" Explain in the light of SA 520.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 520, "Analytical Procedures" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Criteria to determine reliability of data for substantive analytical procedures: - SR NCC cadets are reliable in event of war** • **Source of Data / Relevance of Data / Nature of Data / Comparability of Data / Controls over Preparation of Information to ensure (Completeness / Accuracy / Validity)** SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant criteria when determining whether data is reliable for purposes of designing substantive analytical procedures- • **Source of the information** available. For example, information may be more reliable when it is obtained from independent sources outside the entity; • **Comparability of the information** available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products; • **Nature and relevance** of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and • **Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity**. For example, controls over the preparation, review and maintenance of budgets.	
	Author's Note **SR NCC cadets are reliable in event of war** **First Q talks about** Reliability of Data **which in turn affects** reliability of analytical procedures**, answer is form SA 520. Second Q talks about** extent of reliance**, that again hits on reliability, answer for this question has common points with first question, answer was not exactly as per SA 520, answer was from pre SA 520 Era, so we concluded that answer of first question is suitable for both question and is as per latest SA 520**	

QNO 73.100	**Analytical Procedures (Investigating Inconsistencies)** **BHASKAR CNO--SA520.140**	**New Course – (N18E)**
	In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies **with other relevant information.** State the course of action **that the Auditor** should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level.	

Answer

Part I -- Relevant Standards & Laws

- SA 520, "Analytical Procedures"

Part II -- Requirements of Relevant Standards & Laws

➢ **Investigating Results of Analytical Procedures:**

- **Analytical Procedures will help identify fluctuations.**

  As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- **2 Ways of investigating.**
  - Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
  - Performing other audit procedures as necessary in the circumstances.
- **Evaluate responses of inquiry.**

  Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.
- **Situations where other audit procedures may be required.**

  The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

SA 530

QNO 74.000	Sampling Risk BHASKAR CNO--SA530.020	Old Course – (M06E, M10E, M12R, M12M, N13R, P17M)

Sampling Risk

OR

While planning the audit of S Ltd you want to apply sampling techniques What are the risk factors you should keep in mind?

Part I -- Relevant Standards & Laws

- SA 530, Audit Sampling

Part II -- Requirements of Relevant Standards & Laws

➢ **Sampling Risk:**

As per SA 530 "Audit Sampling", the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- **In the case of a test of controls, that controls are more effective than they actually are**, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- **In the case of a test of controls, that controls are less effective than they actually are**, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Sampling Risk

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Sampling risk can lead to two types of erroneous conclusions

Type I – Error

In the case of a test of controls, that controls are more effective than they actually are **(Over Reliance on Controls)**, or in the case of a test of details, that a material misstatement does not exist when in fact it does **(Incorrect Acceptance)**.

The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. **(Reduces Effectiveness of Audit)**

Type II – Error

In the case of a test of controls, that controls are less effective than they actually are ***(Under Reliance on Controls)*** ,or in the case of a test of details, that a material misstatement exists when in fact it does not. ***(Incorrect Rejection)***

This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. ***(Reduces Effeciency of Audit)***

QNO 75.000	**Statistical Vs Non-Statistical** UNIQUE	**Old Course – (M12E, N15R, P17M, M17E)**
	Write a short note on Statistical and Non-Statistical Sampling **OR** **The auditor should select sample items in such a way that the sample can be** expected to be representative of the population Comment.	

Answer

Part I -- Relevant Standards & Laws

- SA 530, Audit Sampling

Part II -- Requirements of Relevant Standards & Laws

- **Definition: - Audit procedures to less than 100% / all sampling units have equal chance of election / obtain reasonable basis / draw conclusions about population.**
  Audit sampling means the application of **audit procedures to less than 100% of items within a population** of audit relevance such that **all sampling units have a chance of selection in order to provide the auditor with a reasonable basis** on which to **draw conclusions about the entire population.**

- **Representative Sample: - SA 530 says sample should be representative of population**
  As per SA 530, "Audit Sampling", **the auditor should select sample items in such a way that the sample can be expected to be representative of the population.** This requires that all items in the population have an opportunity of being selected.

- **Two Major Methods: - Statistical Vs Non-Statistical Methods**
  There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

- **Statistical Sampling: -**
  Definition: - Approach which has both the following characteristics - Random Selection + Use of Probability Theory to control sample risk and to evaluate sample results

- **Explanation: - Scientific not Judgemental as it uses of Probability / Suitable if there are large number of similar Items / E.g. Trade Receivables Confirmation, Petty Cash Voucher, Payroll Checking**

  Statistical sampling: Statistical sampling – An approach to sampling that has the following characteristics:
  - **Random selection** of the sample items; and
  - **The use of probability theory** to evaluate sample results, including **measurement of sampling risk.**

  A sampling approach that does not have characteristics (i) and (ii) is considered non-statistical sampling.

  This is a method of audit testing which **is more scientific than testing based entirely on the auditor's own judgment** because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. **Statistical sampling has reasonably wide application** where a population to be tested consists of a **large number of similar items** and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

➢ **Non-Statistical Sampling: - Based on personal experience & knowledge of auditor / simple to use** ***E.g. number of pages to be checked or selecting few months in this year and remaining in next year / avoid establishing pattern, maintain surprise element / common practice to check large number of items towards year end.***

Non-statistical sampling: Under this method, the **sample size and its composition** are determined on the basis of the **personal experience and knowledge of the auditor.** This method has been in common application for many years because of its simplicity in operation.

Traditionally, the auditor on the basis of his **personal experience will determine the size of the sample and express it in terms that number of pages or personal accounts in the purchases or sales ledger to be checked.** For example, March, June & September may be selected in year one and different months would be selected in the next year. **An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check.** It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined.

QNO 75.100	**Sampling Methods** **BHASKAR CNO--SA530.120**	**Old Course – (N14E, M16M, N16R, N16M, P17M , N17M,M18E,N18M)**

In the course of your audit assignment of Indraprastha Ltd., you want to guide your audit assistants in selecting sample items in such a way that sample can be expected to be representative of the population and all items have an opportunity of being selected. Guide your assistants with principal methods of collecting samples.

OR

Principal Methods of Selection of Samples

Answer

Part I -- Relevant Standards & Laws

- SA 530, Audit Sampling

Part II -- Requirements of Relevant Standards & Laws

➢ **Random Sampling: - All items in population or within each stratum as known chance of selection i.e. probability is carefully designed to achieve objectives.**

Random selection ensures that **all items in the population or within each stratum** have a **known chance of selection**. It may involve use of random number tables.

Random sampling includes two very popular methods which are discussed below:

- **Simple Random Sampling: - Each unit in population has equal chances of selection / use of random number table, computer or number chits in drum / ensures no bias / population should be homogeneous.**

  Under this method each unit of the whole population *e.g. purchase, or sales invoice* has an **equal chance of being selected.** The mechanics of selection of items may be by choosing numbers from **table of random numbers by computers or picking up numbers randomly from a drum**. **It is considered that random number tables are simple and easy to use and**

also provide assurance that the bias does not affect the selection. This method is considered appropriate provided the population to be sampled consists of **reasonably similar units and fall within a reasonable range.** *For example, the population can be considered homogeneous, if say, trade receivables balances fall within the range of Rs 5,000 to Rs 25,000 and not in the range between Rs 25 to Rs 2,50,000.*

- **Stratified Random Sampling: - Dividing, partitioning whole population in few sperate groups called strata / taking sample from each strata / each stratum is treated as separate population and proportionate items are selected / number of strata depends on auditor judgement / example of receivables all items above 1,00,000, 25% between 75,000 to 1,00,000, 10% between 25,000 to 75,000, 2% below 25,000 / good for diversified strata / weights should be allocated to different strata**

  This method involves dividing the whole population to be **tested in a few separate groups called strata and taking a sample from each of them.** Each **stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratums.** The number of groups into which the whole population has to be divided is determined **on the basis of auditor judgment.** For example, in the above case, trade receivables balances may be divided into four groups as follows: -
  - Balances in excess of Rs 1,00,000;
  - Balances in the range of Rs 75,000 to Rs 1,00,000;
  - Balances in the range of Rs 25,000 to Rs 75,000; and
  - Balances below Rs 25,000.

  From these above groups the auditor may pick up different percentage of items from each of the group. From the top group i.e. balances in excess of Rs 1,00,000, the auditor may examine all the items; from the second group 25 per cent of the items; from the third group 10 per cent of the items; and from the lowest group 2 per cent of the items may be selected. The reasoning behind the stratified sampling is that for a highly-diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata. It can be seen that the stratified sampling is simply an extension of simple random sampling.

➢ **Interval / Systematic Sampling: - Constant intervals between selections / interval can be number of items or monetary total / first item is randomly selected from first interval / ensure that interval doesn't corresponds to pattern of population example for the same / multiple random starting points**

It involves selecting items using a constant interval between selections, the first interval having a random start. **The interval might be based on a certain number of items (for example every 20th voucher) or a monetary total (for example every Rs 1,000 in the cumulative value of the population).** When using systematic selection, the auditor should determine that the population is **not structured in such a manner that the sampling interval corresponds with a particular pattern in the population.**

For example, if in a population of branch sales, **particular branch sales occur only as every 100th item** and the sampling interval selected is 100. The result would be that either the auditor would have selected all or none of the sales of that particular branch**. To minimise the effect of the possible known buyers through a pattern in the population, more than one starting point may be taken.** The multiple random starting points are taken because it minimises the risk of interval sampling pattern with that of the population being sampled.

➢ **Monetary Unit Sampling: - It is a version of interval-based sampling with only difference that interval in monetary amount and probability of item getting selected depends on its monetary amount.**

It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

- *Example (Just for understanding no need to write in exams)*
  Total Sales 20,00,000 / Sample Size 5 / Monetary Interval between 2 bills should be 20,00,000 ÷ 5 = 4,00,000 / Select Starting Point Randomly Between (1 – 2,00,000) is say 620

Selection will be 620 / 4,00,620 / 8,00,620 / 12,00,620 / 16,00,620

Bill No	Bill Amount	Cumulative Amount	Selection Base
1	50,000	50,000	620
2	3,00,000	3,50,000	
3	1,00,000	4,50,000	4,00,620
4	2,50,000	7,00,000	
5	1,00,000	8,00,000	
6	75,000	8,75,000	8,00,620
7	25000	9,00,000	
8	40,000	9,40,000	
9	60,000	10,00,000	
10	1,50,000	11,50,000	
11	85,000	12,35,000	12,00,620
12	60,000	12,95,000	
13	90,000	13,85,000	
14	15,000	14,00,000	
15	45,000	14,45,000	
16	95,000	15,40,000	
17	98,000	16,38,000	16,00,620
18	84,000	17,22,000	
19	1,29,000	18,51,000	
20	1,49,000	20,00,000	

- **Cluster sampling: - Dividing population into groups / number of clusters are randomly selected from all clusters / selection can be done in the form of simple random sampling or stratified random sampling / if any item of cluster is selected that particular cluster will be selected / there can be complete or proportionate checking / it is less effective than random sampling as at the time of selection of item, whole population is not under consideration but only cluster is in consideration**

  This method involves dividing the population into groups of items known as clusters. A number of clusters are randomly selected from all the clusters rather than individual items of the population. Cluster sampling can be used together with both unrestricted random and stratified sampling, for example 500 to 540, 2015 to 2055 etc. **The first item i.e. 500, 2015 is randomly selected from random number tables. The items of selected cluster can either be checked completely or a randomly selected proportion of them can be examined.**

  The cluster is **less effective for a given sample size than unrestricted random and stratified samples as items are not individually selected.** However, the time saved can be utilised to have a larger sample to make the sample results more reliable.
  As per SA 530, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

- **Block Sampling: - Selection of fixed number of consecutive items / first item of block is selected rest of the items automatically get selected as per block size / Simple, Economical / Risk of being biased / Establishing selection pattern which may be noted by auditees**

	This method involves the selection of a defined block of consecutive items. For example, take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion. **Consequently, it has similar characteristics, namely, simplicity and economy. On the other hand, there is a risk of bias and of establishing a pattern of selection which may be noted by the auditees.** ➢ **Haphazard Sampling: - Selection without structure technique / avoid any conscious bias / don't be predictable *e.g. always choosing first and last entries, not choosing difficult to locate items / it is not statistical*** **Haphazard selection, in which the auditor selects the sample without following a structured technique.** Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. **Haphazard selection is not appropriate when using statistical sampling.**

QNO 75.200	**Haphazard Sampling** **BHASKAR CNO--SA530.120**	**Old Course – (M08E, N12M, M13M, M16R, P17M, M17R)**
	Haphazard Sampling	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 530, Audit Sampling **Part II -- Requirements of Relevant Standards & Laws** ➢ **Haphazard Sampling: - Selection without structure technique / avoid any conscious bias / don't be predictable *e.g. always choosing first and last entries, not choosing difficult to locate items / it is not statistical / it can be good alternative to random sampling provided sampling is representative*** In haphazard selection, the auditor selects the sample **without following a structured technique.** Although no structured technique is used, the auditor **would nonetheless avoid any conscious bias or predictability** for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page and thus attempt to ensure that all items in the population have a chance of selection. **Haphazard selection is not appropriate when using statistical sampling.** **Haphazard selection of sample, may be an acceptable alternative to random selection of sample, provided the auditor attempts to draw a representative sample** from the entire population with no intention to either include or exclude specific units. When the auditor uses this method, care needs to be taken to guard against **making a selection that is biased**, for example, towards items which are easily located, as they may not be representative.	

QNO 78.000	**Evaluation of Nature & Cause of Misstatement / Deviation** **BHASKAR CNO--SA530.160**	**Old Course – (N09R, P17M)**
	"An auditor while analysing the errors in a sample need not consider the qualitative aspects of errors detected" Please comment.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 530, Audit Sampling **Part II -- Requirements of Relevant Standards & Laws** ➢ **Qualitative Aspects: - So auditor should go beyond detecting misstatement and deviations and consider qualitative aspects** **Accordingly, the auditor cannot be satisfied by detecting errors only but also would need to consider the qualitative aspects of such errors.** ➢ **Nature & Cause: - Investigate deviations or misstatements and evaluate their possible effect on the purpose of audit procedure and on to other areas of audit**	

	The auditor shall investigate the nature and cause of any deviations or misstatements identified and **evaluates their possible effect on the purpose of the audit procedure and on other areas of the audit.** ➢ **Common Features: - Type of Transactions, Location, Product, Period of time / In such case auditor may identify all items in population with common feature and extend audit procedures** ➢ **Anomaly: - Extremely rare circumstances misstatement or deviation can be anomaly / auditor should obtain high degree of certainty that it is not representative of population / perform additional procedures for the same** **In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.** The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population ➢ **Intentional: - If these are intentional then there is possibility of fraud** In analysing the deviations and misstatements identified, the auditor may observe that many have a common feature, **for example, type of transaction (Counter Sales), location (Mumbai Branch), product line (Old product) or period of time (Peak Season).** In such circumstances, the auditor may decide to identify all items in the population that possess the common feature and extend audit procedures to those items. **In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.**

QNO 78.500	**Sampling Not Providing Reasonable Basis to Support Conclusion** **BHASKAR CNO--SA530.200**	**New Course – (N22R)**
	Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2021 - 2022. Chintan & Mani seem to have different opinions on Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population. Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. **You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.**	
Answer	As per SA 530, "Audit Sampling", the auditor shall evaluate: (a) The results of the sample; and (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may: (I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or (II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.	

QNO 79.000	**Tolerable Misstatement** **UNIQUE**	**Old Course – (M14E, M17E)**
	What is tolerable misstatement and tolerable rate of deviation?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 530, Audit Sampling	

	Part II -- Requirements of Relevant Standards & Laws ➢ SA 530 Audit Sampling defines tolerable misstatement and tolerable rate of deviation. • **Tolerable Misstatement: - Monetary limit set by auditor / he obtains assurance that actual misstatements are not exceeding this monetary limit / this limit will be helpful to conclude whether population is misstated / it is determined at while doing sample designing / this limit is determined for both individual misstatements and that aggregated misstatements may be material / margin is provided that there may undetected misstatements which in aggregate with uncorrected misstatements become material** **Tolerable misstatement:** A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population. When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. • **Tolerable rate of deviation: - Similar to Tolerable Misstatement / It is a rate set by auditor / him obtains assurance that actual deviations are not exceeding this rate / this limit will be helpful to conclude whether controls are operating effectively** **Tolerable rate of deviation:** It is a rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

SA 550

QNO 82.000	**Related Party (Sources)** **BHASKAR CNO--SA550.060**	**Old Course – (M06E, N08R, M11R, M12E, N12E, M14R, N15E, P17M,M19M, N19E)** **New Course – (N18M,M19M)**
	The training partner in your office is aware that you have covered SA 550 Related Parties in your professional studies. He has asked you to help him prepare for a training session he is about to give. **Requirements** **Prepare notes for a training session for junior staff on** how to verify the existence of related party transactions. **OR** **In the course of audit of Q Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying** the possible source of related party information**.** **OR** **JY & Co is appointed as auditor of Breeze Ltd JY & Co seeks your guidance** for reviewing the records and documentation **of the company regarding 'related party transactions in the normal course of business' Describe the steps to be followed**	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 550, Related Parties **Part II -- Requirements of Relevant Standards & Laws** ➢ **Inspecting Records or Documents may indicate existence of related party relationships or transactions which were not identified or Mgt didn't disclose it to auditor.** During the audit, **the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.**	

	➢ **Compulsory to see following documents: -** • **Legal, Bank, TP Confirmations / Minutes of Shareholders, TCWG / Such other documents** In particular, the auditor **shall inspect the following for indications** of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: • **Bank** *(For guarantees / securities given or taken, arrangements such as minimum balance setoff arrangement / joint holders / nominee)* **legal** *(Contracts / MOUs etc)* and **third-party confirmations** *(From Directors / Subsidiaries)* obtained as part of the auditor's procedures; • Minutes of meetings of shareholders and of those charged with governance; and *(Approvals under Sec 177 & Sec 188)* • Such other records or documents as the auditor considers necessary in the circumstances of the entity. *(E.g. Company Restructuring Documents)* ➢ **Documents which can give information about related parties: -** • **AS 18 / Schedule III disclosures of Previous Years *(Old Records)*** • **Shareholders register *(Control / SI)*** • **Director's register *(SI)*** • **Contracts with TCWG / Directors / KMP (SI)** • **Life insurance policies (SI)** • **Records of Entity's pension plans (SI)** • **Statements of Conflict of Interest (SI)** • **Investment Register (Control / SI)** ***(Legal Documents)*** • **BOD / Shareholder Meeting Minutes** • **Sec 189 Register** • **Information supplied to Regulatory Authorities** • **Filing with SEBI / SEC** • **Tax Returns** ***(Other Documents)*** • **Internal Auditor's Report** • **Invoices & Correspondence with professional advisor** • **Contracts not in ordinary course of business** • **Contracts re-negotiated**

QNO 82.500	**Examples of Transactions Which are Outside Normal Course Business** **BHASKAR CNO--SA550.100**	**New Course – (N20E)**
	Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business.	
Answer	In the given case of PQR Ltd, Mr. X, while conducting audit has come across certain significant related party transaction which are identified to be outside the entity's normal course of business. Mr. X wants guidance through examples of such significant transactions which are given in SA 550 As per SA 550 "Related Parties", examples of transactions outside the entity's normal course of business may include: **1.** Complex equity transactions, such as corporate restructurings or acquisitions. **2.** Transactions with offshore entities in jurisdictions with weak corporate laws. **3.** The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged. **4.** Sales transactions with unusually large discounts or returns. **5.** Transactions with circular arrangements, for example, sales with a commitment to repurchase. **6.** Transactions under contracts whose terms are changed before expiry.	

QNO 84.000	Related Party Case Study – Approach of Auditor UNIQUE	Old Course – (N20M, N21M) New Course –(N20M, N21M)

Whilst the Audit team has identified few matters, they need your advice to conclude on the same. Engagement Partner have asked them to review the Board minutes and other secretarial / regulatory records based on which the following additional matters were brought to the attention of the Partner:-

(i) The long-term borrowings from the parent company has no written terms and neither the interest nor the principal has been repaid so far.

(ii) Certain computers were received from the parent company free of cost, the value of which is ` 0.23 lac and no accounting or disclosure of the same has been made in the notes to accounts.

(iii) An amount of ` 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by `0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts' paid, no separate disclosure of this related party transaction has been made in the notes to accounts forming part of the financial statements highlighting the same as a 'related party' transaction.

Audit Manager has reported that she had asked certain information relating to another 'related party' transaction (amounting to approx. ` 47 lac) but the CFO refused to provide the same since the same is perceived to be confidential and cannot be shared with the Auditors.

You are required to advise about items to be reported to those charged with governance, where applicable, based on your audit findings in the given situation.

Part I -- Relevant Standards & Laws

- SA 550, Related Parties
- Ind AS 24 / AS 18
- Clauses (xiii) of Paragraph 3 of CARO 2020
- Sections 177 and 188 of Companies Act, 2013

Part II -- Requirements of Relevant Standards & Laws

➢ **As per SA 550, Related Parties**,

- Communicating significant matters arising during the audit in connection with the entity's related parties helps the auditor to establish a common understanding with those charged with governance of the nature and resolution of these matters.
- Examples of significant related party matters include, non-disclosure (whether intentional or not) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware; The identification of significant related party transactions that have not been appropriately authorised and approved, which may give rise to suspected fraud; etc.
- It may be noted that unless all of those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties.
- The auditor is also required to ensure the compliance of Ind AS 24 / AS 18 Related Party Disclosures.

Part III—Case Study & Conclusion

- In view of above in the given scenario, the auditor is required to prepare a brief summary of following items to be reported to those charged with governance in accordance with SA 260 Communication with Those Charged with Governance:
  - Receipt of free of cost Computers and long-term borrowing (on no agreed terms and repayment of interest and principal) from the Parent Company need separate disclosure in financial statements as per Ind AS 24 / AS 18 Related Party Disclosures.

	• One of related party transaction amounting 3.25 lac per month i.e., in lieu of marketing services has been noticed of which amount ` 0.25 lac per month is exceeds the arm's length price has not been disclosed highlighting the same as related party transactions as per Ind- AS 24 / AS 18 Related Party Disclosures. • Refusal by CFO of the company to provide the details of related party transaction amounting to rupees 47 lac on the ground that same is perceived to be confidential and cannot be shared with auditors, is not in order, as denying for the related part details of ` 47 lac is imposing limitation of scope of auditor in view of SA 705. • Further, in case of all the above cases, the auditor would also need to assess his reporting requirements under the clauses (xiii) of Paragraph 3 of CARO 2020 with respect to related party transactions that whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable Accounting Standards.

QNO 84.500	**Engagement Team Discussion -- Susceptibility of MMST due to Related Party** **UNIQUE**	**New Course – (M22E)**
	JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z-Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant Standard on Auditing.	
Answer	As per SA 550 "Related Parties", the engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include: **1.** The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit). **2.** An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions. **3.** The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organizational structure, use of special - purpose entities for off-balance sheet transactions, or an inadequate information system). **4.** The records or documents that may indicate the existence of related party relationships or transactions. **5.** The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls. 6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example: **(a)** how special-purpose entities controlled by management might be used to facilitate earnings management. **(b)** how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.	

SA 560

QNO 85.000	Subsequent Event (Responsibility of Auditor) BHASKAR CNO--SA560.020/SA560.060	Old Course – (M08R, N09E, P17M) New Course –(N20E)

Briefly describe the auditor's responsibility regarding subsequent events.

OR

You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company need to stock various non- perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also, the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view?

Answer

Part I -- Relevant Standards & Laws

- AS 4 on " Contingencies and Events Occurring after the Balance Sheet Date"
- SA 560, Subsequent Events

Part II -- Requirements of Relevant Standards & Laws

AS – 4

➢ **Subsequent Event Definition: - All significant events / favourable or unfavourable / occur between balance sheet date and date of approval by BOD**

- **Types of Events: - Events giving evidence regarding conditions existing on balance sheet date / Events giving evidence on conditions which arose after balance sheet date**

  Exceptions to above: - Events required to be adjusted by law / Events affecting going concern / Events which are significant / material but not requiring adjustment can be disclosed in notes to accounts

  AS 4 on "Contingencies and Events Occurring after the Balance Sheet Date" deals with **all those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and by the corresponding approving authority in the case of any other entity.** As per AS 4, two types of events can be identified:
  - those which provide further evidence of conditions that existed at the balance sheet date; and
  - those which are indicative of conditions that arose subsequent to the balance sheet date.

SA 560

➢ **Importance of Subsequent Events: - Auditor should plan and examine subsequent events and its accounting because there is possibility that some accounting effects are omitted and examination can help get evidence regarding financial statement items at assertion level**

When the auditor draws up his audit plan, **checking of subsequent events** is **an important audit procedure irrespective of the level of test checks** employed for checking of the transactions during the year. In fact, more detailed check is normally required for subsequent events **to confirm certain assertions contained in the financial statements.** *e.g., the payment made by debtors after the close of accounting period would confirm that outstanding debtors on the date of the balance sheet date have been realised.*

➢ **Definition: - Events between balance sheet date and date of audit report / Facts that become known after balance sheet date**

SA 560 on "Subsequent Events" establishes standards on the auditor's responsibility regarding subsequent events. SA 560 on "Subsequent Events" states that the **term "subsequent events" refers to events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.**

- **Duty of Auditor: - Auditor should obtain S&A evidence that all events between date of financial statements and date of audit report that require adjustment or disclosure have been identified and recorded in CY / No need to check again is some areas are checked in regular audit procedures / nature and extent depends on risk assessment**

SA 560 lays down that the auditor should consider the effect of subsequent events on the financial statements and on the auditor's report. When the time between the close of the year-end and the adoption of accounts is about to take place, examination of subsequent events gains more importance.

SA 560 further requires that the auditor shall perform audit procedures designed to obtain **sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.** The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

- **Audit Procedures: - Understanding procedures, controls set by Mgt / Inquiry with Mgt, TCWG / Reading minutes / Latest subsequent interim financial statements**

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

- **Obtaining an understanding of any procedure's, management has established** to ensure that subsequent events are identified.
- **Inquiring of management and, where appropriate, those charged with governance** as to whether any subsequent events have occurred which might affect the financial statements.
- **Reading minutes,** if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- Reading the entity's **latest subsequent interim financial statements,** if any.

- **Adjusting Event: - If auditor identifies event requiring adjustment / see whether it is adjusted or disclosed in FST / if not then modify the report**

When, as a result of the procedures performed above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

QNO 85.050	**Specific enquiry may be conducted to evaluate subsequent events.** **BHASKAR CNO--SA560.080**	**Old Course – (M19E)**
	M/s LMP Associates, Chartered Accountants while conducting the audit of PQR Ltd want to conduct an inquiry of management and those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. Guide M/s LMP Associates with the matters where specific enquiry may be conducted to evaluate subsequent events.	

Answer	- **Specific Enquiries**
	  - **May make specific inquiries about the following matters**
	  - **(Assets - 3)**
	  - Whether **sales or acquisitions of assets** have occurred or are planned.
	  - Whether any **assets have been appropriated by government or destroyed,** for example, by fire or flood.
	  - Whether any **events have occurred that is relevant to the recoverability of assets.**	

*(**E.g.** Product Banned Etc)*

- **(Capital & Liability -4)**
  - Whether there have been **increases in capital or issuance of debt instruments,** such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
  - Whether **new commitments, borrowings or guarantees** have been entered into.
  - Whether there have been **any developments regarding contingencies.**
  - Whether any events have occurred that is relevant to the **measurement of estimates or provisions** made in the financial statements.
    *(**E.g.** Draft royalty rates)*
- **(All items -2)**
  - Whether any **unusual accounting adjustments have been made or are contemplated.**
    *(**E.g.** Heavy sales return)*
  - Whether any events have occurred or are likely to occur that will bring into **question the appropriateness of accounting policies** used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
    *(**E.g.** Sale of Long-term Investments)*

QNO 85.100	**Financial Statements Reopened by BOD** **BHASKAR CNO--SA560.100**	**New Course – (N18E)**

Amudhan & Co. are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of Rs.5800 crores kept pending on account of incentives pertaining to Financial Year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

Answer

Part I -- Relevant Standards & Laws

- SA 560, Subsequent Events

Part II -- Requirements of Relevant Standards & Laws

➢ **Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued:**

SA 560

- **No obligation to perform audit procedures after date of audit report**
  As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report.
- **If information would have changed opinion, then audit procedures required**
  However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall
  - Discuss the matter with management and, where appropriate, those charged with governance

- Determine whether the financial statements **need amendment** and, if so,
- Inquire how management **intends to address the matter** in the financial statements.
- If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, **the auditor shall extend the audit procedures and provide a new auditor's report** on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

Part III – Case Discussion

➢ In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2017-18 in the month of May 2018 i.e. after finalization of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Amudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

Part IV -- Conclusion

➢ After applying the conditions given in SA 560, Amudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

QNO 87.500	**Subsequent Event-- After Audit Report-- Financial Statements Amended BHASKAR CNO--SA560.100**	**Old Course – (N21R) New Course – (N21R)**

The audit report of Kolsi (P) Ltd. for F.Y. 2020-21 was issued by Bishnoi & Co. on 25th July, 2021. However, a case was filed against Kolsi (P) Ltd. on 4th August, 2021, with the Civil Court, with respect to an incident caused in its factory on 17th January,2021, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.
Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management and it was determined to amend the financial statements for F.Y. 2020 -21.
Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.
The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.
In the context of aforesaid case scenario, please answer the following questions:-
(a) Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?
(b) Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements?

Answer

As per SA 560, 'Subsequent Events', the auditor has no obligation to perform any Audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

(1) Discuss the matter with management and, where appropriate, those charged with governance.
(2) Determine whether the financial statements need amendment and, if so,
(3) Inquire how management intends to address the matter in the financial statements.

In the given case, on becoming aware of the court case filed against Kolsi (P) Ltd., Mr. Raj discussed the said matter with the management and it was determined to amend the financial statements. Also, he inquired how the management intended to address the said matter in the financial statements.

However, If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial

statements in circumstances where Mr. Raj (hereinafter referred as 'the auditor') believes they need to be amended, the auditor shall notify management and, those charged with governance (unless all of those charged with
governance are involved in managing the entity), that the auditor will seek to prevent future reliance on the auditor's report. If despite such notification the management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report in accordance with SA 560.

QNO 88.000	Subsequent Event (Salary Case) UNIQUE	Old Course –(N10E, P17M) New Course – (M18M)

A Co. Ltd. has not included in the Balance Sheet as on 31-03-2017 a sum of Rs 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2017. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2017. The auditor came to know the result of the negotiations on 15-05-2017. Advise.

Answer

Part I -- Relevant Standards & Laws

- SA 560, Subsequent Events
- AS 4 "Contingencies and Events occurring after the Balance Sheet Date"
- AS 29 "Provisions, Contingent liabilities and Contingent Assets"

Part II -- Requirements of Relevant Standards & Laws

AS 4-

➢ **Conditions Exiting at B/S Date: - If events occurring after b/s date provide additional info relating to conditions which existed on B/s date then adjustments should be done to assets & liabilities**

As per AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

AS 29 -

➢ **Future Events: - Future events affecting amount required to be settled should be reflected in amount of provision**

Similarly, as per AS 29 "Provisions, Contingent liabilities and Contingent Assets", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

SA 560 -

➢ **Duty of Auditor: - Auditor should obtain S&A evidence that effect of subsequent events is taken as per applicable FRF requiring adjustments or disclosures**

As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Part III – Case Discussion

➢ **Long Pending Salary Negotiations / Arrears of Salary is finalised on 30-04-17 / Audit Report to be Signed on 31-05-17 / It is a subsequent event identified before signing audit report, which needs adjustment in balance sheet**

In the instant case, the amount of Rs1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The information has become known to the auditor before the date of issue of the Audit Report and Financial Statements.

Part IV -- Conclusion

➢ **Long Pending Salary Negotiations / Conditions exist as on balance sheet date / AS 4 & AS 29 require provisioning of Rs 1.5 Cr in current year / Request Mgt to adjust amount / If Mgt doesn't accept then auditor should qualify audit report**

It will be observed that as a result of long pending negotiations a sum of Rs 1.50 cores representing arrears of salaries of the year 2015-16 and 2016-17 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.

	The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31-3-2017 to the date of Auditors Report i.e.. 31-05-2017. So, the auditor should request the management to adjust the sum of Rs 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.
	Author's Note **Here Successful Negotiation doesn't mean, company doesn't have to pay. It means company** has to pay only 1.5 crore because of successful negotiations.

SA 570

QNO 89.000	Events & Conditions Creating Significant Doubt BHASKAR CNO--SA570.020	Old Course – (N05E, M12R, M14R, P17M, N17E, M19E)

Discuss the points and indications to be noted while examining and evaluating the 'Going Concern' assumption for an entity.

OR

Financial indications to be considered for evaluating the assumption of going concern**.**

Answer

Part I -- Relevant Standards & Laws

- SA 570 on "Going Concern,"

Part II -- Requirements of Relevant Standards & Laws

➢ **Events or Conditions that individually or collectively may cast significant doubt about Going concern / List is not all-inclusive nor does existence of one or more items signify material uncertainty.**

The following are **examples of events or conditions that, individually or collectively,** may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.

➢ **Financial Events or Conditions**

(In sequence of falling business)

- **In Sequence of Falling Business: -Operational Loss / Negative Op Cash Flow / Net current liability / Net Liability / Adverse Key Financial Ratios / Arrears or Discontinuance of Dividend / Deterioration in Value of Asset**
  - Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
  - Negative operating cash flows indicated by historical or prospective financial statements.
  - Net liability or net current liability position.
  - Adverse key financial ratios.
  - Arrears or discontinuance of dividends.

(Borrowing Related Points)

- **Borrowing Related: -Borrowings approaching maturity no prospects of repayment or renewal / Default of Loan Agreement / Inability to obtain financing for essential new product development etc / Excessive Short-Term Borrowings**
  - Inability to comply with the terms of loan agreements. *(Maintaining Stock Levels, Margin Money)*
  - Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets. *(Kingfisher Airlines)*
  - Inability to obtain financing for essential new product development or other essential investments. *(Satyam, Banks refused to give new loans)*

(Creditor Related Points)

- **Creditor Related:**
  - **-No payment on due dates / indication of withdrawal of financial support / change to cash on delivery**
    - Inability to pay creditors on due dates.
    - Indications of withdrawal of financial support by creditors. *(No extension from creditors)*
    - Change from credit to cash-on-delivery transactions with suppliers.

- **Operating Events or Conditions- In Sequence of Business Process**
  - **Mgt Intention to Liquidate or Cease Operations / Supply Shortage / Loss of KMP without replacement / Labour Difficulties / Loss of Major Market or Customer / Emergence of highly successful competitor**
    - Management intentions to liquidate the entity or to cease operations. *(E.g. Start-up's)*
    - Shortages of important supplies. *(Power Generating Plants)*
    - Loss of key management without replacement.
    - Labour difficulties.
    - Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
    - Emergence of a highly successful competitor. *(Milk Butter Vs Peanut Butter)*

- **Other Events or Conditions-Catastrophes**
  Uninsured or underinsured catastrophes when they occur.

(Law related matters)

- **Law related**
  - **Non-Compliance with Capital, Statutory Requirements / Adverse Impact of Changes in Law or Govt Policy / Pending legal or regulatory proceedings against the entity.**
    - Non-compliance with capital or other statutory requirements. *(CAR in Banks)*
    - Changes in law or regulation or government policy expected to adversely affect the entity.
    - Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.

- **Mitigated: - Above E&C can be mitigated by other Factors / Unable to Repay Mitigated by Mgt Plan to dispose assets, reschedule loan, alternative means / Loss of Principal Supplier mitigated by alternative source**
  The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

QNO 90.000	**Additional Procedures** **BHASKAR CNO--SA570.040**	**Old Course – (N16E)**
	Mr Ram, an auditor, identified some events that cast significant doubt on the entity's ability to continue as a going concern What are the additional procedures he should perform as per the related Standard on Auditing?	
Answer	**Part I -- Relevant Standards & Laws**	
	▪ SA 570 on "Going Concern,"	
	Part II -- Requirements of Relevant Standards & Laws	
	➢ **Additional Procedures: - If there are E&C which create significant doubt over going concern / then obtain S&A evidence whether MATERIAL UNCERTANITY exist / also consider mitigating factors**	
	If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, **the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists** related to events or conditions that may	

cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, **including consideration of mitigating factors.** These procedures **shall include:**

➢ ***Compulsory (Mgt Assessment – Future Plan – Cash Flow Forecast – Events – Written Representations)***

- **Management's Assessment if not prepared yet – Request Management to Prepare it**
  Where management has not yet performed an assessment of the entity's ability to continue as a going concern, **requesting management to make its assessment.**

- **Future Action Plan -Effectiveness & Feasibility**
  Evaluating management's plans for future actions (*Introducing new products, cost cutting, sale of assets, sale of investments, issue of shares, taking new loans etc.)* in relation to its going concern assessment, whether the outcome of these plans is **likely to improve the situation**. *(E.g. Will such funds be sufficient to carry on business)* **and whether management's plans are feasible in the circumstances**. *(can they pull off such big changes in given short span)*

- **Cash flow forecast – Reliability of Underlying Data / Adequate Support for Assumption**
  Where the entity has prepared a cash flow forecast, and **analysis of the forecast is a significant factor** in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - Evaluating the **reliability of the underlying data generated** to prepare the forecast; and
  - Determining whether there is **adequate support for the assumptions** underlying the forecast.

- **Events: - Additional info or facts after date of Mgt Assessment**
  Considering whether **any additional facts or information have become available** since the date on which management made its assessment.

- **Written Representation – Regarding Future Plans their Effectiveness & Feasibility**
  Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

➢ **Optional if required**-Audit procedures that are relevant to the requirement **may include the following:**

- **Future Action Plans: - Regulatory Actions / Minutes / Debenture, Loan Agreements / Legal Counsel / Customer Order / Disposal of Assets) (In Sequence of Power**
  - Obtaining and reviewing **reports of regulatory actions.**
  - **Reading minutes** of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
  - **Reading the terms of debentures and loan agreements and determining whether any have been breached.**
  - **Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.**
  - **Evaluating the entity's plans to deal with unfilled customer orders. (When there is shortage of raw material)**
  - **Determining the adequacy of support for any planned disposals of assets.**

- **Cash flow forecast – Discussing Profit, Cash Flow, Forecast with Mgt / Interim Financial Statements**
  - **Analysing and discussing cash flow, profit** and other relevant forecasts with management.
  - Analysing and discussing the entity's **latest available interim financial statements**.

- **Subsequent Events – Either Mitigate or Otherwise Affect**
  Performing audit procedures regarding **subsequent events to identify those that either mitigate or otherwise affect** the entity's ability to continue as a going concern.

- **Written Representation –from TP giving Financial Support / Borrowing Facility**
  - Confirming the **existence, legality and enforceability of arrangements** to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
  - Confirming the **existence, terms and adequacy of borrowing facilities.**

QNO 90.050	Additional procedures and mitigating factor BHASKAR CNO--SA570.040/SA570.060	Old Course – (M19M, N19R) New Course – (M19M, N19R)

AQP Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company's ability to continue as a going concern.
The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2017. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2018. The RP reviewed the resolution plans and ensured conformity with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (CoC) on 2 February 2018 and the resolution plan submitted by PQR Ltd. was evaluated as highest evaluated Compliant Resolution Plan. CoC of AQP Ltd approved the Resolution Plan submitted by PQR Ltd. on 2 March 2018. The approval of NCLT was finally obtained on 4 May 2018.
PQR Ltd submitted detailed plans and commitments as part of the resolution plan including clearance of all outstanding debts which were leading to negative cash flows. Please suggest how would you deal with this situation as the auditors of AQP Ltd.

Answer

Part I -- Relevant Standards & Laws

- SA 570, Going Concern

Part II -- Requirements of Relevant Standards & Laws

➢ **Significant Doubt**

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, **the auditor shall obtain sufficient appropriate audit evidence** to determine **whether or not a material uncertainty exists** related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, **including consideration of mitigating factors.** These procedures **shall include:**

➢ **Additional Audit Procedures (Compulsory)**

- **Management's Assessment if not prepared yet**
  Where management has not yet performed an assessment of the entity's ability to continue as a going concern, **requesting management to make its assessment.**

- **Future Plan**
  Evaluating management's plans for future actions *(Introducing new products, cost cutting, sale of assets, sale of investments, issue of shares, taking new loans etc.)* in relation to its going concern assessment, whether the outcome of these plans is **likely to improve the situation.**
  *(**E.g.** Will such funds be sufficient to carry on business)* ***and whether management's plans are feasible in the circumstances.*** *(can they pull off such big changes in given short span)*

- **Cash flow & forecast**
  Where the entity has prepared a cash flow forecast, and **analysis of the forecast is a significant factor** in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - Evaluating the **reliability of the underlying data generated** to prepare the forecast; and
  - Determining whether there is **adequate support for the assumptions** underlying the forecast.

- **Events**
  Considering whether **any additional facts or information have become available** since the date on which management made its assessment.

- **Written Representation**
  Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

➢ **Auditor Conclusions about Material Uncertainty and Going Concern**
The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

➢ **Disclosure –**
Adequacy of Disclosures When Events or Conditions Have Been Identified but No Material Uncertainty Exists.
If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Part III—Case Discussion

➢ In the instant case, the approval of the resolution plan is a significant mitigating factor to counter the going concern issues of AQP Ltd. PQR Ltd has submitted a detailed plan and commitments that has been given as part of the resolution plan which includes clearance of all outstanding debts which were leading to negative cash flows.

Part IV—Conclusion

➢ Therefore, it can be said that the company that the events and conditions are mitigated effectively and there is no material uncertainty in relation to the ability of the company to continue as a going concern.

Author's Note

- **Factors which compensate going concern risks, reduce it and help going concern assumption, it is called mitigating factor**
  For Example - If there is fund shortages and holding company has promised to send funds it is mitigating factor

- **How did the auditor arrive at the conclusion that material uncertainty related to going concern doesn't exist? The resolution plan is only a mitigating factor and it does not signify nonexistence of material uncertainty related to going concern?**
  - Material uncertainty means uncertain future events affecting going concern having such likelihood and magnitude that disclosure should be made.
  - Mitigating factors are one which reduces material uncertainty, so sometimes mitigating factors may nullify material uncertainty.
  - There can be circumstances where material uncertainty exists but still chances / probability of going concern in next 12 months are more and going concern is valid.
  - In this case there were matters leading to material uncertainty, but they got compensated by mitigating factors, so resultant there is no material uncertainty.

QNO 94.000	Going Concern (Case - Inappropriate) BHASKAR CNO--SA570.060	Old Course – (M15R, N15E,P17M,N17R,N17M) New Course – (S21M)

Sun Moon Ltd. is a power generating company which uses coal as raw material for its power generating plant. The company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2020-21, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Sun Moon Ltd. This happened in the month of December 2020 and as such entire power generation process of Sun Moon Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the company. There were delays in the of payment of wages and salaries and the banks from whom the company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the company.

Further, when discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the financial statements of Sun Moon Ltd. What course of action should the statutory auditor of the company consider in such situation?

OR

S N Projects Limited, a manufacturing company in the Steel industry was allegedly involved in some irregularity relating to allotment of coal blocks for which a complaint was lodged against the company by the government The financial institutions stopped additional working capital finance which caused a financial crisis resulting in stoppage of production The company incurred a massive loss during the year 2015-16 There were delays in salary and other payments Certain key managerial personnel including GM Finance and certain other employees left the company The company has no sound action plan to mitigate these situations Guide the statutory auditor on how he should deal with this situation.

Answer

Part I -- Relevant Standards & Laws

- SA 570 on "Going Concern,"

Part II -- Requirements of Relevant Standards & Laws

- SA 570- "Going Concern" deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.
- The auditor's responsibilities are
  - To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
  - When the use of Going Concern Basis of Accounting Is Inappropriate i.e., if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.
  - When adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements the auditor shall:
    - Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
    - In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Part III – Case Discussion

- In the present case, the following circumstances indicate the inability of Sun Moon Ltd. to continue as a going concern:
  - Ban on the allotment of coal blocks.
  - Halt in power generation
  - Key Managerial Personnel leaving the company.
  - Banks decided not to extend further finance and not to fund the working capital requirements of the company.
  - Non availability of sound action plan to mitigate such circumstances.

Part IV -- Conclusion

- Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the company.
- Further, such circumstances are not reflected in the financial statements of the company. As such, the statutory auditor of Sun Moon Ltd. should:
  - Express an adverse opinion in accordance with SA 705 (Revised) and

In the Basis of Opinion paragraph of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Author's Note

In SA 570 there are questions which are not specific part of SA 570 they are case studies with "**bad business position"**

ICAI gave following answers which is a mixed bag where explain below points in short

TRADITIONAL APPROACH BY ICAI

1. Going concern meaning and disclosure in notes to accounts
2. Responsibility of management
3. Auditor Responsibility
   i. look for events & condition which create significant doubt
   ii. perform additional procedure
   iii. conclusion about material uncertainty & disclosure
   iv. conclusion about going concern & reporting
   v. finally discuss case give conclusion about reporting

NEW APPROACH BY ICAI

In QNO 90.050 again we have a bad business story it was given in M19M & N19R where they explained about

1. Events or condition creating significant doubt
2. Additional procedures
3. MU and its disclosure
4. Case discussion
5. Conclusion

CONCLUSION

So we have traditional approach and new approach of answering bad business questions students can follow any approach both will give marks traditional approach is popular as of now and students can use it

QNO 94.010	Dealing with Material Uncertainty BHASKAR CNO--SA570.060	New Course – (N18E, S21M, N21M,M23M)

M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales **due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite** uncertain as to its ability to continue in near future **and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad, situation. Till the study is completed, according to the Management, the issue involves** uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter.

OR

TUV Ltd. is a company engaged in the business of manufacture of spare parts. Saroj & Associates are the statutory auditors of the company for the FY 2020-21. During the course of audit, CA Saroj noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of TUV Ltd. ended for an unforeseeable time period. When discussed with the management, CA Saroj was told that the company is in the process of identifying new customers for their products. CA Saroj understands that though the use of going concern assumption is appropriate

but a material uncertainty exists **with respect to the identification of new customers. This fact is duly reflected in the financial statements of TUV Ltd. for the FY 2020-21.** How should CA Saroj deal with this matter in the auditor's report for the FY 2020-21?

Answer

Part I -- Relevant Standards & Laws

- SA 570 "Going Concern"

Part II -- Requirements of Relevant Standards & Laws

- **Reporting requirements in case of Uncertainty clamping on the Going Concern:**
  - **Situation when going concern is appropriate but MU exits**

    As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:
    - **Disclosure of Principal Events & Conditions in financial statements**

      Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
    - **Warn may be unable to realise assets & pay liabilities in notes to accounts**

      Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.
    - **If adequate disclosure as given above – unmodified opinion & Separate section with heading "MU related to Going Concern" in Audit Report**

      If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
      - **Draw attention to the note in the financial statements** that discloses the matters set out above; and
      - State that these events or conditions **indicate that a material uncertainty exists** that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Part III – Case Discussion

- In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts.

Part IV -- Conclusion

- Therefore, the auditor should
  - Express an unmodified opinion and
  - Include in his audit report, a separate section under the heading "Material Uncertainty Related to Going Concern" to:
    - Draw attention to the note in the financial statements that discloses the matters and
    - State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter

Author's Note

- **In this question nowhere it is mentioned that mitigating factor exists. It is only written that committee has been constituted to give suggestion for recovery, but answer has been given on the basis that going concern is appropriate and material uncertainty exists. Why Isn't going concern inappropriate?**

	○ Material uncertainty means uncertain future events affecting going concern having such likelihood and magnitude that disclosure should be made. ○ Mitigating factors are one which reduces material uncertainty, so sometimes mitigating factors may nullify material uncertainty. ○ There can be circumstances where material uncertainty exists but still chances / probability of going concern in next 12 months are more and going concern is valid.

QNO 94.500	**Drafting Opinion (Material Uncertainty & No Disclosure in FST)** **UNIQUE**	**New Course -- (M22M, M23M)**
	In the financial year 2020-21, Shreyansh Ltd. faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. These circumstances indicate material uncertainty on the company's ability to continue as going concern. Due to such event, it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. The financial statement and notes to the financial statements of the company do not disclose this fact. What kind of opinion should the statutory auditor of Shreyansh Ltd. issue in such circumstances and why? Also, draft the opinion and basis for opinion para for the same.	
Answer	In the present case, there exists a material uncertainty that cast a significant doubt on the company's ability to continue as going concern and the same is not disclosed in the financial statements of Shreyansh Ltd. As such, the financial statements of Shreyansh Ltd. for the FY 2020-21 are materially misstated and the effect of the misstatement is so material and pervasive on the financial statements that giving only a qualified opinion will be insufficient and therefore the statutory auditor of Shreyansh Ltd . should issue an adverse opinion. The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under: **Adverse Opinion** In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of Shreyansh Ltd. as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India. **Basis for Adverse Opinion** Shreyansh Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such event, it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement and notes to the financial statements of the company do not disclose this fact.	

QNO 94.600	**Material uncertainty Not Disclosed** **BHASKAR CNO--SA570.060**	**New Course- (N22M, M23R)**
	CA.K is appointed statutory auditor of SEEK INDIA LTD under Companies Act, 2013 for the first time. The company is preparing its accounts keeping in view applicable requirements of Division II of Schedule III of Companies Act, 2013. On scrutiny of financial statements of company put up for audit, it was noticed that notes to accounts show ageing of trade payables as per amended requirements of Schedule III of the Companies Act, 2013. **The ageing schedule forming part of notes is as under: -** **Outstanding for following periods from due date of payment (` In crore)**	

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	NIL	NIL	NIL	NIL	NIL
Others	2	4	3	1	10
Disputed dues-MSME	NIL	NIL	NIL	NIL	NIL
Disputed dues-others	NIL	NIL	NIL	NIL	NIL

Besides above, current ratio, debt-equity ratio, trade payables turnover ratio and net profit ratio disclosed in notes to accounts have slipped drastically as compared to last year and from standard norms. Most of the key financial ratios are in red. There is no other relevant information concerning above in notes to accounts.

Further, on reviewing bank statement of cash credit limit (against hypothecation of paid stocks), it was noticed that there is no debit transaction in the month of March,2022. On inquiry, he came to know that stock audit of company was conducted in the month of January,2022 and stock auditors have commented vide their report dated 25.2.2022 that company had negative drawing power due to high creditors. Accordingly, the bankers have refused further debits in cash credit account from start of March,2022. There is no information in this respect in financial statements and notes to accounts.

Discuss how CA K should deal with above for reporting in his audit report under the Companies Act, 2013

Answer

In the given situation, it is clear from the ageing schedule that company is not able to pay its creditors on time. Outstanding to creditors for a period of 1 year or more account for 80% of total dues to the creditors of the company from due date of payment. Most of key financial ratios are adverse.

Further, bankers have refused further debits in cash credit account due to negative drawing power from March 2022. Cash credit loans are repayable on demand. There is no other information or disclosure available how the company plans to run its business without bank finance.

All the above factors are indicators that a material uncertainty exists that may cast a significant doubt on the company's ability to continue as going concern. There is no express disclosure of this fact in financial statements.

Therefore, it is a situation where material uncertainty exists which has cast a significant doubt on company's ability to continue as going concern in accordance with SA 570, "Going Concern".

Keeping in view above the fact that although a material uncertainty exists casting a significant doubt on the ability of company to continue as going concern, adequate disclosure of material uncertainty is not made in financial statements, CA K shall give qualified or adverse opinion in accordance with SA-705, "Modifications to the Opinion in the Independent Auditor's Report".

SA 580

QNO 97.000	Misuse of WR BHASKAR CNO--SA580.020	Old Course – (N04E, N11R, N13R, N14E, M16M, N16M, P17M, M18M) New Course – (S17M, S21M)

The auditor of Moon Pvt. Ltd. having turnover of rupees 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the Management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach?

OR

M/s GBC & Co auditors of Vishu Ltd, accepted a certificate from management to certify the existence and value of machinery as per records as they were unable to get the confirmation that could prove the existence & value of the machinery State whether acceptance of certificate by GBC & Co is right approach of the auditors.

Answer

Part I -- Relevant Standards & Laws

- SA 580 "Written Representations"

Part II -- Requirements of Relevant Standards & Laws

- **WR as Audit Evidence: - Audit Evidence helps in drawing conclusions / WR is also audit evidence / Similar to response of Inquiry / It is necessary audit evidence / But it doesn't affect NTE of other audit procedures / WR cannot substitute other audit evidence that the auditor could reasonable expect to be available / When we take WR for material item / obtain corroborative audit evidence from other source internal or external / Check whether representations are reasonable and consistent / WR should come from well informed individuals**

  As per SA 580 "Written Representations", when representation relate to matters which are material to the financial information, then **the auditor should seek corroborative audit evidence for other sources inside or outside the entity.** He should evaluate whether such **representations are reasonable and consistent with other evidence** and **should consider whether individuals making such representations can be expected to be well informed on the matter.** "Written Representations" **cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.**

- **No S&A Evidence: - Not able to obtain S&A evidence / Evidence which was reasonable expected / regarding material items in FST / it will be limitation on scope / even though there is WR**

  If the auditor **is unable to obtain sufficient appropriate audit evidence** that **he believes would be available regarding a matter, which has or may have a material effect on the financial information,** this will constitute a **limitation on the scope of his examination even if he has obtained a representation from management on the matter.**

- **Physical Verification: - Primary responsibility of the management / Auditor should examine verification programme and try to attend physical verification / S&A evidence for existence and valuation of stock**

  The physical verification of stock is the **primary responsibility of the management.** The auditor, however, is required to **examine the verification programme adopted by the management.** He must satisfy himself about the **existence and valuation of stock**.

Part III – Case Discussion

- **Not able to verify existence & value of certain stock / No physical verification/ certificate from management**

  In the case of Moon Pvt. Ltd., **the auditor has not been able to verify the existence and value** of certain stock despite the verification procedure followed in routine audit. He **accepted the certificate given to him by the management without making any further enquiry.**

Part IV -- Conclusion

- **Auditor's stand is not acceptable and not as per SA 580**

  Therefore, the approach adopted by the auditor is not tenable.

QNO 97.100	Date of and period covered by written representation BHASKAR CNO--SA580.040	Old Course – (M21M) New Course – (M19R, M21M)

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written

	representation. You are required to advise about the date of and period covered by written representation in view of SA 580.
Answer	➢ **Before Audit Report & Near to Signing:** As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the **auditor's report cannot be dated, before the date of the written representations.** Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, **the written representations are dated as near as practicable to**, but not after, the date of the auditor's report on the financial statements. ➢ **Updation of Written Representation** In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation. ➢ **All Periods** The written representations are for **all periods referred to in the auditor's report** because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are. ➢ **Change of Management** Situations may arise where **current management were not present** during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.
	Author's Note **A short summary of the above answer is provided below.** **First Para Explains — WR should be taken before signing (dating) audit report and as it cover subsequent events till date of signing audit report it should be close to date of signing** **Second Para Explains — WR are generally taken at the end of the year but if any WR is taken during the year, auditor can ask for updated WR at the end of year if any information has changed** **Third Para Explains — If you giving audit report for multiple years, like in prospectus we give report for 5 years then WR should be taken for multiple years** **Fourth Para Explains — When we take WR for past years, even if management has changed take it again from current management because they are overall responsible for financial statements** **So it focuses on 4 points** **1. Year end WR** **2. During the year WR** **3. WR for multiple years** **4. WR even when management has changed**

QNO 98.000	**WR (Refusal)** **BHASKAR CNO--SA580.060**	**Old Course – (M10E, N13R, P17M)**
	In the course of audit of ABC Ltd its management refuses to provide written representations As an auditor what is your duty?	
Answer	**Part I -- Relevant Standards & Laws** ➢ SA 580 "Written Representations" **Part II -- Requirements of Relevant Standards & Laws**	

	➢ **Duty of Auditor: - Discuss with Mgt / Re-evaluate integrity of Mgt / Evaluate effect on reliability of their representations / Take Appropriate actions / Effect on the opinion / Auditor may Disclaim as per SA 580 if no WR for any area or matter provided.** Duty of an Auditor if management refuses to provide written representations: As per SA 580 "Written Representations", if the management does not provide one or more of the requested written representations, the auditor shall: • Discuss the matter with management, • Re-evaluate the Integrity of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general, and • Take appropriate actions, including determining the possible effect on the opinion in the auditor's report. • The auditor should disclaim an opinion on the financial statements if management does not provide written representations in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

QNO 127.500	Examples of the matters to be considered With regard to the integrity of a client by the firm as per the requirements of SQC 1 UNIQUE	Old Course – (M19R) New Course – (M19R,N19E)

BSS & Associates is a partnership firm of Chartered Accountants which was established five years back. The firm was offering only advisory services at the beginning, however, after audit rotation and advent of GST, firm sees lot of potential in these areas also and started looking for opportunities in these areas also. These services being assurance in nature, the firm required some internal restructuring and set up some policies and procedures for compliance year on year.

The firm started getting new clients for these new services and is now looking to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it has been setting up a process to document how the issues were resolved**.**

The firm is now looking to work with only select clients which are in line with the policies of the firm**. The firm understands that the extent of knowledge it will have regarding the integrity of a client will grow within the context of an ongoing relationship with that client.** With regard to the integrity of a client, you are required to give some examples of the matters to be considered by the firm as per the requirements of SQC 1**.**

Answer

Part I -- Relevant Standards & Laws

- SQC 1

Part II -- Requirements of Relevant Standards & Laws

- As per SQC 1, the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

  With regard to the integrity of a client, matters that the firm considers include, for example:
  - The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance
  - The nature of the client's operations, including its business practices.
  - Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
  - Whether the client is aggressively concerned with maintaining the firm's fees as low as possible
  - Indications of an inappropriate limitation in the scope of work.
  - Indications that the client might be involved in money laundering or other criminal activities
  - The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

  The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

QNO 127.550	Matters to be addressed after deciding Withdrawal in Acceptance & Continuance procedures BHASKAR CNO— Unique	New Course – (N22E)
	AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.	
	Acceptance and Continuance of Client Relationships and Specific Engagements: As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so. In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship **address issues that include the following:** • Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances. • If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal. • Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities. • Documenting significant issues, consultations, conclusions and the basis for the conclusions. AP & Associates should address the above issues before deciding to withdraw.	

QNO 127.600	Review (Procedures) & Rotation of Partner as per SQC-1 UNIQUE	New Course – (M21E,N22M)
	HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the Last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India **for some personal reasons, so this** year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not.	
Answer	As per SQC 1, an engagement quality control review for audits of financial statements of listed entities includes considering the following: **(i)** The work has been performed in accordance with professional standards and regulatory and legal requirements; **(ii)** Significant matters have been raised for further consideration; **(iii)** Appropriate consultations have taken place and the resulting conclusions have been documented and implemented; **(iv)** There is a need to revise the nature, timing and extent of work performed;	

	(v) The work performed supports the conclusions reached and is appropriately documented; **(vi)** The evidence obtained is sufficient and appropriate to support the report; and **(vii)** The objectives of the engagement procedures have been achieved. The firm should establish policies and procedures: (i) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and (ii) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code. The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a predefined period, normally not more than seven years. From the facts given in the question and from the above stated paras of SQC 1, it can be concluded that firm is not complying with SQC 1 as Engagement Partner H is continuing for more than 7 years.

QNO 127.650	**Responsibility of EP after EQCR & Aspects to be considered by Engagement Quality Control Reviewer** **UNIQUE**	**New Course – (M22E)**
	PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited?	
Answer	**As per SQC 1,** "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the review does not reduce the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct. However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.: **1.** The engagement team's evaluation of the firm's independence in relation to the specific engagement. **2.** Significant risks identified during the engagement and the responses to those risks. **3.** Judgments made, particularly with respect to materiality and significant risks. **4.** Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations. **5.** The significance and disposition of corrected and uncorrected misstatements identified during the engagement. **6.** The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies. **7.** Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached. **8.** The appropriateness of the report to be issued. Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.	

QNO 127.700	How to deal with complaints & allegations against CA Firm UNIQUE	New Course – (N20E,M22M)
	M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period. Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC)**.**	
Answer	In the given question, NK & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", **Policies Procedures** (i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with (a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and (b) Allegations of non-compliance with the firm's system of quality control. **Source** (ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel. **Channel** (iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. **Investigation** (iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented. **Deficiencies** (v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.	

02 Audit Planning, Strategy and Execution

Part 1 -- SA 300

QNO 30.000	Planning in Initial Audit BHASKAR CNO—SA300.080	Old Course – (M17R, M18E)
	Briefly discuss the following statements in view of SA 300 "Planning an Audit of Financial Statements" For an initial audit, the auditor may need to expand the planning activities.	

Answer

Part I -- Relevant Standards & Laws

- SA 300, Planning an Audit of Financial Statements

Part II -- Requirements of Relevant Standards & Laws

➢ Before we start planning for initial audit: -

Auditor should do these 2 things,

▼ 1st Carefully determine acceptance of client and specific audit engagements

▼ 2nd Communicate with Predecessor Auditor

The auditor shall undertake the following activities **prior to starting an initial audit**:

- Performing procedures required by SA 220 regarding the **acceptance of the client relationship** and the specific audit engagement; and
- **Communicating with the predecessor auditor**, where there has been a change of auditors, in compliance with relevant ethical requirements.

➢ Difference in Initial Audit: -

▼ Overall objectives remain same / Expand planning as auditor is not having any previous experience.

The purpose and **objective of planning the audit are the same** whether the audit is an initial or recurring engagement.

However, for an initial audit, the auditor may need to **expand the planning activities because the auditor does not ordinarily have the previous experience** with the entity that is considered when planning recurring engagements.

➢ Additional Matters while establishing Overall Audit Strategy & Audit Plan

▼ Discussion of major issues identified during acceptance procedures with management & TCWG /

▼ Arrangement with previous auditor like discussion or review of working papers if client agree /

▼ Evidence regarding opening balances as per SA 510 /

▼ Compliance with firm's policy w.r.t initial audit engagements

For initial audits, **additional matters the auditor may consider in establishing the overall audit strategy and audit plan** include the following:

- Unless prohibited by law or regulation, **arrangements to be made with the predecessor auditor**, *for example, to review the predecessor auditor's working papers.*
- Any **major issues** (including the application of accounting principles or of auditing and reporting standards) **discussed with management** in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
- The audit procedures necessary to obtain sufficient appropriate audit **evidence regarding opening balances** (SA 510)
- Other procedures required by the **firm's system of quality control for initial audit engagements** (for example, the firm's system of quality control may require the involvement of **another partner or senior individual to review the overall audit strategy** prior to commencing significant audit procedures or to review reports prior to their issuance).

QNO 30.100	Audit Strategy BHASKAR CNO—SA300.040	Old Course – (M06E, N09R, M13M, N13R, P17M,) New Course – (S17M)

Designing an Audit Strategy is the backbone of the "Audit Planning" process Discuss.

OR

M/s Sodhi & Associates have been appointed as the auditor of Raheja Ltd engaged in the business of manufacturing and export of handloom goods The partner of the firm explains to the audit team that the formulation of audit strategy shall form the basis of audit planning to achieve the audit objectives in the most effective and efficient manner As head of the audit team, narrate the steps involved in the formulation of audit strategy.

OR

You have been appointed as auditor of Bahubali Ltd. for the first time. Enumerate the factors to be considered while establishing an overall audit strategy and its benefits.

Answer

First Alternative

- **Overall audit strategy would involve-(R-CRPF)**
  - **Determination of Characteristics of Audit:** Identify the characteristics of the engagement that define its scope.
  - **Reporting Objectives:** Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.
  - **Factors directing Team's Efforts:** Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
  - **Preliminary Work:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.
  - **Nature, timing and Resources:** Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Second Alternative

- Audit strategy is concerned with designing the audit approaches to achieve necessary audit assurance at lowest cost within the constraints of the information available. Audit strategy generally involves the following steps:
  - **Obtaining Knowledge of Business: Help in understanding the events & transactions/framework for judgement/ Better understanding to audit staff.**
    For the conduct of audit, auditor should obtain understanding of the business of the entity. It **will help in understanding the events & transactions** that takes place and its effect on F.S. It **provides a framework,** or it **acts as a framework** within which auditor exercises his **judgement**. It also ensures **that audit staff obtains sufficient knowledge** of business to enable them to carry the work delegated to them.
  - **Evaluating Inherent Risk: Professional Judgement/Experience/Controls/Sign. Changes**
    To assess inherent risk, the auditor would use **professional judgement,** his **experience** from previous audit engagements with the entity**, established controls,** his knowledge of any **significant changes** to evaluate factors such as quality of accounting system, complexity of transaction, unusual transaction etc.
  - **Evaluating Internal Control: Determining N-T-E of Audit Procedures/Judgement of Materiality**
    The auditor's assessment of the control environment is crucial to as this will **determine the Nature, Timing & Extend of audit procedures**. Assessment of the control will act as a base for auditors' **judgement about materiality** and other audit procedures.
  - **Performing Analytical Procedures: Extensive use of Accounting ,Business Knowledge & Experience to identify relevant Risk Indicators/A.P-General & not precise/Purpose -Highlighting not verification.**
    Analytical Procedures at planning stage **require extensive use of Accounting ,Business Knowledge & Experience to identify relevant Risk Indicators.** Analytical Procedures at planning stage **are general and not precise**. Purpose of analytical procedure at this stage

is only highlighting or bringing attention of the auditor towards relevant Risk Indicators and **not verification** of evidence obtained.

Thus, the **audit strategy is evolved after considering the objectives** of engagement, the **results of the business review, preliminary judgements of materiality** and **identified inherent risks. Audit strategy also considers planning and controlling the audit or comments on adequacy of the existing arrangements.**

Thus, **the overall audit plan** involving determination of timing, manpower, coordination and the directions in which the audit work has to proceed **is dependent upon the audit strategy** formulated by the audit firm.



Author's Note

Establishing Overall Audit Strategy (Overall plan, first step in planning) **(R-CRPF)**
R-Resources (Nature / Timing & Extent)
C-Characteristics of Assignment
R-Reporting & Communication
P-Preliminary Engagement Activities Results
F-Significant Factor



#controversy

#Controversies In Audit
Note: - Planning is covered by SA 300 as well as separate chapter on planning. So we have 2 sources talking on planning. Content from these both sources is not exactly same. But ICAI in their new module is moving more towards SA 300 content and reduce differences.
Now this particular question on "Audit Strategy as backbone of Audit Planning" or "Steps involved in formulation of Audit Strategy" has been repeated in ICAI publications from time to time. Earlier they use to answer it as per traditional theory as given in chapter. But in recent study material they have answered it as per SA 300 content "Factors Affecting Overall Audit Strategy". So I will suggest to remember points as given in SA 300 only.
We are providing both the answers as alternatives, but first alternative is preferred over other.

QNO-30.200	**Audit Planning** **BHASKAR CNO—SA300.060**	**Old Course – (M11E, M12R, M16R, P17M, N20R)** **New Course- (S17M, N20R, S21M)**

A & Co was appointed as auditor of Great Airways Ltd As the audit partner what factors shall be considered in the development of overall audit plan?

OR

Contents of an audit plan.

Answer

The auditor shall develop an audit plan that shall include a description of

- The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

Alternative Answer

- **Development of an overall plan –**

The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

- D-**Degree of reliance** to be placed on the accounting system and internal control.
- I -Work of **the internal auditors** and the extent of reliance on their work, if any in the audit.
- A-**Nature and extent of audit evidence** to be obtained.
- M-**Setting of materiality** levels for the audit purpose.
- E-Involvement of other auditors in the audit of subsidiaries or branches of the client and **involvement of experts.**
- T - **Terms of his engagement** and any statutory responsibilities.
- R-**Nature** and **timing of reports** or other communications.
- A-**Accounting policies** adopted by the clients and changes, if any, in those policies.
- L-Applicable Legal **or Statutory requirements**.
- J-Allocation of works to be undertaken **between joint auditors** and the procedures for its control and review.
- S-**Identification of significant audit areas**.

Author's Note



#controversy

#Controversies In Audit
Note: - Planning is covered by SA 300 as well as separate chapter on planning. So we have 2 sources talking on planning. Content from these both sources is not exactly same. But ICAI in their new module is moving more towards SA 300 content and reduce differences.
Now earlier ICAI use to treat overall audit plan equal to overall audit strategy but in new module overall audit plan means audit plan as per SA 300.
On the basis of that we are providing both the answers as alternatives, but first alternative is preferred over other

Authors Note

Note: Since it's a list of things which the student is required to memorize and write, a mnemonic has been created. Student is just required to memorize it and speak it up in the exam like:

Overall audit plan should be "DIAMETRAL, J-abardast & S-calable"

M-Materiality Setting/S-Significant Area Identification/J-Joint auditor/A.P-Accounting Policies/I.N-Internal Auditor/N- Nature and extent of audit evidence/D- Degree of reliance/T-Terms of eng./E-Expert/S- Statutory requirements. /T-Time of Reporting.

QNO 30.300	Audit Strategy & Audit Plan BHASKAR CNO—SA300.070	Old Course – (N16E) New Course – (M22R)

Discuss the relationship between overall audit strategy and audit plan.

Answer

Audit Strategy	Audit Plan
Provides guidelines for developing the audit plan	Prepared on basis of Audit Strategy.
Establishes scope & conduct of the audit procedures. ***(kya kya cover hoga)***	Contains Details on nature, timing and extent of the audit procedures. ***(konsa/ kab tak/kitna)***
The audit strategy is prepared before the audit plan.	The audit plan is prepared after the audit strategy
Less Detailed	More Detailed
Change in audit strategy would result into change in Plan	Change in audit plan would result into change in Strategy.

	Author's Note **-Above is a table on relationship between overall audit strategy and audit plan. The answer has been presented by us in a chart form only for ease of understanding.** **-Answer issued by institute is presented in a (paragraph) manner. Students may write the answer in Para points form in order to maintain consistency.**

QNO 30.310	**Documentation of Audit Strategy & Audit Plan** **BHASKAR CNO—SA300.140**	**Old Course – (N18R)**
	The auditor shall document:- **(i) The overall audit strategy; (ii) The audit plan; and (iii) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes." Explain.**	
Answer	➢ **Documenting the Audit Plan** The auditor shall document-**The overall audit strategy;** The **audit plan;** and Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes as under – ➢ **Documentation of the overall audit strategy** The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit. ➢ **Documentation of the audit plan** The **documentation of the audit plan** is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances. ➢ **Record of the significant changes:** **A record of the significant changes** to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.	

QNO 30.320	**Benefits of Planning** **BHASKAR CNO—SA300.120**	**Old Course –(N18R, M21E)**
	BSA & Company, Chartered Accountants are duly appointed auditors of ASB LTD engaged in manufacturing of various FMCG products and having its manufacturing facilities spread across India. Senior partner CA B has called meeting of audit staff to plan the conduct of audit for the year 2017-18 and at the meeting he addresses as under: **"SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing", states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner".** **In view of above, you are required to analyse and explain the benefits of Planning in an Audit of Financial Statements.** **OR** **Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. Briefly discuss the usefulness of careful and adequate audit planning.**	

Answer

SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner.

- **Benefits/Advantages of Planning in an Audit of Financial Statements**

  Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways described hereunder-

  - **Attention to Important Areas** - Planning would help the auditor to devote appropriate attention to important areas of the audit.
  - **Timely resolution of Potential Problems** - It would also help the auditor identify and resolve potential problems on a timely basis.
  - **Proper Organisation and Management of Audit Engagement** – Adequate planning would help the auditor in properly organizing and managing the audit engagement so that it is performed in an effective and efficient manner.
  - **Proper Selection of Engagement Team -** Planning would assist the auditor in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
  - **Direction and Supervision of Engagement Team** - It would further facilitate the direction and supervision of engagement team members and the review of their work.
  - **Easy Coordination** - Also, planning would be helpful to the auditor in coordination of work done by auditors of components and experts.

Advantages: -

Appropriate selection & assignment of work / responsibility & accountability of work delegated improves / clear set of instructions to juniors / systematic plan with proper emphasis on important areas / less chances of overlooking.

e.g. EPS checking omitted / identify & resolve potential problems.

e.g. need of expert in inventory determination & valuation / helps in co-ordination with other auditors / helps in controlling / supervising audit work / serves as guide in succeeding years / serves as evidence in case of charge against negligence.

QNO 80.000	Estimates (Estimates High Uncertainty) BHASKAR CNO—SA540.100	Old Course – (N16E)
	With reference to the Standards on Auditing state the examples of accounting estimates that may have a high estimation uncertainty	

Answer

Part I -- Relevant Standards & Laws

- SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures

Part II -- Requirements of Relevant Standards & Laws

➢ **High Estimation Uncertainty: -**

If there is high estimation uncertainty in any estimate, then there is significant risk

As per SA 540, the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

High uncertainty in JR HR department

➢ **Examples**

▼ **Judgement Dependent / Review of Prior Period Estimates / Not Calculated using Recognised Measurement Techniques / Highly Specialised Entity Developed Model**

Examples of accounting estimates that may have high estimation uncertainty include the following:

- Accounting estimates that are **highly dependent upon judgment,** for example, judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future.
- Accounting estimates where the results of the auditor's **review of similar accounting estimates made in the prior period financial statements indicate a substantial difference between the original accounting estimate and the actual outcome.**
- Accounting estimates that are **not calculated using recognised measurement techniques.**
- Fair value accounting estimates for which **a highly specialised entity-developed model is** used or for which there are no observable inputs.

QNO 80.050	Estimates (Estimates low Uncertainty) BHASKAR CNO—SA540.100	Old Course – (N19E)
	During the audit of Data Solutions Ltd., a listed company, your audit manager observed that several estimates are made by the Company. He seeks your guidance to know areas of accounting estimates that may give rise to lower level of risk of material misstatement. Guide him with examples.	

Answer

Part I -- Relevant Standards & Laws

- SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures

Part II -- Requirements of Relevant Standards & Laws

➢ **Examples of Low Estimation Uncertainty**

FMCG ki **R**eport mine bahut kam uncertainty hai	
▼ Accounting estimates that are **Frequently made and updated because they relate to routine Transactions**	• *(Inventory Valuation)*
▼ **Fair value accounting estimates** where the **Method of measurement prescribed by the applicable financial reporting framework is simple and applied easily** to the asset or liability requiring measurement at fair value.	• ***(E.g.,** Ind AS 113 gives method of computing fair value, if this is used then it is reliable)*

➢ Accounting estimates arising in entities that **engage in business activities that are not Complex**	• ***(E.g.,** Depreciation of furniture in trading entity) (Fixed Asset)*
➢ Fair **value accounting estimates** where the model used to measure the accounting estimate is **well known or Generally accepted,** provided that the assumptions or inputs to the model are observable.	• ***(E.g.,** Equity share valuation through net asset method is very simple and well-known method)*
➢ Accounting estimates **derived from data that is Readily available,** such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.	• ***(E.g.,** Average PE ratio was computed for retail industry from share prices and earnings of listed companies and same was used to value a private company shares in retail industry) (Investment)*

Authors Note

- **Shortcut to remember - FMCG** ki **R**eport mine bahut kam uncertainty hai
- **Examples are provided for better understanding of the points.**

QNO 81.000	**Estimates (Risk Assessment)** **BHASKAR CNO—SA540.040**	**Old Course – (M11E, M12M, N12R, M16M, P17M,M21M)** **New Course – (S17M, M18M, S21M,M21M,M22E)**

While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

OR

"CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing. "

Answer

Part I -- Relevant Standards & Laws

- SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures

Part II -- Requirements of Relevant Standards & Laws

➢ **Risk Assessment Procedures: - In risk assessment procedure we obtain understanding which will become basis of identifying and assessing risk**

As per SA 540, the auditor shall obtain an **understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements** for accounting estimates:

➢ **Important Overall Understandings: -**

➢ **How Mgt Identifies TEC which need accounting estimates to be recognised, disclosed or need to revise existing estimates / Requirements of applicable FRF**

- The **requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.**
- How Management **identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements.** In obtaining this understanding, the auditor shall make **inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.**

➢ **Estimation Process Including: -**

	➢ Relevant Controls / Expert / Methods Including Model / Assumptions ➢ Additional Information: - ➢ Changes from Prior Period / Management's Assessment of Estimation Uncertainty The **estimation making process** adopted by the management including- **Relevant controls.** • Whether **management has used an expert?** • The **method, including where applicable the model,** used in making the accounting estimates. • The **assumption underlying the accounting estimates.** • Whether there has been or ought to have been a **change from the prior period in the methods for making the accounting estimates**, and if so, why; and • Whether and, if so, how the **management has assessed the effect of estimation uncertainty.**

QNO 81.020	**Obtaining Understanding of Assumptions Used for Determining Estimates** **UNIQUE**	**Old Course – (M21E)**
	Assumptions are integral components of accounting estimates. State the matters **that the auditor may consider in obtaining an** understanding of the assumptions underlying the accounting estimates **with reference to relevant SA's.**	
Answer	**As per SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures,** how management makes the accounting estimates, and an understanding of the data on which they are based, including assumptions underlying the accounting estimates. Assumptions are integral components of accounting estimates. Matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates include, for example: • The nature of the assumptions, including which of the assumptions are likely to be significant assumptions. • How management assesses whether the assumptions are relevant and complete (that is, that all relevant variables have been taken into account). • Where applicable, how management determines that the assumptions used are internally consistent. • Whether the assumptions relate to matters within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life), and how they conform to the entity's business plans and the external environment, or to matters that are outside its control (for example, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or the variability and the timing of future cash flows). • The nature and extent of documentation, if any, supporting the assumptions. Assumptions may be made or identified by an expert to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions.	

QNO 81.050	**Further Audit Procedures Where Significant Risk is Identified, Whether Effect of Estimation Uncertainty is Considered While Making Estimates** **BHASKAR CNO—SA540.120**	**New Course – (N20E, M22M, M23M)**
	M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated	

	business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made?
Answer	In the given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a lo ss due to that provision. As an auditor evaluation would be done as under: For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following: (i) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate. (ii) Whether the significant assumptions used by management are reasonable. (iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so. (iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

QNO 81.100	**Content of WR, in case of estimates and consequences of refusal** **BHASKAR CNO—SA540.160**	**Old Course – (M19M)** **New Course – (M19M,N19E, S21M)**
	Statutory auditor of O Ltd requested the management for a written representation in respect of obsolescence of inventory and warranty obligations recognized by the company in its financial statements. The management denied the representation on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report. Please comment. **OR** **Mr. L while conducting the observed that inventory and warranty obligation in the financial statements, Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable.** **Guide Mr. L with reference to the relevant Standard on Auditing,**	
Answer	➢ **As per SA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures:** The auditor shall obtain written representations from the management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations: ➢ About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.	

- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

➢ For those accounting estimates not recognised or disclosed in the financial statements, written representations may also include representations about:
- The appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.
- The appropriateness of the basis used by management to overcome the presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework, for those accounting estimates not measured or disclosed at fair value.

➢ Thus, management's contention on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report, for not providing written representation is not correct. The management should provide written representations to the auditor.

Further as per SA 580 Written Representation, if management does not provide one or more of the requested written representations, the auditor shall:-
- Discuss the matter with management.
- Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

QNO 81.200	**Review of Prior period estimates** **BHASKAR CNO—SA540.170**	**Old Course – (M19R)** **New Course – (M19R,S21M,N21M)**
	A Pvt Ltd is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period. **The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.**	

Answer

➢ **Mandatory to review outcome of prior period estimates**

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor **shall review the outcome of accounting estimates** included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. **The nature and extent of the auditor's review** takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

➢ **Benefits of Reviewing outcome of Prior Period Estimates**

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:
- Information regarding the **effectiveness of management's prior period estimation process,** from which the auditor can judge the likely effectiveness of management's current process.
- **Audit evidence that is pertinent to the re-estimation**, in the current period, of prior period accounting estimates.
- **Audit evidence of matters, such as estimation uncertainty,** that may be required to be disclosed in the financial statements.
- The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of

	accounting estimates to, or **indicate the presence of, possible management bias.** The auditor's professional scepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures. ➢ **Not Intended to question or doubt prior period estimates** However, the review is **not intended to call into question the judgments made in the prior periods that were based on information available at that time.** ➢ **Conclusion** In the given case, the management is not correct in refusing the relevant information to the auditor.

QNO 100.400	Aspects to be considered while accepting position of principal auditor BHASKAR CNO—SA600.020	New Course –(M21E)
	PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmer directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. What factors will be considered by you while accepting the position of Principal auditor?	
Answer	**Factors to be considered while accepting the position of Principal auditor -** SA 600 – Using the work of Another Auditor – While accepting the position of Principal Auditor, the auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.For this purpose, the auditor would consider: The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For this purpose the auditor would consider: (a) the materiality of the portion of the financial information which the principal auditor audits; (b) the principal auditor's degree of knowledge regarding the business of the components; (c) the risk of material misstatements in the financial information of the components audited by the other auditor; and (d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.	

QNO 100.500	Aspects related to responsibilities of parent auditor (auditor of HO) and branch office auditors BHASKAR CNO—SA600.040	Old Course – (M19R)
	RAJ Ltd has a branch office which maintains its separate set of books of accounts. The statutory audit of RAJ Ltd and its branch office is conducted by two separate firms of Chartered Accountants. RAJ Ltd being the company with Head Office, its statutory auditors, always intervene in the work of the statutory auditors of branch office. Due to this, the audit completion takes longer period. Due to the company's internal policies, they need to continue with two separate auditors for head office and branch office. Please explain the aspects related to reporting and responsibilities of parent auditor (auditor of HO) and branch office auditors.	
Answer	➢ **Requirement of Company's Act** ▼ **Relevant Section** Sub-section (8) of Section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. ▼ **Who can do branch audit?** • **Domestic Branch** Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under Companies Act, 2013 or by any other person qualified for appointment as an auditor of the company under Companies Act, 2013 and appointed as such under section 139, or • **Foreign Branch** where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant	

or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.

- **SA 600**
  - **Clear understanding & rapport between principal auditor & branch auditor is required**

    When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor".

- **Responsibility of Principal Auditor**
  - **Sufficient & Appropriate Evidence – Work of other auditor is sufficient**

    The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

  - **Mandatory Procedures**

    arrangement for co-ordination / use of work of other auditor / areas requiring special consideration / intercomponent transactions / timetable --- advise & obtain representation as to compliance to accounting, auditing and reporting requirements.

    When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:
    - advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for coordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of intercomponent transactions that may require disclosure and the time-table for completion of audit; and
    - advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

  - **Discretionary Procedures**
    - **Discussion / Summary / Check List / Visit**

      The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor.

    - **Need not apply above 4 procedures – S&A evidence that acceptable quality**

      The principal auditor may conclude that it is not necessary to apply procedures such as those described in above paragraph because sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice.

    - **NTE – Circumstances / Principal Auditor's Knowledge & Professional Competence of Other Auditor**

      The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

- **Right to Visit**

  Visit – law may give right to visit & examine books of account / principal auditor would normally be entitled to rely upon the work of other auditor unless there are special circumstances requiring visit & examination of books

  In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

- **Responsibility of Branch Auditor**
  - **Submit Report to Principal Auditor & Also Fraud Reporting**

    The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

    Further as per Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

QNO 101.000	Branch Audit (Co-Ordination) BHASKAR CNO—SA600.080/SA600.100	Old Course – (M08R, N16E, P17M, N20M) New Course –(N20M, M23M)

"There should be sufficient liaison between a principal auditor and other auditors" Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by other auditor.

B Ltd is the Subsidiary company of A Ltd ABC & Associates has been appointed as auditor of A Ltd for the Financial Year 2014-15 and XYZ & Associates has been appointed as auditor of B Ltd for the year 2014-15 Explain the role of ABC & Associates and XYZ & Associates as auditors of the parent company and subsidiary respectively

Answer

Part I -- Relevant Standards & Laws

- SA 600 – "Using the Work of Another Auditor"

Part II -- Requirements of Relevant Standards & Laws

- **Co-ordination – Between PA & OA / To Achieve this there should be Sufficient Liaison / If necessary Written Communication by P.A to O.A**

  SA 600 contemplates coordination between auditors and requires that **there should be sufficient liaison between the principal auditor and the other auditor.** For this purpose, **the principal auditor may find it necessary to issue written communication(s) to the other auditor.**

OA to PA

- **Understand how his work is to be used & Co-ordinate with the PA / Ensure Compliance with Statutory Requirement / Inform Significant Findings material at entity level/ adhering to Timetable/ Responding to Questionnaire**

  The other auditor, knowing the context in which his work is to be used by the principal auditor, **should co-ordinate with the principal auditor.** For example, by bringing to **the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level, adhering to the timetable for audit of the component, etc.** He should ensure **compliance with the relevant statutory requirements**. The **other auditor should respond to such questionnaire on a timely basis.**

PA to OA

- **Advice on imp. Matter/ Require OA to answer detailed Questionnaire if req.**

  Similarly, **the principal auditor should advise the other auditor** of any matters that come to his attention that he thinks may have an **important bearing on the other auditor's work.**

When considered necessary by him**, the principal auditor may require the other auditor to answer a detailed questionnaire** regarding matters on which the principal auditor requires information for discharging his duties.

Reporting Requirements

- **Modifying Opinion**

  PA shall Evaluate Nature & Significance of Subject Matter with respect to financial information of Entity

  In all circumstances**, if the other auditor issues**, or intends to issue**, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance**, in relation to the financial information of the entity on which the principal auditor is reporting that it requires a **modification of the principal auditor's report.**

- **Qualified / Disclaimer**

  If OA work cannot be used / PA Cannot perform Suff. Audit procedures/P.A should express Q/DOM

  When the principal auditor concludes, based on his procedures, that the **work of the other auditor cannot be used** and the principal auditor **has not been able to perform sufficient additional procedures regarding** the financial information of the component audited by the other auditor, **the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit**.

QNO 103.000	Branch Audit (Without Visiting) UNIQUE	Old Course – (N05E, P17M)

As a Statutory Auditor, how would you deal with the following:
P Ltd of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches M/s XYZ conducted the audit of the branch without visiting the branch and instead getting the books at the HO M/s XYZ has submitted their Branch Audit Report to you.

Answer

Part I -- Relevant Standards & Laws

- Company Act Sec 143(8)
- SA 600 – "Using the Work of Another Auditor"

Part II -- Requirements of Relevant Standards & Laws

Sec 143(8)

- **Who Can Audit Branch? – Sec 143(8) Principal Auditor / Person Who is Qualified & Not Disqualified to be Auditor – Further even if audit is done by Branch Auditor Principal Auditor has right to visit branch and access books of accounts & voucher for audit purpose**

  As per provisions of the Companies Act, 2013, the accounts of a branch office of a company are required to be audited either by the **company's auditor or by any other person qualified for appointment as auditor of the company.** At the same time, the statutory auditor has **the right to visit branch offices and to have access to the books of accounts and vouchers** maintained at the branch office in this case.

Requirement of SA 600

- **Can principal auditor rely on work done by Branch Auditor? – As per SA 600, No need to evaluate professional competence if branch auditor is CA and as per company act branch auditor of Indian branch is CA. Further Yes Principal Auditor entitled to rely on work of branch auditor provided branch auditor has exercised adequate skill & care and there are no special circumstances or reason to believe that he should not rely on work of branch auditor.**

  In any case, the principal auditor i.e. the statutory auditor of Head Office P Ltd. is **entitled to rely on the work of branch auditor unless there are special circumstances to make it essential for him to visit the branch and examine the books of account and voucher records.** As per basic principles governing an audit, the principal auditor is **entitled to rely upon the work performed by others provided he exercises adequate skill and care** and is not aware of any reason to believe that he should not have so relied. As per SA 600, "Using the work of another auditor", the principal auditor is **not required to evaluate professional competence** because branch auditor happens to be

member of ICAI. The statutory auditor is also required to deal with the Branch Auditor's report in the manner, he considers necessary.

- **Whether Visiting Branch by Branch Auditor is Compulsory? – Not necessary / Matter of Professional Judgement**

  It **is not necessary for branch auditor M/s XYZ to visit the branch** and conduct the audit only at branch's premises. It is a **matter of professional judgement** for the branch auditor to decide as to whether he needs to visit the branch.

Part III – Case Discussion

- In present case branch auditor has not visited branch and instead called records of branch at HO for audit.

Part IV -- Conclusion

- Principal auditor has right to visit branch / but it is not necessary to visit branch / he can rely on branch auditor unless there are reasons otherwise / Further visiting branch by branch auditor is not necessary its matter of professional judgement / Hence principal auditor will have to evaluate whether approach of branch auditor not to visit branch is appropriate and then act accordingly.

  Therefore, the statutory auditor is required to deal with M/s XYZ's report in the manner it considers fit under the circumstances.

QNO 103.050	Access to Working Papers of Branch Auditor BHASKAR CNO—SA600.040	New Course – (M18E)
	B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers?	

Answer

- **Clear understanding of the role of such auditor and the company's auditor/ Proper rapport between these two auditors**

  When the accounts of the branch are audited by a person other than the company's auditor, there is **need for a clear understanding of the role** of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a **proper rapport between these two auditors** for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor**".

- **Special circumstances**
  - **Visit – law may give right to visit & examine books of account / Principal auditor would normally be entitled to rely upon the work of other auditor unless there are special circumstances requiring visit & examination of books**

    In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component

  - **Mandatory Procedures – arrangement for co-ordination / use of work of other auditor / areas requiring special consideration / intercomponent transactions / timetable --- advise & obtain representation as to compliance to accounting, auditing and reporting requirements**

    When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:
    - advise the other auditor of the **use that is to be made of the other auditor's work and report** and make sufficient arrangements for **coordination of their efforts at**

the planning stage of the audit. The principal auditor would inform the other auditor of matters such as **areas requiring special consideration**, procedures for the **identification of intercomponent transactions** that may require disclosure and the **time-table** for completion of audit; and

- advise the other auditor of the **significant accounting, auditing and reporting requirements** and **obtain representation** as to compliance with them.

➢ **Discretionary Procedures --- Discussion / Summary / Check List / Visit**

The principal auditor might **discuss with the other auditor the audit procedures** applied or **review a written summary** of the other auditor's procedures and findings which may be in the form of a **completed questionnaire or check-list.** The principal auditor may also wish to **visit the other auditor.**

➢ **Need not apply above 4 procedures – S&A evidence that acceptable quality**

The principal auditor may conclude that it is **not necessary to apply procedures** such as those described in above paragraph because **sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied** with in the conduct of other auditor's practice.

➢ **(NTE – Circumstances / Principal Auditor's Knowledge / Professional Competence of Other Auditor)**

The **nature, timing and extent of procedures** will depend on the **circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.** This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

➢ **SA 230 and SQC 1**

Further, SA 230 issued by ICAI on Audit Documentation, and "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", issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel."

➢ **Conclusion**

In the light of aforesaid, principal auditor was not within his right for asking for such sharing of working papers. It depends upon the **discretion of auditor**.

Author's Note

- **It must to noted that documents of branch auditor are his own property, but he can share this with principal auditor after taking permission from client such thing is common, being owner doesn't mean he cannot share, in fact it means, sharing can be done at discretion of branch auditor.**
- **So final conclusion as per SA 600 , Principle Auditor can review working papers of branch auditor but branch auditor will decide whether he wants to share documents or not.**

QNO 103.100	Evaluation of Internal Audit Function BHASKAR CNO—SA610.060	Old Course – (M05E,N08E,M09E,M12R,N12M,N13R,M13M,N14R,M15E,P17M,) New Course – (S17M,S21M)
	State the important aspects to be considered by the External auditor in the evaluation of the Internal Audit Function. **OR** **You are appointed statutory auditor of X Ltd X Ltd has an internal audit system and reports for the same are given to you Mention the factors you will consider to ensure that the said system of internal audit of X Ltd is commensurate with the size of the company and nature of its business**	

Answer

Part I -- Relevant Standards & Laws

- SA 610 – " Using Work Of the Internal Auditor"

Part II -- Requirements of Relevant Standards & Laws

STEP-1

➢ **Before relying on work of internal auditor evaluate:**

⮟ **Competence : Qualification/Training/Knowledge of the internal auditor/Objectivity: Status of the I.A within the organisation/access of TCWG/Systematic &Disciplined Approach: Audit was properly planned, directed & reviewed or not.**

Using the Work of Internal Auditor: As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors is likely to be adequate for the purpose of the audit, **the external auditor shall evaluate-**

- the **objectivity** of the internal audit function;
- **technical competence** of the internal auditors;
- whether the work of the internal auditors is likely **to be carried out with due professional care**; and
- whether there is likely **to be effective communication** between the internal auditors and the external auditor.

QNO 103.250	How to use/rely on work/report of internal auditor- BHASKAR CNO—SA610.060	Old Course (M12E,N15R,N15E,N16M,P17M) New Course – (N18M)
	CA Amboj, a practicing-chartered accountant has been appointed as an internal auditor of Textile Ltd He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Kishor, the statutory auditor of the Company, for his view and reporting Can CA Kishor rely on such report? **OR** **In the course of the statutory audit of Z Ltd, its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of internal auditor in respect of physical verification of fixed assets How an evaluation of this specific work done by the internal auditor can be done**	

Answer

Part I -- Relevant Standards & Laws

- SA 610 – " Using Work Of the Internal Auditor"

Part II -- Requirements of Relevant Standards & Laws

➢ **How to use the work?**

⮟ Discuss planned use & Co-ordinate Activities (Auditor will not check salary till 30th May, he will check on 1st June)

⮟ Read report to understand NTE and related findings (1st Week Test of Controls, 2nd Week Substantive Testing 3rd Week rectifications & reporting)

⮟ Perform Audit Procedures on body of work of Internal Auditor to evaluate whether work is planned / performed / supervised / reviewed / documented / S&A Evidence to draw conclusions / conclusions drawn are consistent with evidence obtained. (Read detailed plan, check sign of performer & reviewer, analyse misstatements and conclusion)

- His own audit procedures should be responsive depending on factors discussed earlier Judgment / RMM / (Competence / Objectivity / Work Performed by IA) and should always include reperformance of some work.
- Evaluate whether his own conclusions regarding internal audit function and its uses remain appropriate as per SA's

Part III–In this case Kishor should determine:

- **Whether reliance can be placed on the work of the internal auditor /Shall determine Internal Auditors Scope of: Verification , Area Of Coverage and Method of Verification.**

In the instant case, CA. Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible, he should also test check few items and he can also observe the procedures performed by the internal auditors.

Part IV – Conclusion

- **After Considering the above If the external auditor is satisfied – rely/if not satisfied decide otherwise./Final Responsibility to express opinion remains with the external auditor**

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

QNO 103.300	Direct Assistance BHASKAR CNO—SA610.080	Old Course – (M17R, N17M, M19R, M19M, N19M, M20R,M21M,M21E) New Course – (M18R, M19R,N19M,M19M, M20R, S21M,M21M,N22E)

Mr Anand is appointed as statutory auditor of Xerox Ltd Xerox Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr Bhanu as its internal auditor The external auditor Mr Anand asked internal auditor to provide direct assistance **to him regarding** evaluating significant accounting estimates **by the management and** assessing the risk of material misstatements **Discuss whether Mr Anand, statutory auditor, can ask direct assistance from Mr Bhanu, internal auditor as stated above in view of auditing standards.**

OR

OPQ Ltd is in the software consultancy business. The company had large balance of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2019, in respect of the valuation of accounts receivable, the statutory auditor was assigned with the checking of accuracy of the aging of the accounts receivables and provision based on ageing, **to the internal auditor** providing direct assistance to him. Comment.

OR

Smart Ltd is a manufacturing unit and you are External Auditor of the company. Internal auditors are also appointed as per the provisions of the Companies Act, 2013. As an external auditor you want to use the internal auditors to provide direct assistance for the purposes of audit. State the circumstances where the internal auditors cannot be used to provide direct assistance. **What would you include in the audit documentation?**

Answer

Part I -- Relevant Standards & Laws

- SA 610 – "Using Work Of the Internal Auditor"

Part II -- Requirements of Relevant Standards & Laws

- **Auditor Shall Not Take Direct Assistance: -**
  - **Higher RMM / Significant Judgments in Audit / Areas Where Internal Auditors are Involved & it Includes Reporting to TCWG or Management / Decisions Under SA 610 regarding Internal Audit**

The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- Relate to **higher assessed risks of material misstatement** where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
- Involve making **significant judgments in the audit;**

- Relate to work with which **the internal auditors have been involved** and which has already been, or will be, **reported to management or those charged with governance by the internal audit function; or**
- Relate to **decisions the external auditor makes in accordance with SA 610** regarding the internal audit function and the use of its work or direct assistance.

➢ **Significant Judgement Includes:**

▼ **Assessing RMM / Evaluation of-Adequacy of Test Performed Significant Acc. Estimates / Disclosure Requirement / Going Concern Assumption**

Significant judgments include the following: (**GRADES**)

- **Assessing the risks of material misstatement**
- Evaluating the **sufficiency of tests performed;**
- Evaluating **significant accounting estimates**; and
- Evaluating the adequacy of **disclosures** in the financial statements, and other matters affecting the auditor's report.
- Evaluating **the appropriateness** of management's use of the **going concern assumption;**

➢ **External auditor should make significant judgments as External auditor has sole responsibility for the audit opinion expressed,**

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Part III –Facts

➢ Mr Anand(E.A) asked I.A to provide direct assistance on evaluating significant Acc. estimates & assessing the RMM.

Part IV –Conclusion

➢ **External Auditor cannot take direct assistance from internal auditors.**

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

Author's Note: include the following audit documentation points in the answer.

If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:
(1) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;
(2) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;
(3) Who reviewed the work performed and the date and extent of that review in accordance with SA 230, Audit Documentation;
(4) The written agreements obtained from an authorized representative of the entity and the internal auditors; and
(5) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

QNO 103.400	Nature of Work to be Assigned to Internal Auditor BHASKAR CNO—SA610.080	New Course – (M18E, S21M)

Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

Answer

➢ **Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance:**

SA 610 'Using the work of Internal Auditor' Deals about the concept of direct assistance of internal auditor. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

- The amount of judgment involved in:
  - Planning and performing relevant audit procedures; and
  - Evaluating the audit evidence gathered.
- The assessed risk of material misstatement; and
- The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

Part 5 - SA 620

QNO 105.000	Agreement (Need for Detailed agreement) BHASKAR CNO—SA620.120	Old Course – (N16E,M21M) New Course –(M21M)
	Mr Mohan, an auditor of KTEN Limited wants to use the work of an expert With reference to the Standard on Auditing state the factors, which suggest the need for detailed and written agreement between the auditor and the auditor's expert.	

Answer

Part I -- Relevant Standards & Laws

- SA 620 – "Using Work Of an auditors Expert"

Part II -- Requirements of Relevant Standards & Laws

➢ **Factors which suggest the need for detailed and written agreement:**

➢ As per SA 620, "Using the work of an Auditor's Expert**", some of the matters may affect** the level of detail and formality of the **agreement between the auditor and the auditor's expert,** including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for a more detailed agreement than would otherwise be the case, or for the agreement to be set out in writing:

Nuclear-**DEAL** should have detailed agreement as they are **C**-omplex

- **N**- The auditor has **N**ot previously used work performed by that expert.
- **D**- The **respective roles or responsibilities of the auditor and the auditor's expert are D**ifferent from those normally expected.
- **E**- The greater the **E**xtent of the auditor's expert's work, and its significance in the context of the audit.
- **A** - The auditor's expert will have **A**ccess to sensitive or confidential entity information.
- **L -Multi-jurisdictional L**egal or regulatory requirements apply.
- **C**-The matter to which the **auditor's expert's work relates is highly C**omplex.

Author's Note

Nuclear-**DEAL** should have detailed agreement as they are **C**-omplex

QNO 105.100	Agreement With Expert (Matters Covered) BHASKAR CNO—SA620.120	Old Course – (M19R,M19M) New Course – (N18M,M19R,M19M,S21M, M23R)
	X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit . The auditor did not enter into any formal agreement with the auditor's expert. Please advise.	

Answer

➢ **Matters to be considered in Agreement**

The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:

➢ The nature, scope and objectives of that expert's work.

➢ The respective roles and responsibilities of the auditor and that expert.

➢ The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and

When the work of the auditor's expert relates to the auditor's conclusions regarding a significant risk, both a formal written report at the conclusion of that expert's work, and oral reports as the

work progresses, may be appropriate. Identification of specific partners or staff who will liaise with the auditor's expert, and procedures for communication between that expert and the entity, assists timely and effective communication, particularly on larger engagements.

- The need for the auditor's expert to observe **confidentiality requirements.**
  It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's expert. Additional requirements may be imposed by law or regulation. The entity may also have requested that specific confidentiality provisions be agreed with auditor's external experts.

3. Objective
-Width
-Depth
-Quality
-Valuation

4. Role of Expert
-To arrange equipment
-To arrange team
-To follow time limits

5. Role of Auditor
-To get permissions to access & use oil well from management
-Request Management to send drilling data (source data)
-To arrange satellite images

2. Scope
-Only oil wells in Orissa
-Without considering climate change



6.Communication
Status report every 15 days
Mid term report after 3 months
Final Report after 6 months

1. Nature of work
-Analysing company drilling data of past 2 years
-Satellite Images Evaluation
-10 Samples from different spots for lab testing
-Drilling 5000 ft

7.Confidentiality
Declaration from each team member of expert
Penalty of Rs 25 lakhs if there is a breach + damages

Facts and Conclusion

- In the instant case X Ltd. had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him in accordance with SA 220.

QNO 106.000	**Evaluating work of Expert** **BHASKAR CNO—SA620.140**	**Old Course – (M08R, P17M)** **New Course – (S17M, N18R, N18E, M19E, S21M,M23M)**

State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes.

OR

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2017-18. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known actuaries. Due to difference of opinion, all the joint auditors consulted their respective actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

OR

Briefly explain how an auditor can use the work of an expert.

OR

CA Dabu has been appointed as an auditor of M/s MAP Techno craft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay , an engineering consultant . Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay.

Answer

Part I -- Relevant Standards & Laws

- SA 620 – "Using Work Of an auditors Expert"

Part II -- Requirements of Relevant Standards & Laws

➢ **Evaluating the Adequacy of the Auditor's Expert's Work:**

As per SA 620 Using the work of an Auditor's Expert, the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence, etc.

➢ **Specific Procedures**

- Enquiries of the auditor's expert.
- Reviewing the auditor's expert's working papers and reports
- Corroborative procedure such as-
  - Observing the auditor's expert's work
  - Examining the published data, such as statistical reports from reputed source
  - Confirming the relevant matters with third parties
  - Performing detailed analytical procedure to see whether principles of materiality aspects considered.
  - Re performing calculations
- Discussions with another expert with relevant expertise when, for example, the findings or the conclusion of the auditor's expert are not consistent with other audit evidence.
- Discussing the expert's report with the management.

➢ **Evaluation of the adequacy of the auditor's expert's work**

Therefore, as per SA 620 on "Using the Work of an Auditor's Expert", the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

- The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
- If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

➢ **Inadequate Work**

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

- Agree with that expert on the nature and extent of further work to be performed by that expert; or
- Perform further audit procedures appropriate to the circumstances.

QNO 106.100	Reference to Work of Expert in auditors report BHASKAR CNO—SA620.140/SA620.160	New Course – (M19M)
	O Ltd. is in the business of manufacturing of steel. The manufacturing process requires raw material as iron ore for which large stock was maintained by the company at year end – 31 March 2019. The nature of raw material is such that its physical verification requires involvement of an expert. Management hired their expert for stock take and auditors also involved auditor's expert for the stock take. **The auditor observed that the work of the auditor's expert was not adequate for auditor's purposes and the auditor could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor.** **Basis above, the auditor concluded that it would be necessary to express a modified opinion in the auditor's report because the auditor has not obtained sufficient appropriate audit evidence. However, the auditor issued a clean report and included the name of the expert in his report to reduce his responsibility for the audit opinion. Comment.**	
Answer	**Part I -- Relevant Standards & Laws**	

- SA 620 – "Using Work Of an auditors Expert"

Part II -- Requirements of Relevant Standards & Laws

➢ **Work of Expert not adequate**

As per SA 620, Using the work of an Auditor's Expert, if the auditor concludes that the **work of the auditor's expert is not adequate** for the auditor's purposes and the auditor cannot resolve the matter through the additional audit, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence

➢ **Unmodified Opinion**

In addition, the auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

➢ **Modified Opinion**

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.

Facts and Conclusion

➢ In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a clean report. Auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of auditor's expert does not reduce his responsibility for that opinion.

QNO 29.000	Continuous Phase BHASKAR CNO—C2OC.040	Old Course – (M17R, N18R)
	Briefly discuss the following statements in view of SA 300 "Planning an Audit of Financial Statements": Audit planning is not a discrete phase but a continuous phase.	

Answer

Part I -- Relevant Standards & Laws

- SA 300, Planning an Audit of Financial Statements

Part II -- Requirements of Relevant Standards & Laws

➢ **Continuous in Nature: - Not a discrete phase but rather continuous, iterative in nature. Starts from completion of previous audit and continues until the completion of current audit.**

Planning an Audit of Financial Statements, **planning is not a discrete phase** of an audit, but rather a **continual and iterative process** that often begins shortly after (or in connection with) the **completion of the previous audit and continues until the completion of the current audit** engagement.

Extra Points Just to Make Answer Lengthy & Justified as per Marks

➢ **Three types of plans: -**

- **Plan for risk assessment procedures before further audit procedures**
- **Plan for further audit procedures**
- **Plan to perform audit procedures as required by SAs.**

Planning, however**, includes consideration of the timing of certain activities and audit procedures** that need to be **completed prior to the performance of further audit procedures.**

➢ **Planning for risk assessment procedures: -**

- **include obtaining general understanding of legal & regulatory requirement / determining materiality / analytical procedures for RA / other procedures for RA / involvement of expert.**

For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as-

- Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
- The determination of materiality.
- The analytical procedures to be applied as risk assessment procedures.
- The performance of other risk assessment procedures.
- The involvement of experts.

➢ **Discussing plan with Mgt: -**

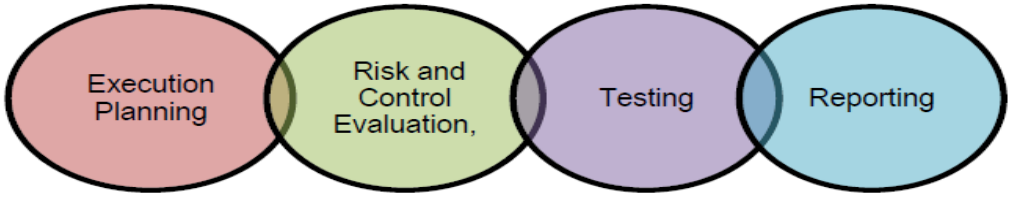
- **Can discuss elements of planning with Mgt / Ensure not to compromise the effectiveness / Sharing can make auditor predictive / Even if discussion is done overall responsibility remains with Auditor / It cannot be delegated**

The auditor may decide to **discuss elements of planning with the entity's management** to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the **overall audit strategy and the audit plan remain the auditor's responsibility.** When discussing matters included in the overall audit strategy or audit plan, care is required in order **not to compromise the effectiveness of the audit.** For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

QNO 149.010	Key phases of audit execution BHASKAR CNO—C2OC.100	New Course – (N18R)
	Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting. Explain.	

Answer

➢ **Key phases in the audit execution stage are Execution Planning, Risk and Control Evaluation, Testing and Reporting.**



- **Execution Planning:**
  Prior to commencement of an audit engagement, it is important to lay down the **roadmap for audit execution** to ensure **timely and quality audit results**. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner. A detailed audit program is prepared laying down the **audit objectives, scope and audit approach**. The **manpower requirement, audit team qualifications, and the time element, etc.** are some of the important considerations during execution planning. In order to plan effectively, the auditor may need some more information about the audit area. A **preliminary survey** would help in gathering the required information.

- **Risk and Control Evaluation:**
  For each segment of audit, the auditors should conduct a detailed risk and control assessment i.e. list the risks that must be reviewed in that segment, capture for each risk the controls that exist or those that are needed to protect against the risk and show for each control, the work steps required to test the effectiveness of the controls. While **making Risk &Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.**

- **Testing:**
  Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, the auditors should test the operating effectiveness of the controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls

- **Reporting:**
  SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity. **The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements**. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the **relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.**

  The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole. A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

- **Other Important Considerations:**
  In addition to above, there are certain other consideration which auditor is required to take care while executing the audit such as using the work of other auditor, using the work

	of an auditor's expert etc.
	Author's Note **These are phases in audit. Flow is similar to core audit process that we teach before starting SA's**

QNO 149.020	**Formulating Audit Programme - Involves Evaluation of System of Internal Control & Accounting** **UNIQUE**	**Old Course – (M21E)**
	Audit planning is necessary to conduct an effective audit in an efficient and timely manner for which purpose formulating an audit programme becomes an essential part of audit plan. Study and evaluation of system of Internal control and accounting procedures are important part of it. As auditor, discuss the features of examination of the system of Internal control.	
Answer	**System of internal control and accounting procedures:** The study and evaluation of internal control helps the auditor to establish the reliance he can place on the internal control in determining the nature, timing and extent of his substantive auditing procedures. The auditor also obtains an understanding of the accounting system to identify points in processing of transaction and handling of assets where errors or fraud may occur. When the auditor relies on internal control, it is at these points that he must be satisfied that internal control procedures applied by the entity are effective for his purpose. The auditor's examination of the system of internal control should have three features - review and preliminary evaluation, testing of compliance and evaluation. **(i) Review and preliminary evaluation** - The auditor should review the accounting system and related internal control to gain an understanding of the flow of transactions and the specific control procedures to be able to make a preliminary evaluation and identification of these aspects of internal control on which it might be efficient and effective to rely in conducting his audit. **(ii) Test of compliance -** Compliance tests should be conducted by the auditor to gain evidence that those internal controls on which he intends to rely operate generally as identified by him and that they function effectively throughout the period of intended reliance. Based on the results of his compliance procedure including observed deviations, the auditor should evaluate whether the internal controls are adequate for his purposes. **(iii) Evaluation -** It is essentially an objective process of application of auditor's judgement to determine whether all or any of the internal controls in the client's organisation can be relied upon in carrying out the audit. Based on the degree of reliance which may be full, partial or none, the auditor will programme for the substantive verification of transactions for expression of audit opinion. The results of compliance procedure directly provide the basis for this evaluation and, in turn, basis to determine the nature, timing and extent of the substantive audit procedure. In evaluating the auditor recognises that some deviations from compliance may have occurred.	

QNO 149.030	**Nature and extent of Planning & Changes to Planning decisions** **UNIQUE**	**Old Course – (M21E)**
	Mr. S & Mr. J are a senior and junior articled assistant respectively, in a renowned audit firm. Both were assigned statutory audit of a manufacturing company. Mr. S instructed his junior to draft an audit plan by taking reference from a similar client (a partnership firm) who was engaged in the same business. Mr. J was confused as to how that reference could suit in this case, since the nature and extent of planning would vary for both clients. After few days, the audit work commenced. During the course of the audit, certain events took place, which made Mr. J to rethink about the audit plan initially designed. He approached Mr. S and enquired about when would an audit plan require a change. Comment about both the situations face by Mr. J in the above situation.	
Answer	**SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing"** states that in order to achieve the overall objectives of the audit, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit, in an efficient and timely manner. So far as the nature of planning is concerned, it would vary according to-	

	(i) Size and Complexity of the Auditee - If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small. (ii) Past Experience & Expertise - The key engagement team members' previous experience & expertise also contributes towards variation in planning activities. (iii) Change in Circumstances - Another factor contributing towards variation in planning activities is change in circumstances. **Changes to Audit Planning:** The auditor should update and change the overall audit strategy and audit plan as necessary during the course of the audit. The auditor may need to modify the overall audit strategy and audit plan due to the factors such as (i) result of unexpected events, (ii) changes in conditions, or (iii) the audit evidence obtained from the results of audit procedures. Further, the auditor would also have to modify the nature, timing & extent of further audit procedures, based on the revised considerations of assessed risks. This may be the case when information coming to the auditor differs significantly from the information when he planned the audit process. In addition to the above, there may be possibilities of change in law, notifications, government policies, which warrants updation of overall audit strategy and audit plan.

QNO **149.040**	**Changes to Audit Programme** **BHASKAR CNO— Unique**	**New Course – (N22E)**
	CA. Raj is the auditor of a multiplex cinema house. He has observed during the course of the audit, that the existing venue has undergone renovation. The auditorium was split into smaller ones and additional auditoriums were constructed. CA. Raj, who finalised the audit plan and audit programme wanted to reconsider the same during the course of the audit. Discuss a few circumstances where the audit programme would have to be suitably altered by the auditor.	
	In the given case of multiplex cinema house, CA Raj observed that existing venue undergone renovation, being split into smaller ones and additional auditoriums were constructed. Since CA Raj developed the audit program keeping in view a multiplex cinema house but during the audit, circumstances have changed significantly and hence CA Raj should suitably alter the audit program. Given below are a few circumstances where in the audit programme would have to be suitably altered: 1) If the audit procedures were designed for a certain volume of turnover and sub-sequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures, and personnel sub-sequent to the audit procedures. 2) Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed. 3) Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year. 4) When a suspicion has aroused during the course of audit or information has been received that assets of the company have been misappropriated. It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.	

QNO 153.000	Audit Programme for Multiplex, Sale of tickets UNIQUE	Old Course – (N09E, M12R, N15R, P17M,M21M) New Course – (M18R, N19E, S21M , M21M, M22M)

You have been appointed as the auditor of a Multiplex Cinema House Draw an audit programme in respect of its Revenue and Expenditure.

OR

XLoud, a movie theatre complex, is the foremost theatre located in Delhi Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe shops, pubs etc located in the complex Its 'other income' includes advertisements exhibited within/outside the premises such as hoarding, banners, slides, short films etc The facility for parking of vehicles is also provided in the basement of the premises.

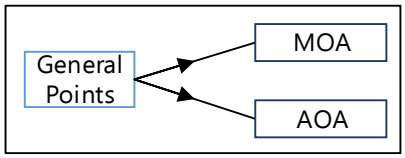
XLoud appointed your firm as the auditor of the entity Being the head of the audit team, you are therefore required to draw an audit programme initially in respect of its revenue and expenditure considering the above-mentioned facts along with other relevant points related to a complex.

Answer

Audit Programme of Multiplex

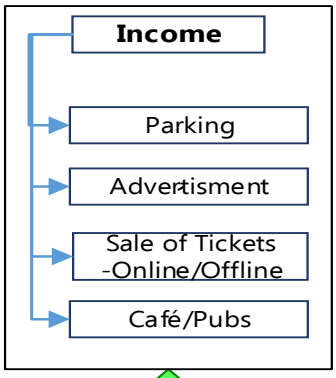
Just Think About Going For A Movie - Imagine the Events that take place .

General points



- Peruse the **Memorandum of Association** and **Articles of Association** of the entity.
- Ensure the **object clause permits** the entity to engage in this type of business.

Incomes

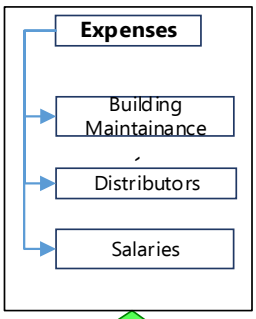


Check Internal Control System & Its Effectiveness with respect to Incomes

In the case of income from sale of tickets:

- Verify the system of **collection from the parking** areas in respect of the vehicles parked by the customers.
- Verify the system of control exercised relating to the **income receivable from advertisements exhibited** within the premises and inside the hall such as hoarding, banners, slides, short films etc.
- Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
- Verify the system of relating to online booking of various shows and the system of realization of money.
- Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- Verify the internal control system and its effectiveness relating to **the income from cafe shops, pubs** etc., located within the multiplex.

Expenses



Check Internal Control System & Its Effectiveness with respect to payment of expenses

- Verify the payments effected in respect of **the maintenance of the building** and ensure the same is in order.
- In the case **of payment to the distributors** verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due. Verify the system of **payment of salaries** and other benefits to the employees and ensure that statutory requirements are complied with.

QNO 159.000	Audit Programme for Wastage UNIQUE	New Course – (M22M)

Darshan Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to enquire into causes of abnormal wastage of raw materials. Draw out an audit plan.

Wastage percentage are

July 2021	**1.3%**
Aug 2021	**1.6%**
Sep 2021	**1.5%**
Oct 2021	**3.9%**

Answer

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor of Darshan Ltd. should first assess the general requirements as under:

(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.

(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break-up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.

(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.

(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrappage work.

(v) Assess whether personnel employed are properly trained and working efficiently.

(vi) See whether quality control techniques have been consistent or have undergone any change.

(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.

(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.

(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

In addition, some specific reasons for abnormal wastage in process may be considered by the auditor are as under:

(i) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.

(ii) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.

(iii) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.

(iv) It is possible that the wastage may have occurred because the particular lot out of which issues were made was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures.

(v) Abnormal wastage in storage and handling may arise due to the following reasons:

(1) Write offs on account of reconciliation of physical and book inventories: In case of periodical physical inventory taking, such write offs will be reflected only in the month such reconciliation takes place.

(2) Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose.

(vi) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

QNO 160.000	**Audit Strategy For Online Business** UNIQUE	**Old Course – (M15E, N16M, P17M, N17R, N17M) New Course – (S17M, S21M)**
	As an auditor of garment manufacturing company for the last five years you have observed that new venture of online shopping has been added by the company during current year As an auditor what factors would be considered by you in formulating the audit strategy of the company?	

Answer

➢ Formulation of Audit Strategy: While formulating the audit strategy for a company, following factors may be considered.

- **General Factors:**
  - The engagement **objectives**.
  - Main **points relating to planning and controlling the audit** or comments on the adequacy of the existing arrangements.
  - **Preliminary judgements as to materiality**
  - The **results of the business review**, including major developments in the client's business and industry, significant operating results and financial arrangements.
  - **Identified inherent risks**. The team should also consider the risk of fraud and, in particular, any evidence of a high level of risk to the firm. They should take into account the results of procedures for the acceptance and continuation of clients.
  - The **degree to which the team should carry out further assessment of controls as** a means of reducing substantive tests.

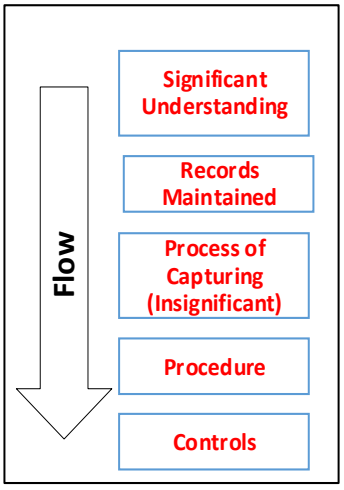


The broad **nature, extent and timing of substantive tests,** or changes to the previous year's strategy for substantive testing.

- **Specific Factors for Online Shopping**

  The auditor shall also obtain an understanding of the business ,it processes ***(Example: B-B , Supplier-Business-Customer-Own or mediator)*** and of the information system including the related business processes due to new venture of online shopping in the following areas :

  - **Obtain an understanding of the Class of transactions : Significant.**
    The classes of transactions in the entity's operations that are significant to the financial statements;
    Example: For Jabong -Clothes, shoes(S)/Amazon Clothes, Shoes, Electronics(S)
  - **Manual /Electronic Records Maintained**
    Records/Documents (manual or electronic) used to initiate, process, record and report transactions; includes the correction of incorrect information how information is transferred to the general ledger.
  - **Process of Capturing events and conditions :**
    How the Info. System captures events and conditions, insignificant to the financial statements.
  - **Procedure :**
    The procedures by which transactions are initiated, processed, recorded, corrected as necessary, transferred to the general ledger and reported in the financial statements;
  - **Controls :**
    Controls surrounding Standard journal entries/ non-standard journal entries -non-recurring, unusual transactions or adjustments



Author's Note

The above points have been rearranged in the flow of audit (core audit process).However instead of above you can use points of overall audit strategy as given in QNO 147.000

03 Risk Assessment and Internal Control

Part 1 - SA 315

QNO 31.000	Audit Risk BHASKAR CNO—SA315.RISK.020	Old Course – (P17M, N17R)
	Audit Risk	

Answer

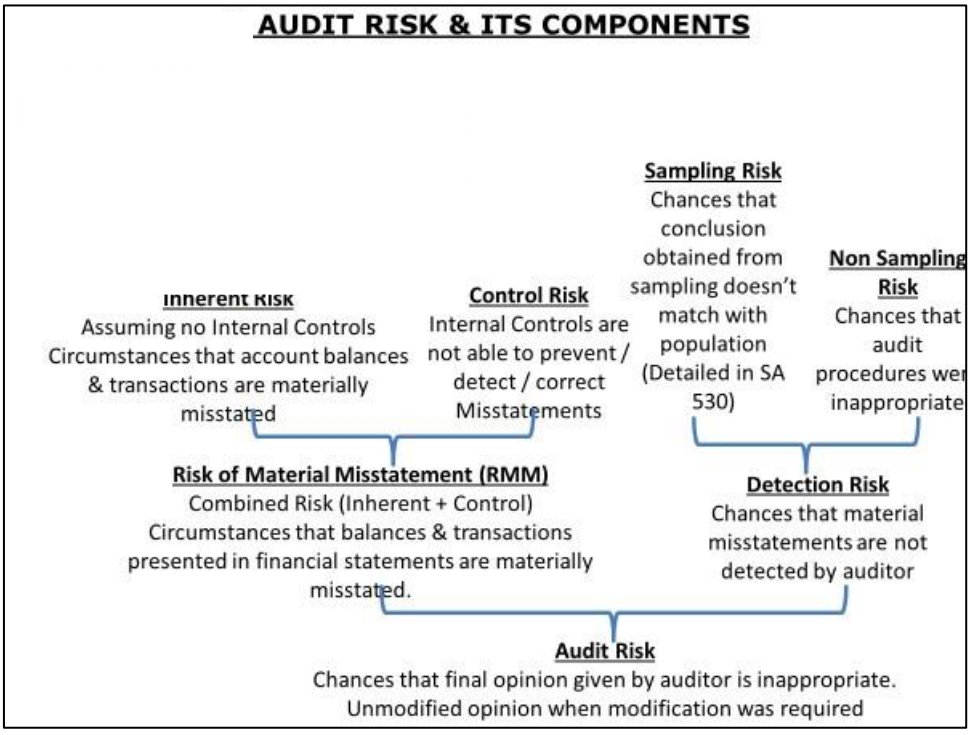
Part I -- Relevant Standards & Laws

- **SA 200, Overall Objectives Of The Independent Auditor And The Conduct Of An Audit In Accordance With Standards On Auditing**
- **SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment**

Part II -- Requirements of Relevant Standards & Laws

(These Definitions are explained in SA 200, but they are relevant while discussing SA 315. Give reference of SA 200 while explaining definition and related points)

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➢ **Audit Risk – Chances that auditor expresses inappropriate opinion when financial statements are having MMST.**

The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Audit risk is a function of the risks of material misstatement and detection risk. From the above, it is clear that –

- **Components**

  Audit Risk = Risk of Material Misstatement x Detection Risk------(1)

  Further Risk of Material Misstatement= Inherent Risk x Control Risk------(2)

  From (1) and (2), we arrive at Audit Risk = Inherent Risk x Control Risk x Detection Risk

- **Not Included**

  What is not included in Audit Risk? – Chances of inappropriate opinion when financial statements are free from MMST / Auditor's Business Risk from loss of litigation, adverse publicity

  - Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
  - Further, audit risk is a technical term related to the process of auditing; it does not refer to the **auditor's business risks** such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

- **Risk of Material Misstatement – Chances that FST presented to auditor prior to audit are having MMST / Function of Inherent Risk & Control Risk**

  Definition - The risk that the financial statements are materially misstated **prior to audit.**

  Components

  As per SA 200, the risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. The nature of each of these types of risk and their interrelationship is discussed below

- **Inherent Risk – Assuming no Internal Controls Circumstances that account balances & transactions are materially misstated**

  Definition

  The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. *(E.g. Retail, Jewellery, Telecom)*

- **Control Risk & Its 3 Reasons – Chances that Internal Controls are not able to prevent / detect / correct Misstatements. Reasons can be Design / Implementation / Maintenance**

  Definition

  The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, **will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.**

  It is a function of the effectiveness of the **design, implementation and maintenance** of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements.

  (Design Problem: - No monthly stock counting rule, Implementation Problem: - Rule exists but not followed, Maintenance Problem: - Counting sheets and procedures not updated as per new products)

- **Detection Risk: - Chances that material misstatements are not detected by auditor**

  Meaning

  The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

- **Interrelationships – Inherent Risk & Control Risk are Independent of each other but when combined they become RMM. They cannot be controlled by Auditor, but they can be assessed by Auditor. Detection risk is inversely adjusted to given RMM. So as to keep Audit Risk within acceptable limits**

  Interrelationship of the components of audit risk:

  Inherent and control risks differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted.

	Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce an acceptable level of detection risk, thereby reducing audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

QNO 33.000	**Assertions** **BHASKAR CNO—SA315.RISK.080**	**Old Course – (P17M)** **New Course--(S21M)**
	What do you mean by Assertions? **OR** **SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" categorises the types of assertions used by the auditor to consider the different types of potential misstatements that may occur. Briefly explain with example.**	

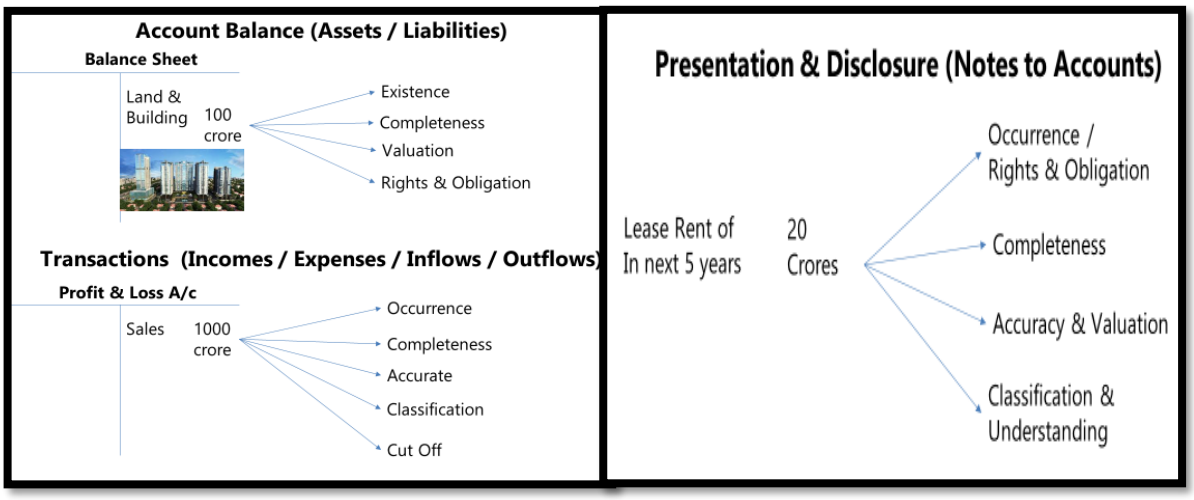
Answer

➢ **Define Assertions: - Representations made by management i.e. information given by management through financial statements. There are 2 types explicit and implicit. Whatever written in financial statements is explicit. Whatever is not but understood is implicit. To reduce confusion SA 315 prescribes standard implicit assertions which also help in detecting important misstatements.**

Assertions – **Representations by management**, **explicit or otherwise,** that are embodied in **the financial statements, as used by the auditor to consider the different types of potential misstatements t**hat may occur.

➢ **Three types of Assertions: - Three types of data is given in financial statements, Account Balances / Transactions / Notes to Accounts Hence three types of Assertions**

Assertions at different levels are discussed below:



➢ **Assertions about Account Balances: - Existence / Completeness / Valuation & Allocation / Rights & Obligation**

Assertions about account balances at the period end:

- **Existence**—assets, liabilities, and equity interests exist.
- **Completeness**—all assets, liabilities and equity interests that should have been recorded have been recorded.
- **Valuation and allocation**—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
- **Rights and obligations**—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

➢ **Assertions about Transactions & Events: - Occurrence / Completeness / Accuracy / Classification / Cut-Off**

Assertions about classes of transactions and events for the period under audit:

- **Occurrence**—transactions and events that have been recorded have occurred and pertain to the entity.
- **Completeness**—all transactions and events that should have been recorded have been recorded.
- **Accuracy**—amounts and other data relating to recorded transactions and events have been recorded appropriately.
- **Classification**—transactions and events have been recorded in the proper accounts.
- Cut-off—transactions and events have been recorded in the correct accounting period.

➢ **Assertions about Presentation & Disclosure: - Occurrence and Rights & Obligation / Completeness / Accuracy and Valuation / Classification & Understandability / Cut-Off**

Assertions about presentation and disclosure:

- **Occurrence and rights and obligations**—disclosed events, transactions, and other matters have occurred and pertain to the entity.
- **Completeness**—all disclosures that should have been included in the financial statements have been included.
- **Accuracy and valuation**—financial and other information are disclosed fairly and at appropriate amounts.
- **Classification and understandability**—financial information is appropriately presented and described, and disclosures are clearly expressed.

QNO 36.000	Reduction of Detection Risk UNIQUE	Old Course – (N11R, N13R, P17M, M17E)
	While commencing the statutory audit of ABC Company Ltd, the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level Explain	

Answer

Part I -- Relevant Standards & Laws

- SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment
- SA 330, The Auditor's Responses To Assessed Risks

Part II -- Requirements of Relevant Standards & Laws

➢ **Determining Risk & Designing Audit Procedures: - Obtain Understanding of Business, Accounting, ICS to Determine Inherent Risk & Control Risk / Use Professional Judgement to Assess Risk and then Design Audit Procedures**

SA 315 & 330 gives us **procedures to be followed to obtain an understanding of the accounting and internal control systems** and on audit risk and its components: inherent risk, control risk and detection risk. These SAs require that the auditor should use **professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level.**

➢ **Detection Risk & Its Relations: - DR means substantive procedures will not detect MMST / Higher Inherent Risk & Control Risk means Higher RMM adjust Detection Risk Inversely at lower level by Perform higher Substantive Procedures so as to keep audit risk within acceptable limits.**

"Detection risk" is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures. When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level.

➢ **AR within limit or Modify: - Auditor should keep Audit Risk within acceptable limits, if he is not able to do it modify opinion give qualified or disclaimer as suitable.**

	The auditor should use his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion, or a disclaimer of opinion as may be appropriate.

NO 36.500	Audit Risk (Calculation) BHASKAR CNO—SA315.RISK.020	Old Course – (M19R, M19M, N20M) New Course– (M19M,N20M,S21M)
	Compute the overall Audit Risk if looking to the nature of business there are chances that 40% bills of services provided would be defalcated, inquiring on the same matter management has assured that internal control can prevent such defalcation to 75%. At his part the Auditor assesses that the procedure he could apply in the remaining time to complete Audit gives him satisfaction level of detection of frauds & error to an extent of 60%. Analyse the Risk of Material Misstatement and find out the overall Audit Risk.	
Answer	According to SA-200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated. ➢ **Audit Risk, has two components:** ▼ Risk of material Misstatement and ▼ Detection Risk. The relationship can be defined as follows. • **Audit Risk = Risk of material Misstatement X Detection Risk** • Risk of material Misstatement: - Risk of Material Misstatement is anticipated risk that a material. ➢ Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as ▼ **Risk of material Misstatement = Inherent risk X control risk** • **Inherent risk:** it is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case. • **Control risk:** it is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%. Hence, control risk is 25% (100%-75%) ▼ Risk of material Misstatement: Inherent risk X control risk i.e. 40% X 25 % = 10% . Chances of material Misstatement are reduced to 10% by the internal control applied by management. • **Detection risk:** It is a risk that a material Misstatement remained undetected even if all Audit procedures applied, Detection Risk is 100-60=40% ➢ In the given case, overall Audit Risk can be reduced up to 4% as follows: Audit Risk: Risk of Material Misstatement x Detection Risk = 10 X 40% = 4%	

QNO 37.000	Specific Risks because of IT System BHASKAR CNO—SA315.ICS.280	Old Course – (M10E, P17M, N17E)
	IT systems also pose specific risks to an entity's internal control. What are those risks? Enumerate the specific risks that Information Technology (IT) systems can pose to an entity's internal control.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment **Part II -- Requirements of Relevant Standards & Laws** **Risks because of IT Systems** IT system also poses specific risks to an entity's Internal Control. They are– **(First Comes IT Personnel)** ➢ **IT Personnel gaining access, Privileges beyond necessary**	

- The possibility of **IT personnel gaining access privileges** beyond those necessary to perform their assigned duties thereby breaking down segregation of duties. *(Approved Purchase & Payment)*

(Then comes Data)

- **Unauthorised Access to Data leading to destruction, unauthorised transaction, non-existent transaction / Potential loss of Data**
  - Unauthorised **access to data** that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
  - **Potential loss of data or inability to access data** as required. *(Ransomware)*

(Then happened processing)

- **Manual Intervention / Inaccurate Processing / Processing Inaccurate Data**
  - **Inappropriate manual intervention.**
  - Reliance on systems or programs that are **inaccurately processing data, processing inaccurate data**, or both. *(TDS Calculator / NPA Calculator)*

(If required Changes)

- **Failure to make Changes / Unauthorised changes to systems / Unauthorised changes to Master Files**
  - **Failure** to make necessary **changes to systems or programs**. *(Boss shifted to Office 365, Rest of the office on Office 2007)*
  - Unauthorised **changes to systems or programs.**
  - Unauthorised **changes to data in master files**.

QNO 38.000	Significant Risk BHASKAR CNO—SA315.RISK.100	Old Course – (M15R, N18E) New Course –(N20E)
	Explain, how an auditor may determine, while doing Risk Assessment, whether any risk is a significant risk	

Answer

Part I -- Relevant Standards & Laws

- SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment

Part II -- Requirements of Relevant Standards & Laws

- **Significant Risk Definition: - Assessed RMM which in auditor's judgement require special audit consideration / it is part of identifying and assessing risk / exclude effect of identified controls.**

  Significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

  As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

- **Factors useful in determining significant Risk**

  Agar (CFO-CSR) karge toh it is significant risk to society

  Changes legal, economic, accounting / risk of Fraud / Outside normal course of business / Complexity / Subjectivity / Related party
  - C-Whether the risk is related to recent significant economic, accounting, or other developments like **changes** in regulatory environment, etc., and, therefore, requires specific attention; *(AS to Ind AS)*
  - F-Whether the risk is a risk of **fraud**; *(Mismatch in Cash Balance)*
  - 0-Whether the risk involves significant transactions that are **outside the normal course of business** for the entity, or that otherwise appear to be unusual. *(E.g. Sold 50% of Inventory to Employees instead of Salary of the month)*
  - C-The **complexity** of transactions;*(E.g. 2 group companies will demerge to form 10 companies and out of them 3 will amalgamate to form a new company which will be bank financed*

- S-The degree of **subjectivity** in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and *(E.g. Brand valuation can change from person to person)*
- R-Whether the risk involves significant transactions with **related parties**; *(Major Sales happen through subsidiaries registered in Tax Haven)*

➢ **Obtain understanding of relevant controls to understand effect on FST**

- When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

QNO 39.000	**Understanding Entity & Its Environment** **BHASKAR CNO—SA315.RISK.060**	**Old Course – (M09E, N12R, P17M)**
	What are the points to be considered while evaluating the "Knowledge of the Business" in the conduct of an audit?	

Answer

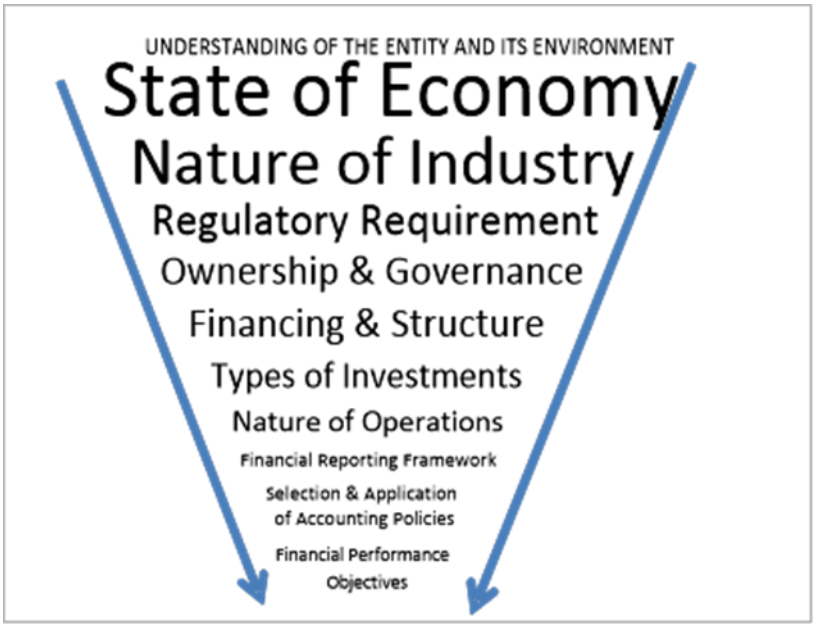
Part I -- Relevant Standards & Laws

- SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment

Part II -- Requirements of Relevant Standards & Laws

Matters to be Considered for Understanding Entity & Its Environment

The broad matters to be considered while obtaining knowledge of business for a new audit assignment are set out in SA 315.

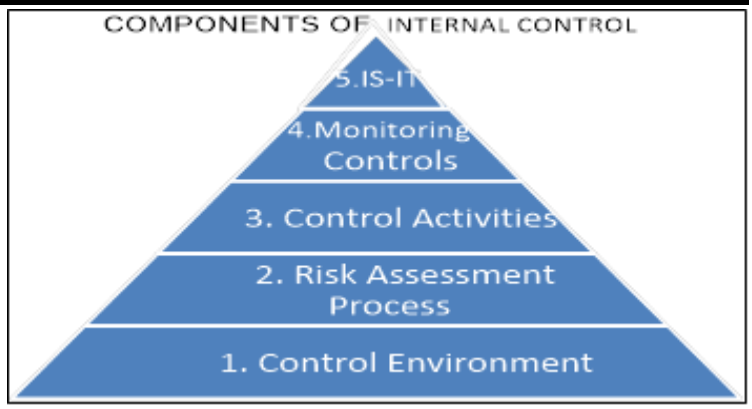


These are:

- Relevant industry, regulatory, economic and other external factors including the applicable financial reporting framework.
- The nature of the entity, including:
  - its operations;
  - its ownership and governance structures;
  - the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
  - the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- The entity's selection and application of accounting policies.
- The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- The measurement and review of the entity's financial performance

➢ **Useful: - Establishing Overall Plan / Areas of Special Audit Consideration / Reasonableness of Estimates & Mgt Representations / Appropriateness of Accounting Policies**

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

QNO 40.000	ICS (Components) BHASKAR CNO—SA315.ICS.040	New Course –(S17M,S20M)
	What are the components of an internal control framework?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment **Part II -- Requirements of Relevant Standards & Laws** There are five components of an internal control framework. They are as follows: 1. Control Environment; 2. Risk Assessment; 3. Information & Communication; 4. Monitoring; 5. Control Activities 	

40.010	Component (Control Environment-Communication of Integrity & Ethical Value) BHASKAR CNO—SA315.ICS.060	Old Course – (N18R) New Course – (S21M)
	The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Explain.	
Answer	➢ **Communication and enforcement of integrity and ethical values.** The effectiveness of controls cannot rise above the integrity and ethical values of the people who **create, administer, and monitor** them. Integrity and ethical behavior are the product of the entity's ethical and behavioral standards, how they are **communicated,** and how they are **reinforced in practice.** The enforcement of integrity and ethical values includes, for example, management actions to **eliminate or mitigate incentives or temptations** that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values\ may include the communication of behavioral standards to personnel through **policy statements and codes of conduct and by example**.	
	Author's Note **If people who create, implement and maintain systems are honest, sincere, unbiased then systems will work with honesty, sincerity and in unbiased manner. So, it depends on ethical values of people who create maintain and implement it.**	

40.100	Identify & Assess RMM & Response to Risk BHASKAR CNO—SA315.RISK.080	Old Course – (N14E, M17R, P17M, N18E) New Course – (M18R)
	While commencing the statutory audit of Alex Co Ltd, what would you consider as an auditor to assess risk of material misstatement and responses to such risks?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 315, Identifying And Assessing The Risk Of Material Misstatement Through Understanding The Entity And Its Environment. **Part II -- Requirements of Relevant Standards & Laws** ➢ **RMM at 2 Levels: - Financial Statement Level & Assertion Level** The auditor shall **identify and assess** the risks of material misstatement at: ➢ The **financial statement level;** an ➢ The **assertion level** for classes of transactions, account balances, and disclosures; to provide a basis for designing and performing further audit procedures.	

- **4 Steps in Identifying & Assessing Risk**
  - **Identify risks while obtaining understanding /Identify which assertions will get affected / Identify whether risks are affecting financial statement as a whole and affecting many assertions / Consider likelihood and Magnitude of Misstatement and whether there could be Material Misstatement**

    For this purpose, the auditor shall:
    - **Identify risks throughout the process** of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements; ***(Har information collect karne ke baad risk ke baarein mein sochtein raho)***
    - Relate the **identified risks to what can go wrong at the assertion level, taking account of relevant controls** that the auditor intends to test; **and** ***(Kahi assertion level pet oh nahi)***
    - Assess the identified risks, and evaluate whether they relate more **pervasively to the financial statements as a whole and potentially affect many assertions;** ***(Ya financial statement level pet oh nahi)***
    - Consider the **likelihood of misstatement,** including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. ***(Badi risk toh nahi hai , with big amount and more probability)***

SA 330 The Auditor's Responses to Assessed Risks

- **Response for Risk at Financial Statement Level: - Overall Responses (E.g. More Seniors, Experts / Professional Scepticism / Surprise Element / Supervision etc)**

  The auditor shall design and implement **overall responses** to address the assessed risks of material misstatement at the financial statement level.

- **Response for Risk at Assertion Level: - Further Audit Procedures / NTE should be Responsive to RMM**

  The auditor shall design and perform **further audit procedures** whose nature, timing and extent are based on and are **responsive to the assessed risks of material misstatement** at the assertion level.

- **More Explanation: - Consider Reasons for RMM :- 1i. It is due to high likelihood because of nature of item (i.e. inherent risk) 1ii. Which are relevant controls compensating this risk, what's control risk, if we are relying on this control then we need to check operating effectiveness**

  In designing the further audit procedures to be performed, the auditor shall
  - Consider the **reasons for the assessment given to the risk of material misstatement at the assertion level** for each class of transactions, account balance, and disclosure, including:
    - The **likelihood** of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and
    - Whether the **risk assessment takes into account the relevant controls** (i.e., the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively(i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and ext000ent of substantive procedures); and

- **Higher RMM: - Higher RMM More Persuasive Evidence**
  - Obtain **more persuasive audit evidence the higher the auditor's assessment of risk.**

QNO 40.120	Internal Control Structure (Components) BHASKAR CNO—CH30C.070	New Course – (N18M)
	XYZ Hospital Private Ltd. is engaged in running a hospital of 200 Beds since last 20 years. Revenue Track of the hospital for last 3 years is as under: **2015-16 - 20 Crores** **2016-17 25 Crores** **2017-18 35 Crores** **Hospital has its own Pharmacy, Laboratory, Blood Bank, Radiology & General Stores. Its management suspects that leakages/theft is happening in Pharmacy, Radiology, Laboratory and General Stores departments. It seeks advice of RST & Co., Internal Auditors of the Company, as to how it can Institute/Improve its Internal Control. In this context, Management wants to understand the concept of components of Internal Control Structure in detail. Advise.**	
Answer	The Internal Control structure in an organization is referred to as the policies and procedures established by the entity to provide reasonable assurance that the objectives are achieved. The control structure in an organization basically has the following components: ➢ **Control Environment** - Control environment covers the effect of various factors like management attitude; awareness and actions for establishing, enhancing or mitigating the effectiveness of specific policies and procedures. ➢ **Control Procedure** - Policies and procedures means those policies and procedures in addition to the control environment and accounting systems which the management has established to achieve the entity's specific objectives. ➢ **Accounting System** - Accounting system means the series of task and records of an entity by which transactions are processed for maintaining financial records. Such system identifies, \ assemble, analyze, calculate, classify, record, summarize and report transactions and other events. Specific Requirement under **SA 315 - "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"** deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control. In this regard, the **management is responsible** for maintaining an adequate accounting system incorporating various internal controls to the extent that they are appropriate to the size and nature of the business. There should be reasonable assurance for the auditor that the **accounting system is adequate** and that all the accounting information required to be recorded has in fact been recorded. **Internal controls normally contribute to such assurance**. The auditor should gain an understanding of the accounting system and related internal controls and should study and **evaluate the operation of those internal controls** upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. **Where the auditor concludes that he can rely on certain internal controls, he could reduce his substantive procedures which otherwise may be required and may also differ as to the nature and timing.**	
	Author's Note **Question wants to simply ask— What do you mean by "internal control structure"**	

QNO 40.150	Circumstances in which risks can arise or change- BHASKAR CNO—SA315.ICS.080	Old Course – (N20E) New Course – (N19E,S21M)
	The Entity's Risk Assessment Process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of occurrence and decides upon actions to respond to and manage them and the results thereof. Elucidate the circumstances in which risks can arise or change. **OR** **For financial reporting purposes, the entity's risk assessment process 5 includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof. Explain the circumstance under which risk can arise or change.**	

Answer

➢ **Risks can arise or change due to circumstances such as the following:**

(Shortcut PFA – TRAGIC risk assessment)

- **P- New Personnel.**
  New personnel may have a different focus on or understanding of internal control.
- **F- Expanded Foreign operations.**
  The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- **A- New Accounting pronouncements.**
  Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.
- **T- New Technology.**
  Incorporating new technologies into production processes or information systems may change the risk associated with internal control.
- **R-Changes in Regulatory or operating environment.** Changes in the regulatory or operating environment can result in changes in competitive pressures and significantly different risks. *(E.g., Change in NPA Norms, Change in Loan Processing System Etc.)*
- **A-New business models, products, or Activities.** Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.
- **G- Rapid Growth.** Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- **I- New or revamped Information systems.** Significant and rapid changes in information systems can change the risk relating to internal control.
- **C- Corporate restructurings.** Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.

Author's Note

- **Shortcut is created in a Logical sequence. Try to remember it in this sequence only**
- Shortcut **PFA – TRAGIC** risk assessment

PART 2 - SA 265

QNO 26.000	Letter of Weakness BHASKAR CNO—SA265.060	Old Course - (M15R, N15E, M20R,M20M) New Course- (S17M,N18M,N18R,M20R,M20M,S21M)
	During the course of his audit, the auditor noticed material weaknesses in the internal control system, and he wishes to communicate the same to the management You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.	

Answer

Part I -- Relevant Standards & Laws

- SA 265, Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management

Part II -- Requirements of Relevant Standards & Laws

➢ Shall be in Writing.

⮟ Description of Deficiencies / Sufficient Information to understand nature & context of communication

The auditor shall **include in the written communication** of significant deficiencies in internal control:

- A **description of the deficiencies** and an explanation of their **potential effects**; and
- **Sufficient information** to enable those charged with governance and management to understand the context of the communication.

➢ Explain purpose of the Audit.

⮟ →Test of controls is part of audit not purpose of expressing opinion on IFCR →There can be other deficiency also we are certifying your system.

In particular, the auditor shall explain that:

- The **purpose of the audit** was for the auditor to express an **opinion on the financial statements;**
- The audit included consideration of **internal control relevant to the preparation of the financial statements** in order **to design audit procedures** that are appropriate in the circumstances, **but not for the purpose of expressing an opinion on the effectiveness of internal control;** and
- The matters being reported are **limited to those deficiencies that the auditor has identified** during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

➢ Usefulness for Management & Auditor: -

⮟ Valuable refence document for Mgt revising the system and insisting strict compliance / Minimises auditor's legal liability in event of major defalcation or other loss resulting from weakness.

- This letter serves as a **valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.**
- The letter may also serve to **minimize legal liability in the event of a major defalcation or other loss resulting from a weakness** in internal control.

QNO 27.000	Significant Deficiencies BHASKAR CNO—SA265.080	Old Course - (M15R) New Course- (N20E,N22M, M23R)

Give some examples of matters which auditor may consider while determining the significant deficiencies in internal control.

OR

CA. N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA. N with some examples of matters to be considered while determining `significant deficiency' in internal control with reference to relevant SA.

OR

During the course of the audit of Tirthankara Limited, CA. Shreyansh Manager in the audit team identified that there is significant risk in lease transactions due to complex cross-border sale and lease back arrangements. This significant risk or risk of material misstatement was not identified in management's risk assessment process. Upon various inquiries with Management regarding their risk assessment process, it was identified and concluded by the audit team that the management's risk assessment process is not effective to identify all the significant risks. CA. Shreyansh decided that this in combination with other potential deficiencies in internal control constitutes significant deficiencies in internal control and hence, is required to be communicated to those charged with governance. However, the engagement partner had a different view regarding the audit of Tirthankara Limited. According to him, the only matter that is identified and poses significant deficiencies due to their magnitude is only required to be communicated. Matters of potential misstatements that are not actual misstatements cannot be termed as significant deficiencies. You are required to guide CA. Shreyansh with respect to examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency.

Answer

Part I -- Relevant Standards & Laws

- SA 265, Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management

Part II -- Requirements of Relevant Standards & Laws

➢ **Definition: - Significant Deficiency: - Deficiency or combination of deficiency, as per auditor's judgement is important enough to be brought to attention of TCWG**

Significant deficiency in internal control means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

➢ **Only occurrence of material misstatement is not must to decide whether deficiency is significant deficiency, even if there is likelihood of MMST it will be significant deficiency**

The significance of a deficiency or a combination of deficiencies in internal control depends **not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur** and the **potential magnitude** of the misstatement. **Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.**

➢ **Examples of matters which should be considered while deciding significant deficiency.**

(Very Amazing FLOSS)

Volume of activity / Amounts exposed / Frequency of the exceptions Detected & its Causes / Likelihood of the deficiencies / Other deficiencies interacting / Susceptibility to loss or fraud of the related asset or liability / Subjectivity and complexity of determining estimated amounts

Examples of matters that the auditor may consider in determining whether deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The **Volume of activity** that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies. *(Coal is purchased 5 times in a week, wooden blocks are purchased once a week)*
- The financial statement **Amounts** exposed to the deficiencies. *(Coal accounts for 80% of fuel while wooden blocks account for 5% of fuel)*

- The cause and **Frequency of the exceptions** detected as a result of the deficiencies in the controls. *(Already 5 instances of fraud detected in coal)*
- The **Likelihood of the deficiencies** (Probability) leading to material misstatements in the financial statements in the future. *(Chances of misstatement is higher in purchase of coal as compared to wooden blocks)*
- The interaction of the deficiency with **Other deficiencies** in internal control. *(There is fixed policy of coal quality assessment & there is no experienced, knowledgeable supervisor also)*
- The **Susceptibility to loss or fraud** of the related asset or liability. *(Moisture level in coal has huge impact on coal weight as compared to wooden blocks)*
- The **Subjectivity and complexity** of determining estimated amounts, such as fair value accounting estimates. *(Quality determination is difficult in coal as compared to wooden blocks)*

➢ **Important Controls: - POMPS**

▼ **Controls over Prevention & Detection of Frauds / Outside Normal Course of Business / Monitoring Controls / Period End Financial Reporting Process / Significant Accounting Policies**

- The **importance of the controls** to the financial reporting process; for example:
- General **monitoring controls** (such as oversight of management).
- Controls over the **prevention and detection of fraud.**
- Controls over **significant transactions with related parties**.
- Controls over significant transactions **outside the entity's normal course of business.**
- Controls over the **period-end financial reporting process** (such as controls over non-recurring journal entries)
- Controls over the **selection and application of significant accounting policies.**

QNO 162.000	Risk Based Audit BHASKAR CNO— CH30C.060	Old Course – (M08R, M15R, M16E,N16E, M17E, N16M, N18M, M19M, M19R, N20R, N20E) New Course – (S17M,M19R, M19M, N20M, ,M22R)

What are the main phases in the conduct of Risk Based Audit?

OR

What do you mean by risk-based audit? What are the general steps in the conduct of risk-based audit?

OR

Audit should be risk-based or focused on areas of greatest risk to the S achievement of the audited entity's objectives. Risk based Audit (RBA) is an approach to audit that analyses 'audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas. What are the general steps for conducting Risk Based Audit?

Answer

➢ **General Steps in The Conduct of Risk Based Audit (RBA)**

⩔ **Concept of RBA**

- **Auditor's Objective**
  The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.
- **3 Key Steps**
  This involves the following three key steps:
  - **Assessing the risks of material misstatement** in the financial statements
  - **Designing and performing further audit procedures** that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low level; and
  - Issuing an **appropriate audit report** based on the audit findings.
- **3 Phases**
  The risk-based audit process is presented in three distinct phases:
  - Risk assessment.
  - Risk response; and
  - Reporting.

⩔ **Risk Assessment**

The risk assessment phase of the audit involves the following steps:

- **Acceptance or Continuance**
  Performing **client acceptance or continuance** procedures.
- **Planning**
  Planning the overall engagement.
- **Understanding Business**
  Performing risk assessment procedures to **understand the business and identify inherent and control risks**.
- **Relevant Controls**
  Identifying **relevant internal control procedures** and assessing their design and implementation (those controls that would prevent material misstatements from occurring or detect and correct misstatements after they have occurred).
- **Financial Statement Level Vs Assertion Level**
  Assessing the risks of material misstatement in the financial statements.
  Making an informed assessment of the risks of material misstatement at the financial statement level and at the assertion level.
- **Significant Risk**
  Identifying **the significant risks** that require special audit consideration and those risks for which substantive procedures alone are not sufficient.
- **Communication**

Communicating any material weaknesses in the design and implementation of internal control to management and those charged with governance; and

- **Risk Response**

This phase of the audit is to design and perform further audit procedures that respond to the assessed risks of material misstatement and will provide the evidence necessary to support the audit opinion. Some of the matters the auditor should consider when planning the audit procedures include:

- **Audit procedures designed** to address the assessed risks could include a mixture of:
  - Tests of the operational effectiveness of internal control; and
  - Substantive procedures such as tests of details and analytical procedures.
- The need to perform further audit procedures to **address the potential for management override of controls or other fraud scenarios.**
- Existence of **internal control** that, if tested, could reduce the need / scope for other substantive procedures.
- The potential for **substantive analytical procedures** that would reduce the need/scope for other types of procedures.
- Assertions that **cannot be addressed by substantive procedures alone.** This can occur where there is highly automated processing of transactions with little or no manual intervention.
- The need to perform **specific procedures to address "significant risks"** that have been identified.
- The need to incorporate an **element of unpredictability** in procedures performed.

- **Reporting**

The final phase of the audit is to assess the audit evidence obtained and determine whether it is sufficient and appropriate to reduce the risks of material misstatement in the financial statements to an acceptably low level.

It is important at this stage to determine:

- If there had been a **change in the assessed level of risk**;
- Whether **conclusions** drawn from work performed are appropriate; and
- If **any suspicious circumstances** have been encountered.
- Any **additional risks** should be appropriately assessed, and further audit procedures performed as required.
- When **all procedures have been performed** and conclusions reached:
- **Audit findings** should be reported to management and those charged with governance; and
- **An audit opinion** should be formed, and a decision made on the appropriate wording for the auditor's report.

Author's Note

In December 2020 when Study Material was revised content of Risk Based Audit was changed, conceptually it is almost same. Answer given above is as per recent Study Material & it may not match exactly as per NOV 20 exam Suggested Answer.

QNO 163.000	Steps in RAP BHASKAR CNO—CH30C.060	New Course – (S17M)
	Briefly describe the various stages of a Risk Assessment process	

Answer

- **Risk Assessment**

The risk assessment phase of the audit involves the following steps:

- **Acceptance or Continuance**
  Performing **client acceptance or continuance** procedures.
- **Planning**
  Planning the overall engagement.
- **Understanding Business**
  Performing risk assessment procedures to **understand the business and identify inherent and control risks**.

	• **Relevant Controls** Identifying **relevant internal control procedures** and assessing their design and implementation (those controls that would prevent material misstatements from occurring or detect and correct misstatements after they have occurred). • **Financial Statement Level Vs Assertion Level** **Assessing the risks** of material misstatement in the financial statements. **Making an informed assessment** of the risks of material misstatement at the financial statement level and at the assertion level. • **Significant Risk** Identifying **the significant risks** that require special audit consideration and those risks for which substantive procedures alone are not sufficient. • **Communication** **Communicating any material weaknesses** in the design and implementation of internal control to management and those charged with governance; and

QNO 163.500	**Steps for Risk Identification** **BHASKAR CNO—CH30C.060**	**New Course – (S21M)**
	Your engagement team is seeking advice from you as engagement partner regarding steps for risk identification. Elaborate.	

Answer

➢ **Steps For Risk Identification**

⩔ **Inherent Risks**

- Consider the existence of any particular characteristics (inherent risks) in the class of transactions, account balance or disclosure that need to be addressed in designing further audit procedures. Consider any unique characteristics of the risk.
- Examples could include high value inventory, complex contractual agreements, absence of a paper trail on certain transaction streams or a large percentage of sales coming from a single customer.

⩔ **Nature of Controls**

Consider the nature of the internal control system in place and its possible effectiveness in mitigating the risks involved.

- Ensure the controls :
  - Routine in nature (occur daily) or periodic such as monthly.
  - Designed to prevent or detect and correct errors.
  - Manual or automated.

⩔ **Impact on Assertions**

Consider the impact of the risk on each of the assertions (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.

⩔ **Likelihood of Risk**

Determine the **likelihood for assessed risk** to occur and its impact on our auditing procedures.

⩔ **Significance of Risk**

Assess the **significance of the assessed risk**, impact of its occurrence and also **revise the materiality** accordingly for the specific account balance.

⩔ **Degree of significant risks that required separate attention**

Identify the degree of Significant risks that would require separate attention and response by the auditor. Planned audit procedures should directly address these risks.

⩔ **Document**

Document the assertions that are effected.

⩔ **Management's Response**

Enquire and document the management's response.

QNO 165.100	Control Objectives (Accounting Control System) BHASKAR CNO—CH30C.100	Old Course – (M09E, M12M, N13R, M15E, M16M, P17M,M21M) New Course – (S21M, M21M)
	As auditor of Z Ltd, you would like to limit your examination of account balance tests What are the control objectives you would like the accounting control system to achieve to suit your purpose?	
Answer	➢ **Basic Accounting Control Objectives:** The basic accounting control objectives which are sought to be achieved by any accounting control system are – ⩔ Whether recorded **transactions are real** ⩔ Whether **all transactions are recorded** ⩔ Whether all transactions are **recorded timely** ⩔ Whether all transactions are **properly classified** ⩔ Whether all recorded transactions are **properly valued** ⩔ Whether all transactions are **properly posted** ⩔ Whether all transactions are **properly summarized** ⩔ Whether all transactions are **properly disclosed**	
	Author's Note **The above answer has been arranged as per the flow so that it becomes easy to visualize.** **This question and the above question are different to each other as above one asks about control objectives and this one asks about accounting control objective.**	

QNO 166.200	Standard Operating Procedures (SOPs)of assessment and evaluation of control environment BHASKAR CNO—CH30C.180	New Course – (M19E,N21E, M23R)
	A newly qualified professional has received his first appointment as auditor of a large company and is very much concerned about the effectiveness of internal control and wants to assess and evaluate the control environment as part of his audit program. Towards achieving his objective, he seeks your help in knowing the Standard Operating Procedures (SOPs) of assessment and evaluation of control.	
Answer	The quality & effectiveness of internal controls is directly dependent on the Organizational environment. The tone at the top (the Board & Executive Management) & the credibility of the message on internal controls from top plays an important role in establishing strong control environment. Following are some of the key components to assess & evaluate the controls environment: ➢ **Standard Operating Procedures (SOPs):** A well-defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover ⩔ **Enterprise Risk Management:** An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls are likely to be few. ⩔ **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person. **Example-a buyer should not be involved in receiving of materials or passing of bills. Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book**. ⩔ **Job Rotation in Sensitive Areas**: Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor	

development, competitive quotes etc.

- **Delegation of Financial Powers Document**: As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
- **Information Technology based Controls:** With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

QNO 168.000	Flow Chart Technique BHASKAR CNO—SA315-ICS.200	Old Course – (M04E, N08R, N09E, M13M, P17M) New Course – (S17M,S21M)
	Explain briefly the Flow Chart technique for evaluation of the Internal Control system.	

Answer

Flow Chart Technique

A diagram full with lines and symbols

It can be used as an effective way of presenting the state of internal controls In an organisation

Provides a neat visual picture of entire flow of documents and activities

Provides a graphic presentation of internal controls

Shows relevant details in condensed but wholly in a meaningful manner

It is a Concise and comprehensive way for reviewing the internal controls and the evaluator's findings .

Few precautions in drawing the flow chart

1.Symbols and lines should be proper used.
2.flow-charts should not be lengthy and cumbersome,
3.It should be neat,
4.Shall portray the flow completely along with final disposal of papers

More specifically it can show –

(i) Point at which document is raised-internally or received-external ;
(ii) Number of copies raised or received;
(iii) Intermediate stages sequentially through which document and the activity pass;
(iv) distribution of the documents to various sections
(v) checking authorisation and matching at relevant stages;
(vi) filing of the documents; and
(vii)final disposal by sending out or destruction.

A flow chart can be of sales, purchase, wages, production etc.

Purchases	linked with	sundry creditors and payment
Sales	linked with	sundry debtors and collections

It will make the flow chart self-contained, complete and meaningful for evaluation of internal controls

.

Generally, a questionnaire is also enclosed with a flow chart, incorporating questions, the answers to which are to be looked into from the flow chart.

QNO 168.010	ICQ Assumptions UNIQUE	New Course – (N18E)
	In the use of standardized Internal Control Questionnaire (ICQ), certain basic assumptions about elements of a good internal control system are taken into account. List down few such assumptions	
Answer	➢ **Basic Assumption about Elements of Good Control in Standardized Internal Control Questionnaire:** In the use of standardized internal control questionnaire, certain basic assumptions about elements of good control are taken into account. These are– ⩔ Certain procedures in general used by most business concerns are essential in achieving reliable internal control. This is a time-tested assumption. Deposit into bank of the entire receipts of a day or daily balancing of the cash book and ledgers or periodic reconciliation with the control accounts are examples of widely used practices which are considered good internal control practices. Besides, basic operations giving rise to these practices exist in all businesses irrespective of their nature. ⩔ Organizations are such that permit an extensive division of duties and responsibilities. The larger the organisation, the greater is the scope of such division. ⩔ Employees concerned with accounting function are not assigned any custodial function. ⩔ No single person is thrust with the responsibility of completing a transaction all by himself. ⩔ There should always be evidence to identify the person who has done the work whether involving authorization, implementation or checking. ⩔ The work performed by each one is expected to come under review of another in the usual course of routine. ⩔ There is proper documentation and recording of the transactions.	
	Authors Note: **Question is on Assumptions of Good Internal Control System. Ultimately they explain requirements of good internal controls system. Answer by ICAI explains that good internal control system, need following assumptions / requirements.** **(I know question is not properly drafted there is ambiguity), so assumptions here means basic requirements of good internal control system**	

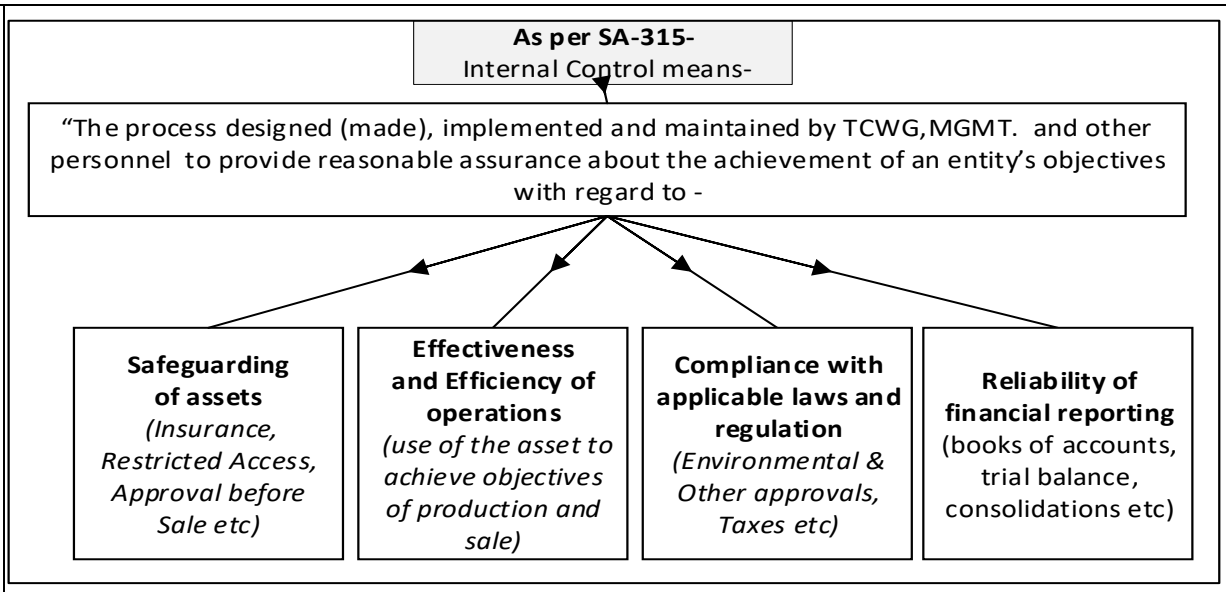
QNO 168.018	Basic Accounting Control System Objectives BHASKAR CNO—CH30C.100	New Course – (M21E)
	One of the objectives of Internal control relating to accounting system is that all transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets. To achieve this objective, certain matters should be ensured by accounting controls. List down matters to be ensured by accounting controls.	
Answer	**Matters to be ensured by accounting controls –** **Basic Accounting Control Objectives:** The basic accounting control objectives which are sought to be achieved by any accounting control system are - (i) Transactions are executed in accordance with management's general or specific authorisation; (ii) Transactions and other events are real & promptly/timely recorded at correct amounts; (iii) Transactions should be classified in appropriate accounts and in the appropriate period to which it relates; (iv) Transactions are properly posted. (v) Transactions should be recorded in a manner so as to facilitate preparation of financial statements in accordance with applicable accounting standards, other accounting policies and practices and relevant statutory requirements; (vi) Transactions are properly disclosed. (vii) Recording of transactions should facilitate maintaining accountability for assets;	

	(viii) Assets and records are required to be protected from unauthorized access, use or disposition; (ix) Records of assets, such as sufficient description of the assets (to facilitate identification, its location should also be maintained, so that the assets could be physically verified periodically. (x) Transactions are properly summarized.

QNO 168.020	**Internal Control Weakness Identified in Purchase & Account Payable, What audit procedure should be performed ?** **UNIQUE**	**New Course – (M21M, M23M)**
	During the process of extracting the exception reports, the auditors noted numerous purchase entries without valid purchase orders. In terms of percentage, about 40% of purchases were made without valid purchase orders whereas few purchase orders were validated after the actual purchase. Also, there was no reconciliation between the goods received and the goods ordered. You are required to briefly explain the audit procedures to address the validity of account balance level.	
Answer	In the given scenario, the auditors noted numerous purchase entries without valid purchase orders during the process of extracting the exception reports. Further, in terms of percentage, about 40% of purchases were made without valid purchase orders and also few purchase orders were validated after the actual purchase. Also there was no reconciliation between the goods received and the goods ordered. **Audit Procedures:** The following procedures may address the validity of the account balance: ▪ Make a selection of the purchases, review correspondence with the vendors, purchase requisitions (internal document) and reconciliations of their accounts. ▪ Review Vendor listing along with the ageing details. Follow up the material amounts paid before the normal credit period and analyse the reasons for exceptions. ▪ Meet with the company's Purchase officer and obtain responses to our inquiries regarding the purchases made without purchase orders. ▪ Discuss the summary of such issues with the client.	

QNO 170.000	**Inherent Limitations of Internal Control** **BHASKAR CNO—SA315-ICS.300**	**Old Course – (M17R)** **New Course – (M18R)**
	Prabhu Ltd, a manufacturing concern wants to develop internal control system You are an expert in developing the internal control system, hereby called to brief about the same In view of above, you are required to brief about internal control system and inherent limitations of the internal control?	

Answer



➢ **Limitations of Internal Control-**

Internal control, no matter how effective, can provide an entity with only reasonable assurance and not absolute assurance about achieving the entity's operational, financial reporting and compliance objectives.

➢ **Inherent limitations:**

Internal control systems are subject to certain inherent limitations, such as:

⩔ **H-Human error**

The potential for human error, such as, due to carelessness, distraction, mistakes of judgement and misunderstanding of instructions.

⩔ **U-Unusual nature Transactions**

The fact that most internal controls do not tend to be directed at transactions of unusual nature.

⩔ **M-Manipulations by management**

Manipulations by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

⩔ **C-Cost Benefit**

Management's consideration that the cost of an internal control does not exceed the expected benefits to be derived.

⩔ **C-Collusion Among employees and parties outside the entity.**

- The possibility of circumvention of internal controls through collusion with employees or collusion with parties outside the entity.
- The possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding an internal control.

Author's Note

H-U-M C-ertified C-A limitation door kar denge

QNO 171.000	Internal Check BHASKAR CNO—CH30C.160	Old Course – (M08R, N13E, M14E, N15E, N16M, N16E, P17M, N17R, N17M, M18M, N18M, N19R, N19M,M20R) New Course – (M18M, N19R, N19M, M20R,S21M, S20M,M22M)

New Life Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records.

According to you, which basis system of control has been violated? Also advise the other general conditions pertaining to such system which needs to be maintained and checked by the management.

OR

State the considerations on which effectiveness of an efficient system of internal check depends.

OR

Write a short note on Objectives of Internal Check System

OR

BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the sales department of the company, you visited the department and noticed the work division as follows:

(1) An officer was handling the sales ledger and cash receipts.

(2) Another official was handling dispatch of goods and issuance of Delivery challans.

(3) One more officer was there to handle customer/ debtor accounts and issue of receipts.

a) As an internal auditor you are required to briefly discuss the general condition pertaining to the internal check system.

b) Do you think that there was proper division of work? If not, why?

Answer

➢ **Basic system of Control:**

Internal Checks and Internal Audit are important constituents of Controls. Internal Check means check on day to day transactions operating continuously as a part of routine system in which work done by one person can be checked by others.

➢ **Objectives of the Internal Check System:**

- To detect error and frauds with ease.
- To avoid and minimize the possibility of commission of errors and fraud by any staff.
- To increase the efficiency of the staff working within the organization
- To locate the responsibility area or the stages where actual fraud and error occurs.
- To protect the integrity of the business by ensuring that accounts are always subject to proper scrutiny and check
- To prevent and avoid the misappropriation or embezzlement of cash and falsification of accounts.

➢ **General Condition:**

The general condition pertaining to the internal check system may be summarized as under-

(Start)

- **No Single Control**- No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person
- **Distribution of Power**- The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- **Budgetary Control**- Budgetary control should be exercised and wide deviations observed should be reconciled.

(During)

- **Job Rotation**- Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- **Leave**-Every member of the staff should be encouraged to go on leave at least once a year.
- **Segregation of Duties**- Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- **Accounting Control**-There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- **Cash Control**- Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.

(End)

- **Inventory Control**- For inventory taking, at the close of the year, trading activities should,

if possible be suspended, and it should be done by staff belonging to several sections of the organization.

- **Record Control**-Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate

➢ **Division of work**

Company has not done proper division of work as:

- the receipts of cash should not be handled by the official handling sales ledger.
- delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

Case Discussion & Conclusion

➢ In the given case of Modest Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

Author's Note

The above answer can be considered as one of the master answer w.r.t internal control system. Student are not always required to write the entire answer. They should see what specifically has been asked in the question before writing the answer

QNO 174.000	**Internal Controls (Multiple Location Business)** UNIQUE	**Old Course – (N11E, M16R, M16M, N16M, P17M, N17M, N18M) New Course – (M18M, S21M)**

Funtoosh Ltd has five entertainment centres to provide recreational facilities for public especially for children and youngsters at five different locations in the peripheral of 250 kilometres Collections are made in cash Specify the adequate internal control system towards collection of money.

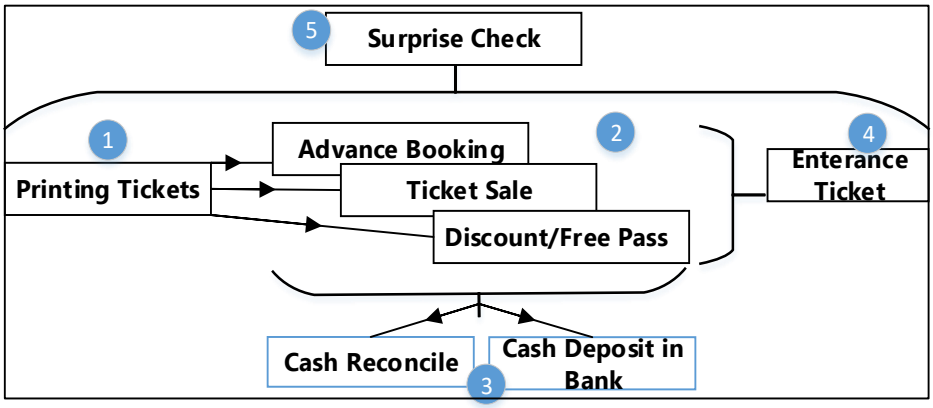
OR

Y Ltd has five entertainment centres to provide frivolous facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kms Collections are made in cash Specify the adequate control system towards collection of money.

Answer

➢ **Internal Control System:**

In order to achieve proper internal control over the sale of tickets and its collection by Funtoosh Ltd., following system should be adopted-



- **Printing of tickets:** Serially numbered pre-printed tickets to avoid duplication to prevent forgery. Non-repetition of serial no. for reasonable period.
  - **Advance booking:** System shall ensure that all advance booked tickets are paid for.
  - **Ticket sales:** Sale of tickets should take place from the Central ticket office , preferably through machines
  - **Discounts and free pass:** Discount policy should be properly authorized and

such authorization should be preserved

- **Daily cash reconciliation:** Cash collection should be reconciled with the number of tickets sold. Serial number of tickets will facilitate the reconciliation.
- **Daily banking**: Each day's collection should be deposited in the bank on next working day. Cash should be in the custody of properly authorized person, preferably in joint custody. Daily cash in hand report should be signed by the authorized persons.

⩔ **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate

⩔ **Surprise check:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc

Author's Note
In the Institute's answer each point was an individual point by itself .However in order to give a better picture for the sake of understanding the points:
-A diagram has been created and
-Points have been rearranged in the order of the diagram

QNO 175.500	**Five Components as per COSO & Three Objectives** BHASKAR CNO—CH30C.190	**New Course – (N20E)**

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

Answer

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

Five Components of COSO are as follows:
(i) Control Environment

(ii) Risk Assessment

(iii) Control Activities

(iv) Information and Communication

(v) Monitoring

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

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

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

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

QNO 175.600	Checklist for IFCR Over C&B BHASKAR CNO—CH30C.200	New Course – (M22E)
	Mr. K has been appointed as statutory auditor of SK Limited for issuing an audit opinion on financial statements and internal controls over financial reporting (ICFR) for the year ended March 31, 2022 under the Companies Act, 2013. Guide Mr. K to prepare a checklist in the form of questions for testing internal control over cash and bank balances. When forming an opinion on ICFR is it necessary for Mr. K to test the transactions only at the balance sheet date?	
Answer	In the given case of SK Limited, the appointed auditor Mr. K would prepare checklist for testing internal control over cash and bank balances. An illustrative set of questions to be answered by the audit staff is as follows: Have you checked that the cashier - (i) is not responsible for opening the incoming mails; (ii) does not authorise any of the ledgers; (iii) does not authorise any expenditure or receipt; (iv) does not sign cheques; (v) takes his annual leave regularly; (vi) inks and balances the cash book every day; (vii) verifies physical cash balance with the book figure daily at the end of the day; (viii) prepares monthly bank reconciliation statement; (ix) holds no other funds or investment; (x) holds no unnecessary balance in hand; (xi) does not pay money without looking into compliance with proper procedure and due authorisation; and (xii) has tendered proper security or has executed a fidelity bond? In the given situation, Mr. K is Statutory Auditor of SK Limited for issuing opinion on financial statements and internal control over financial reporting. He should surely test transactions during the financial year and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. From the discussion given above, it can be concluded that it would not be necessary for Mr. K to test the transactions only at the balance sheet date.	

04 Special Aspects of Auditing in an Automated Environment

QNO 204.005	**Approach to identify risks associated with the IT systems.** UNIQUE	**New Course – (S21M)**
	A Company is using ERP for all its business processes including Procurement, Sales, Finance and Reporting. You are required to explain the Statutory Auditor's approach to identify the risks associated with the IT systems.	
	➢ The Auditor should understand and document each of the business processes in form of narratives and / or flowcharts. ➢ The next process will be to identify areas / events that can lead to risks, viz. manual Invoicing and accounting once goods are dispatched could lead to incorrect Invoicing and accounting and hence is a 'risk'. ➢ The Auditor should also analyze the risks i.e., the impact it will have if materializes. ➢ Next will be prioritization in terms of probability of how often the risks will materialize.	

QNO 204.010	**Entity Level Risks & Controls** BHASKAR CNO—AAE.240	**New Course – (M18E,N22E)**
	While evaluating the risks and controls at entity level, the Auditor should take cognizance of the prevalent direct and indirect entity level controls operating in the entity. Explain what they pertain to, with few examples.	
Answer	➢ **Entity Level Risks and Controls:** There are direct entity level controls and indirect entity level controls. ⩔ **Direct ELCs** Direct entity level controls operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner. • **Examples include:** ○ Business performance reviews; ○ Monitoring of effectiveness of controls activities by Internal Audit function; ⩔ **Indirect ELCs** Indirect entity level controls do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities. • **Examples include:** ○ Company code of conduct and ethics policies; ○ Human resource policies and Employee job roles & responsibilities; ○ Employee job roles & responsibilities	

QNO 204.020	**Types of Automated Environment** BHASKAR CNO—AAE.040	**New Course – (N18R, N18M, M20M, S21M, M21M)**
	A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay. It has several critical IT components that enable anytime, anywhere transactions to take place. You are required to name the components and its example of real-time environment.	
Answer	➢ **Real Time Environment: IT Components:** To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. A real -time environment has several critical IT components that enable anytime, anywhere transactions to take place. Any failure even in one component could render the real -time system unavailable and could result in a loss of revenue. IT Components include:	

	⩔ H- Hardware	*For example, Data centers, Backup and Storage devices, Power supply.*
	⩔ M-Middleware	*For example, Web servers like Apache, ATM switches.*
	⩔ A-Applications	*For example, ERP applications SAP, Oracle R12, Core banking applications.*
	⩔ N-Networks	*For example, Wide Area Networks, Internet hosting.*
	Author's Note **H-it MAN (Order of Points is rearranged to match with mnemonic)**	

QNO 204.024	Types of IT Controls BHASKAR CNO—AAE.100	New Course –(N22R)
	M/s RST & Associates have been appointed as auditors of ADI Ltd. for the financial year 2021-22. The processes, operations, accounting and decisions are carried out by using computers in ADI Ltd. M/s RST & Associates understand that there are several aspects that they should consider to determine the level of automation and complexity in the business environment of ADI Ltd. While planning the audit work, the engagement partners discussed with the audit staff about the various types of controls in the automated environment that are put in place to mitigate the IT risks and to maintain the confidentiality, integrity, availability and security of data such as General IT Controls; Application Controls; and IT-Dependent Controls. **You are required to briefly explain:** **(i) General IT Controls.** **(ii) Application Controls.** **(iii) IT-Dependent Controls.**	

Answer

The controls that are put in place to mitigate the IT risks and to maintain the confidentiality, integrity, availability and security of data are General IT Controls, Application Controls and IT-Dependent Controls.

General IT Controls: "General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environment. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:" (SA 315)

- Data center and network operations;
- System software acquisition, change and maintenance
- Program change;
- Access security;
- Application system acquisition, development, and maintenance (Business Applications).

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Application Controls: Application controls include both automated or manual controls that operate at a business process level. Application controls can be preventive as well as detective in nature and are designed to ensure the integrity of the accounting records. application controls relate to procedures used to initiate, record, process and report transactions or other financial data. These controls help ensure that transactions occurred, are authorised, and are completely and accurately recorded and processed. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. Examples of automated applications include edit checks and validation of input data, sequence number check, limit check, format check, range check, reasonableness check, mandatory data fields, existence check etc.

IT dependent controls: IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications. In this case, even though the control is performed manually, the design and effectiveness of such controls depend on the reliability of source data. Due to the inherent dependency on Information Technology, the effectiveness and reliability of Automated application controls and IT dependent controls require the General IT Controls to be effective.

QNO 204.030	Manual vs. automated control UNIQUE	New Course –(M18M)
	Identify the controls which are automated, manual or IT dependent manual for the below mentioned cases? **(i) Price master configured in the sales master can only be edited by authorised personnel in the system.** **(ii) Invoice cannot be booked in SAP in case Purchase orders are not approved.** **(iii) Inventory ageing report is pulled out from the system based on which provisioning is calculated after analysing the future demand by the inventory personnel and approved by the controller.** **(iv) All invoices are signed by warehouse personnel before the goods are dispatched to the customer.** **(v) Credit limit is assigned to the customer and goods cannot be sold in excess of credit limit configured in the system.** **(vi) All changes to the credit limit are approved manually by sales manager.** **(vii) Ageing report is pulled out from SAP based on which provisioning is calculated by accounting personnel and approved by financial controller.** **(viii) PO, GRN (Good received note) and invoice are matched by the system before it is posted in the financial records.**	
Answer	(i) **Automated control** as there is inbuilt control for editing of the price master by the authorized personnel. (ii) **Automated control** as system doesn't allow approval of invoice in case Purchase Order is not booked. (iii) **IT dependent manual control** as Inventory ageing report is pulled out from the system after which provision for inventory is manually approved. (iv) **Manual control** as sign off is required to be done for the invoice before the dispatch of the goods. (v) **Automated control** as system doesn't allow goods to be sold if credit limit assigned to the customer has been crossed. (vi) **Manual control** as sign off is required for every change to the credit limit. (vii) **IT dependent manual control** as ageing report is relied upon for calculation of provisioning for debtors. (viii) **Automated control** as PO, GRN and invoice is matched by the system before recording of the invoice to the vendor account.	

QNO 204.040	Consideration of Automated Environment at each phase of audit cycle" BHASKAR CNO—AAE.080	New Course – (M18R ,N18M, N18E, N19E, S21M)
	"The audit cycle consists of Planning, Execution and Completion. The automation in processing of business transactions has considerations to be weighed by Auditor at every phase of this cycle"- Enumerate the focal points of such considerations when auditing in automated environment. **OR** **In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. You are required to briefly explain the relevant considerations for every phase in above audit approach in case of an automated environment.** **OR** **CA. M is commencing the Statutory Audit of a limited company, which is engaged in trading software products and providing software solutions. CA. M was evaluating the controls environment and noted that the established internal controls are functioning in an automated environment. Enumerate any five focal points for the consideration of CA. M, when auditing in the automated environment, with respect to his audit approach during planning, execution and completion phases.**	
Answer	➢ **Phases of Audit** In a controls-based audit, the audit approach can be classified into three broad phases comprising of **:** ⩔ Planning, ⩔ Execution, and	

- Completion.

➢ **Relevance of Automated Environment**

In this approach, the considerations of automated environment will be relevant at every phase as given below:

- **Planning Phase**
  - During risk assessment, the auditor should consider risk arising from the use of IT systems at the company;
    Example: *System Outage / Data safety & security / Recovery etc.*
  - When obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered
    Example*: Which locations & Processes are Computerized?*
- **Execution / Testing**
  - While assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
    Example: How IT system is used for Decision Making & Monitoring?
  - Pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
    Example: *Affects many users & applications, such as job rotation, access passwords*
  - During testing phase, the results of general IT controls would impact the nature, timing and extent of testing.
  - When testing of reports and information produced by the entity (IPE) generated through IT systems and applications.
- **Completion / Reporting**
  - At completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

Author's Note

Few examples have been included in the answer by us for better understanding .

QNO 204.050	Application Controls BHASKAR CNO—AAE.100/AAE.200	New Course – (S17M, M18M,S21M)

Describe application controls and give three examples of automated application controls.

OR

Explain Application Controls and General IT Controls

Answer

➢ **Application Controls** are automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. Examples of automated applications include:

- User limit checks
- Edit checks and validation of input data
- Sequence number checks
- Mandatory data fields
- Reasonableness checks

➢ **General Control**

"General IT controls is policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environment. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:" (SA 315)

- Data centre and network operations.
- System software acquisition, change and maintenance
- Program change.
- Access security.
- Application system acquisition, development, and maintenance (Business Applications).

	These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

QNO 204.055	Entity Level Control--Whistle Blower Policy BHASKAR CNO—AAE.250	New Course – (M22M,M21E)
	The auditors are required to understand and evaluate the entity level controls as a part of audit engagement, the result of which has an impact on the nature, timing and extent of other audit procedures. In evaluating the effect of such control, existence, effectiveness and assessment of the whistle-blower policy in the company is very important. Specify the procedure you would perform for an understanding and evaluation of such whistle-blower policy.	
Answer	**Procedure for understanding and evaluation of whistle-blower policy -** Auditors are required to understand, evaluate and validate the entity level controls as a part of an audit engagement. The results of testing entity level controls could have an impact on the nature, timing and extent of other audit procedures including testing of controls. For example, when the entity level controls at a company are effective, the auditor may consider reducing the number of samples in the test of controls and where the auditor finds the entity level controls ineffective, the auditor may consider to increase the rigour of testing by increasing sample sizes. In small and less complex companies, the entity level controls may not formally defined or documented. In such situations, the auditor should design audit procedures accordingly to obtain evidence of the existence and effectiveness of entity level controls. **The following example shows how the auditor performs an understanding and evaluation of the whistle-blower policy in a company:** **Procedure to be performed to obtain an understanding and evaluation of whistle-blower policy: Auditor may obtain an understanding and evaluation of the whistle-blower policy in a company by inquiring the following:** • Does the company have a **whistle-blower policy**? • Is this policy **documented and approved**? • Has the whistle-blower policy been **communicated** to all the employees? • **Are employees aware** of this policy and understand its purpose and their obligations? • Has the company taken measures viz., **training**, to make the employees understand the contents and purpose of the policy? • Does the company monitor **effectiveness of the policy** from time-to-time? • How does the company deal with **deviations and non-compliance**?	

QNO 204.060	Data Analytics BHASKAR CNO—AAE.280	New Course – (M19R, S21M, M22R)
	In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates. This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high-level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics and example of circumstances when auditing in an automated environment, auditors can apply the concepts of data analytics.	
Answer	➢ **Data Analytics:** Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following: ⩔ preliminary analytics; ⩔ risk assessment; ⩔ control testing; ⩔ non-standard journal analysis;	

	⩔ evaluation of deficiencies; ⩔ fraud risk assessment.

QNO 204.062	Uses / Benefits of Data Analytics / CAAT BHASKAR CNO—AAE.280	New Course – (N19R,N20M, S21M, N21E,N22M, M23R)
	"Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics and the data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs." You are required to give a suggested approach to get the benefit from the use of CAATs.	
Answer	Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given in the illustration below: ⩔ Understand Business Environment including IT *(Business uses ERP)* ⩔ Define the Objectives and Criteria *(Use of analytical procedures to verify cash discount)* ⩔ Identify Source and Format of Data *(ERP, CSV File)* ⩔ Extract Data *(Export Data from ERP)* ⩔ Verify the Completeness and Accuracy of Extracted Data *(Match total from ERP)* ⩔ Apply Criteria on Data Obtained *(Identify transactions eligible for cash discount and check whether only these transactions are given cash discount)* ⩔ Validate and Confirm Results *(See documentary evidence for few items)* ⩔ Report and Document Results and Conclusions *(Document Results)*	

QNO 204.070	Enterprise Risk types and managing those risk BHASKAR CNO—AAE.300	New Course –(M19E, M22M, M23M)
	The volatility, unpredictability and pace of fast changes that exists in the automated environment today is far greater than in the past and consequently it throws more risk to business which requires them to have a need to continuously manage such risks. State various risks which an enterprise may have to face and manage.	
Answer	➢ **Various Risk** Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today are far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks. Examples of risks include: ⩔ Market Risks ⩔ Regulatory & Compliance Risks; ⩔ Business Partner Risk ⩔ Technology & Security Risks ⩔ Product or Project Risk; ⩔ Operational Risks ⩔ Credit Risk; ⩔ Environmental Risks. ⩔ Financial Reporting Risks ➢ **Definition of Risk Management** Risk Management is a combination of process, people, tools and techniques through which companies ⩔ Identify, ⩔ Assess, ⩔ Respond, ⩔ Mitigate and ⩔ Monitor risks.	

	Enterprise Risk Management is a formal program or framework that is implemented across an enterprise or company for enabling risk management.

QNO 204.090	**Understanding and documenting automated environment** **BHASKAR CNO—AAE.060**	**New Course – (M20R,N20E,M22E)**
	"Beta Hotel operates in an automated environment and uses application softwares for front desk, Guest reservations, Restaurant and kitchen orders and billing for which CA Anil has been appointed as an auditor. Guide CA Anil the various key aspects that needs to be considered by him while understanding of the automated environment of the Company in accordance with SA 315. Is he required to document the same? If yes, illustrate by giving one example. " **OR** **Understanding and documenting automated environment** **OR** **CA Vipin has been appointed as Statutory Auditor by IG Insurance Co. Ltd. for 3 of its branches for the F.Y. 2019-2020. Insurance Company is using a software called "Applied Epic" wherein all transactions (policy issuance, premium receipts, expense of insurance company, incomes, assets and liabilities) are recorded and financial statements generated at the end of the financial year. CA Vipin not technically equipped and well versed with technology decided to follow traditional manual auditing approach and started the audit. He is of the view that understanding and using the auditee's automated environment is optional and not required. Do you agree with the approach and views of CA Vipin?**	

Answer

Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

1. The applications that are being used by the company;
2. Details of the IT infrastructure components for each of the application;
3. The organisation structure and governance;
4. The policies, procedures and processes followed;
5. IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230. The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server and Storage
SAP ECC/ HANA	Integrated application software	Oracle 19c	HP-UX	LAN, WAN	HP Server and NAS
REVS	Front Desk, Guest Reservations	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
KOTS	Restaurant and Kitchen Orders	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
BILLSYS	Billing	Oracle 12c	Windows 2016 Server	Packaged Software	HP Server Internal HDD

QNO 204.095	**International IT related Standards, Guidelines and Framework.** **BHASKAR CNO—AAE.320**	**New Course – (S21M)**
	Explain some of the International IT related Standards, Guidelines and Framework.	
	➢ **C- Control Objectives for Information and Related Technologies (CoBIT)** is best practice IT Governance and Management framework published by Information Systems Audit and Control Association. CoBIT provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security. ➢ **C-The Cybersecurity Framework (CSF)** published by the National Institute of Standards and Technology is one of the most popular frameworks for improving critical infrastructure cybersecurity. This framework provides a set of standards and best practices for companies to manage cybersecurity risks. ➢ **L- ITIL (Information Technology Infrastructure Library) and ISO 20000** It provides a set of best practice processes and procedures for IT service management in a company. For example, change management, incident management, problem management, IT operations, IT asset management are some of the areas that could be relevant to audit. ➢ **A-The American Institute of Certified Public Accountants** has published a framework under the Statements on Standards for Attest Engagements (SSAE) No.16 for reporting on controls at a service organisation that include: - ⩔ SOC 1 for reporting on controls at a service organization relevant to user entities' internal control over financial reporting (ICFR). ⩔ SOC 2 and SOC 3 for reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy i.e., controls other than ICFR. ⩔ While SOC 1 and SOC 2 are restricted use reports, SOC 3 is general use report. ➢ **P-The Payment Card Industry – Data Security Standard or PCI-DSS**, It is the most widely adopted information security standard for the payment cards industry. Any company that is involved in the storage, retrieval, transmission or handling of credit card/debit card information are required to implement the security controls in accordance with this standard. ➢ **I -ISO 27001:2013** It is the Information Security Management System (ISMS) standard issued by the International Organization for Standardization (ISO). This standard provides the framework, guidelines and procedures for implementing information security and related controls in a company. For example, this standard cover password security, application security, physical security, backup and recovery, that are relevant when auditing in an automated environment. ➢ **S- Sarbanes Oxley Act of 2002**, Commonly known as SOX, is a requirement in America. Section 404 of this act requires public listed companies to implement, assess and ensure effectiveness of internal controls over financial reporting and auditors' independent opinion on the design and operating effectiveness of internal controls over financial reporting (ICFR) – which is similar to the requirements of IFC-FR for Indian companies. Similar legal and statutory requirements over internal controls exist in several other countries including Japan, China, European Countries, etc.	
	Author's Note: **Shortcut to Remember: C^2LAP-for-International-Standard**	

05 Company Audit

Part 1 – Company Audit (Sec 139 to 148)

QNO 281.100	Sec 139 -- Appointment Procedure BHASKAR CNO—CA.180	Old Course – (N18R)
	Subject to the provisions of sub-rule (1) of Rule 3 of The Companies (Audit and Auditors) Rules, 2014 where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment. Explain manner and procedure of selection and appointment of auditors as per Rule 3 of CAAR 2014.	
Answer	➢ **Rule 3 of CAAR 2014 prescribes the following manner and procedure of selection and appointment of auditors.** ⩔ In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company. It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court. ⩔ The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit. ⩔ Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment. ⩔ If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting. ⩔ If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement. ⩔ If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting. ⩔ The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.	

QNO 282.000	Sec 139--Appointment First Auditor (Silk)- BHASKAR CNO—CA.120	Old Course – (M17R)
	KM Pvt. Ltd., engaged in the manufacturing business of Silk shirts, is a newly incorporated company dated 01.09.2016. On 28.09.2016, the members of KM Pvt. Ltd. themselves appointed CA Raj, a renowned practitioner, as the first auditor of the company opposing that Board is not authorised to appoint the auditor. You are required to comment on the action of the Members.	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 139(6) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ Section 139(6) of the Companies Act, 2013 deals with appointment of First Auditor in the case of a company, other than a Government Company. ⩔ The first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. ⩔ In the case of failure of the Board to appoint the auditor, it shall inform the members of the company. ⩔ The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. ⩔ Appointed auditor shall hold office till the conclusion of the first annual general meeting. **Part III – Case Discussion** As per the facts given in the case, the members of KM Pvt. Ltd. themselves appointed CA Raj, a renowned practitioner, as the first auditor of the company opposing that Board is not authorised to appoint the auditor **Part IV – Conclusion** The appointment of CA Raj as first auditor by the Members of KM Pvt. Ltd. by themselves is in violation of section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within one month of registration of the company. It may be noted that, only in the case of failure by the Board to appoint the auditor, the members of the company may appoint the auditor at an extraordinary general meeting. Thus, the appointment of CA Raj by the Members of the company is not in order.	
	Author's Note **90 days should be counted after completion of 30 days from the date of registration of the company**	

QNO 284.000	Sec 139--Appointment Government Company (Prem)- BHASKAR CNO—CA.120	Old Course – (N14R, S17M, P17M, N19M) New Course – (N19M, S20M)
	As an auditor, how would you deal with the following situations: **Nick Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nick Ltd. appointed Mr. Prem as statutory auditor for the year.**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 139(5) of the Companies Act, 2013 ▪ Section 2(45) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 139(5) of the Companies Act, 2013** As per section 139(5) of the companies act 2013, in the case of a Government company the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting. ➢ **Section 2(45) of the Companies Act, 2013** As per section 2(45), a Government company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments	

	and includes a company which is a subsidiary of a Government Company as thus defined". **Part III – Case Discussion** ➢ In the given case Ajanta Ltd is a government company as its 20% shares have been held by Central Government, 25% by U.P. State Government and 10% by M.P. State Government. Total 55% shares have been held by Central and State governments. **Part IV – Conclusion** ➢ Therefore, it is a Government company. Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence Nick Ltd. is covered in the definition of a government company. Therefore, the Auditor of Nick Ltd. can be appointed only by C & AG. Consequently, appointment of Mr. Prem is invalid and he should not give acceptance to the Directors of Nick Ltd.
	Author's Note: • **Question does not clarify whether it is first auditor or subsequent auditor. Practically subsequent auditor cases are much more than first auditor (as It is once in life time affair for company) so we should assume it is subsequent auditor if question is silent and solve accordingly. ICAI did the same they assumed it as subsequent auditor, you can write same assumption. No need to take different assumption.** • **So, if question is silent, we should always assume, case of subsequent auditor because, it is more frequent, famous than first auditor.**

QNO 285.000	**Sec 139--Appointment Government Company (IO)- BHASKAR CNO—CA.120**	**Old Course – (M16E) New Course – (S17M)**
	M/s IO Ltd. is registered with Registrar of Companies on 1st of May 2014. The Company's 27% of paid up share capital is held by Central Government; 28% by State Government and the remaining 45% by public. The Board of Directors appointed RMG, Chartered Accountants as statutory auditors for the financial year 2014-15 by passing a resolution at the Board Meeting held on 25th May, 2014. Comment whether appointment is valid or not. **OR** **The first auditor of M/s Healthy Wealthy Ltd., a Government company, was appointed by the Board of Directors.**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 139(7) of the Companies Act, 2013 ▪ Section 2(45) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 139(7) of the Companies Act, 2013** According to section 139(7) of the Companies Act, 2013, the first auditor of a government company shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. ➢ **Section 2(45) of the Companies Act, 2013** As per section 2(45) of the said Act, a Government Company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government Company. **Part III – Case Discussion** ➢ In the given case, 27% of paid-up share capital has been held by Central Government, 28% by State Government and remaining 45% by Public i.e. total 55% of the paid-up share capital has been held by Central Government and State Government which is more than 51% as prescribed in the Companies Act, 2013 **Part IV – Conclusion** ➢ M/s IO Ltd. is a government company. Therefore, the appointment of RMG, Chartered Accountants as first auditor by the Board of Directors of M/s IO Ltd. for the financial year 2014-15 is not valid as the first auditor of a government company can be appointed by Comptroller and Auditor-General of India.	

	If the CAG fails to make such appointment within 60 days, the Board of Directors shall appoint within next 30 days.

QNO 286.000	Sec 139--Appointment of First Auditor (Managing Director)- BHASKAR CNO—CA.120	Old Course – (N15R, P17M, N17R) New Course-- (S17M)

Malta Pvt. Ltd., a newly incorporated company dated 01.07.2017 is engaged in the manufacturing business of Cotton Shirts. On 30.07.2017, the Managing Director of Malta Pvt. Ltd. himself appointed CA. Rajnath, his daughter's husband, as the first auditor of the company.

You are required to –

1. **State the provisions of the Companies Act, 2013 relating to appointment of first auditor.**
2. **Comment on the action of the Managing Director.**

Answer

Part I -- Relevant Sections & Laws

- Section 139(6) of the Companies Act 2013

Part II -- Requirements of Relevant Sections & Laws

- As per section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

  In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

  The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

Part III – Case Discussion

- In the above case, Malta Pvt. Ltd., a newly incorporated company dated 01.07.2017 is engaged in the manufacturing business of Cotton Shirts. On 30.07.2017, the Managing Director of Malta Pvt. Ltd. Himself appointed CA. Rajnath, his daughter's husband, as the first auditor of the company.

  Apparently, there are two issues arising out of the situation given in the question, viz.,
  1. first one relates to appointment of first auditor by the Managing Director; and
  2. Second pertains to relation of such an auditor with the Managing Director.

Part IV – Conclusion

- **First Issue-** As per the facts given in the case, the appointment of CA Rajnath as first auditor by the Managing Director of Malta Pvt. Ltd. by himself is in violation of section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within one month of registration of the company. Thus, the appointment of CA Rajnath is not valid.
- **Second Issue** - Under the circumstances, the second issue relating to relationship of auditor with Managing Director becomes redundant.

QNO 287.000	Sec 139--Casual Vacancy Short Note BHASKAR CNO—CA.160	Old Course – (N15R, P17M)

While auditing Y Ltd., CA Max, the statutory auditor of Y Ltd. encounters exceptional circumstances that bring into question his ability to continue performing the audit. Considering it appropriate, CA Max resigned from the office of auditor of Y Ltd. Due to the resignation of the existing auditor, the Board of Directors of Y Ltd. itself appointed CA Mini, a practicing Chartered Accountant, as the statutory auditor till the conclusion of 6th meeting.

You are required to state the provisions related to filling of casual vacancy as per the Companies Act, 2013 and comment upon the validity of appointment made by the Board.

Answer

Part I -- Relevant Section & Laws

- Section 139(8) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- **Casual Vacancy–**

  In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

  If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be

	approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
	Part III – Case Discussion
	➢ In the given case, CA Max, the statutory auditor of Y Ltd. has resigned from the office of auditor. The Board of Directors of Y Ltd. itself appointed CA Mini, a practicing Chartered Accountant, as the statutory auditor till the conclusion of 6th meeting.
	Part IV – Conclusion
	➢ Such casual vacancy can be filled by the Board of Directors subject to approval by the company at a general meeting convened within 3 months of the recommendation of the Board. Thus, the appointment of CA Mini made by the Board of Directors without the approval of the company at a general meeting is invalid. Further, if appointment is approved by the company, CA Mini cannot hold the office of auditor till the conclusion of 6th meeting i.e. the appointment cannot be made for five years. The auditor can hold office only till the conclusion of the next AGM

QNO 288.000	**Sec 139--Appointment of Statutory Auditor Verification** **UNIQUE**	**Old Course – (M08E, P17M)**
	What are the steps to be taken by a firm of Chartered Accountant to ensure that its appointment as Statutory Auditor of a Company is valid?	
Answer	**Part I -- Relevant Section & Laws**	
	▪ Section 139 of the Companies Act, 2013	
	Part II -- Requirements of Relevant Section & Laws	
	➢ Validity of Appointment as a Statutory Auditor: To ensure that the appointment is valid, the incoming auditor should take the following steps before accepting his appointment. ⩔ L- Ceiling Limit: Ensure that a certificate has been issued under section 139 of the Companies Act, 2013 so that the total number of company audits held by the firm (including the new appointment) will not exceed the specified number. ⩔ A - Resolution at AGM: Verify that at AGM of the Company, a proper resolution is passed. Inspect general meeting minute's book to see that the appointment is duly recorded. ⩔ L - Compliance with Law: Satisfy that the legal procedure contemplated in section 139 and 140 of the said Act, dealing with the appointment and removal of existing auditor, have been followed. Also check whether section 139(5) and 139(7) (in case of a government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments- appointment by the Comptroller and Auditor General of India) are attracted and complied with. ⩔ C - Code of Conduct: Communicate with the previous auditor, if any, in writing, to ascertain if there are any professional reasons for not accepting the appointment.	
	Author's Note **CALL -** **C**- Code of **Conduct / A**- Resolution at **AGM / L**- Compliance with **Law/ L** - Ceiling **Limit**	

QNO 291.000	**Sec 139--Rotation Applicability (Apple)** **BHASKAR CNO—CA.200**	**Old Course – (M15R, P17M, N17R)** **New Course – (M18R)**
	Ram Ltd. is a private company. Its balance sheet shows paid up share capital of ` 5 crore and public borrowings of ` 100 crore. The company appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September 2017 for 11 years. **You are required to state the provisions related to - rotation of auditors and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.** **OR** **Apple Ltd is an unlisted public company Its balance sheet shows paid up share capital of Rs 5 crore and public deposits of Rs 100 crore The company appointed M/s Pear & Co, a chartered accountant firm, as**	

the statutory auditor in its annual general meeting held at the end of September 2016 for 11 years .

You are required to state the provisions related to rotation of auditor and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions

Answer

Part I -- Relevant Section & Laws

- Section 139(2) of the Companies Act, 2013
- Proviso to Section 139(2)

Part II -- Requirements of Relevant Section & Laws

➢ **Provisions related to Rotations**

Applicability

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely: -

(a) all unlisted public companies having paid up share capital of ` 10 crore or more;
(b) all private limited companies having paid up share capital of ` 50 crore or more;
(c) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.

➢ **Section 139(2) of the Companies Act, 2013**

Max Tenure

No listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

(a) an individual as auditor for more than one term of 5 consecutive years; and
(b) an audit firm as auditor for more than two terms of 5 consecutive years.

➢ **Proviso to Section 139(2)**

Cooling Period

(i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
(ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:

Part III – Case Discussion

➢ In the given case, Ram Ltd. is a private company having paid up share capital of ` 5 crore and public borrowings of ` 100 crore. The company has appointed M/s Shyam& Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2017 for 11 years.

Part IV – Conclusion

➢ The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds ` 50 crore.

Therefore, Ram (P) Ltd. can appoint M/s Shyam& Co. as an auditor of the company for not more than two terms of 5 consecutive years. i.e. M/s Shyam & Co. shall hold office from the conclusion of this meeting up to conclusion of sixth AGM to be held in the year 2022 and thereafter can be reappointed as auditor for one more term of five years i.e. up to year 2027. ~~The appointment shall be subject to ratification by members at every annual general meeting of the company~~.

As a result, the appointment of M/s Shyam & Co. made by Ram Ltd. for 11 years is void.

Author's Note:-

Both the questions will have common conclusion as the question is same, except instead of borrowing second question has public deposits and first question is of private company and second is of unlisted public company.

QNO 292.000	Sec 139--Rotation Applicability (Rano) BHASKAR CNO—CA.200	New Course – (S17M)
	Rano Ltd. is a private limited Company, having paid up share capital of rupees 48 crore but having public borrowing from nationalized banks and financial institutions of rupees 42 crore, manner of rotation of auditor will not be applicable.	

Answer

Part I -- Relevant Section & Laws

- Section 139(2) of the Companies Act, 2013 to be read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014.

Part II -- Requirements of Relevant Section & Laws

➢ **Provisions related to Rotations**

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely: -

(a) all unlisted public companies having paid up share capital of ` 10 crore or more;
(b) all private limited companies having paid up share capital of ` 50 crore or more;
(c) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.

➢ **Section 139(2) of the Companies Act, 2013**

No listed company or a company belonging to such class or classes of Companies as mentioned above, shall appoint or re-appoint-

(a) An individual as auditor for more than one term of five consecutive years; and
(b) An audit firm as auditor for more than two terms of five consecutive years.

Part III – Case Discussion

➢ In the above case, Rano Ltd. is a private limited Company, having paid up share capital of rupees 48 crore but having public borrowing from nationalized banks and financial institutions of rupees 42 crore

Part IV – Conclusion

➢ Rotation will not be applicable to RANO Ltd

QNO 293.000	Sec 139--Rotation Common Partner After 3 Months BHASKAR CNO—CA.200	Old Course – (M17E)
	M/s. ABC & Co. is an audit firm having partners Mr. A, Mr. B and Mr. C, whose tenure as statutory auditor in R Ltd. a listed entity, has expired as per the Companies Act, 2013 . **M/s. XY is another audit firm which is appointed as the statutory auditor of R Ltd. for the subsequent year.** Mr. A joins M/s XY as partner, 3 months after it was appointed the statutory auditor of R Ltd. Comment.	

Answer

Part I -- Relevant Section & Laws

- Section 139(2) of the Companies Act, 2013
- Proviso to Section 139(2)

Part II -- Requirements of Relevant Section & Laws

➢ **Section 139(2) of the Companies Act 2013,**

No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

(a) an individual as auditor for more than one term of five consecutive years; and
(b) an audit firm as auditor for more than two terms of five consecutive years:

➢ **Proviso to Section 139(2)**

Provided further that as **on the date of appointment** no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years

Part III – Case Discussion

➢ In the given case, R Ltd. is a listed entity, thus, rotational provisions are applicable. Mr. A is a partner in M/s. ABC & Co., whose tenure as statutory auditor in R Ltd. has expired. He joined M/s.

XY as partner, 3 months after it was appointed as statutory auditor of R Ltd.

Part IV – Conclusion

- It may be noted that that there should not be a common partner in the firms as on the date of appointment, however, in the given case, Mr. A has joined M/s. XY after 3 months of its appointment as statutory auditor of R Ltd.

  Thus, M/s. XY may continue as statutory auditor of R Ltd. for the subsequent term.

- **As per institute an alternative view is possible.**
  As 'Auditor Rotation' provisions are intended to maintain the auditor's independence. Though as per the Companies Act, 2013, there should not be common partner in the firms on the date of appointment but to maintain the integrity and independence it is important to apply this auditor rotation rule for whole term. Therefore, if there are common partners in previous firm and newly appointed audit firm the purpose of law for the auditor's rotation will be defeated.

  In view of above provisions, if, after the date of appointment of new firm (M/s . XY), old partner Mr. A (of M/s. ABC & Co.-old audit firm) joins the new audit firm, it would defeat the objective and intention of lawmakers. Thus M/s. XY should vacate the office as an auditor.

Author's Note

1. **It has been assumed in the question that Mr. A joins M/s XY as partner and he continues to remain partner at M/s. ABC & Co.**
2. **If we don't assume that he is continuing with old firm then it will become case of concerned partner leaving old firm and joining or making new firm, in such case new firm will not eligible irrespective of whether he joins new firm before or after appointment because its only in common partner situation we have to see it as on date of appointment, afterwards its accepted. but joining new firm or making new firm, date of joining is not relevant, if anytime such things happen new firm is not eligible for appointment as partner.**

QNO 293.500	Sec 139--Rotation (Common Partner Undisclosed) BHASKAR CNO—CA.200	Old Course – (N21R) New Course – (N21R)

AB & Co. were appointed auditors for NOME Limited, a listed company, for the term of two five consecutive years from 2010-11, 2011-12, 2012-13, 2013-14, 2014-15, 2015-16, 2016-17, 2017-18, 2018-19, 2019-20. As per the provision of the section 139(2)(b) "No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years".

Hence, Management of NOME Limited reached out (based on the recommendation of Audit Committee) to BCD & Co. for their nomination as the appointment of Statutory Auditor for the financial year 2020-21. However, BCD & Co. did not provide any written consent to such appointment neither they provided a certificate that the appointment, if made, shall be in accordance with the conditions laid in the Act and Rules therein.

Still the management went ahead and proposed an appointment in AGM and BCD & Co. were appointed as an auditor for the financial year 2020-21. Post appointment, those charged with governance identified that majority of the partners in the BCD & Co. are same which were there in AB & Co. Now, fearing the contravention of the provision of Companies Act, 2013. Management, on guidance of those charged with governance, decided to file a complaint with tribunal under section 140(5) of the Companies Act against statutory auditors.

You are required to guide the BCD & Co. regarding the contravention of the provisions of the Companies Act, 2013 with respect to appointment of Auditor.

Answer

As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed.

It may be noted further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

It may also be noted that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Companies Act, 2013.

Further, as per section 139(2), "(2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint (a) an individual as auditor for more than one term of five consecutive years; and (b) an audit firm as auditor for more than two terms of five consecutive years.

It may also be noted further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:"

In the current case, while appointing the auditors of the company a written consent of the auditor to such appointment was not obtained. Moreover a certificate from him that the appointment if made shall be in accordance with the conditions laid down in the Act and Rules was also not obtained. Further, majority of the partners of AB & Co. were partners in BCD & Co. AB & Co. already served two terms of five consecutive years i.e., from 2010- 11 to 2019-20 as a statutory auditor of the company.

Hence, BCD & Co. were not eligible to be appointed as an auditor of NOME Limited as all partners of BCD & Co are partner of AB & Co. who have already served two terms of five consecutive years as an auditor of NOME Limited. Since, before the appointment of Statutory Auditor, the management should have obtained the required certification and written consent from BCD & Co., therefore, in this case both, the management and the auditors have contravened the provision of the Companies Act, 2013 as a result fine as per section 147 of Companies Act will be applicable i.e. if any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees. If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty - five thousand rupees, but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less.

It may be noted that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than fifty thousand rupees, but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

QNO 294.000	Sec 139--Rotation (Ajay & Vijay) BHASKAR CNO—CA.200	Old Course – (M16R)

Answer

(a)

Part I -- Relevant Section & Laws

- Section 139(2) of the Companies Act, 2013
- Proviso to Section 139(2)

Part II -- Requirements of Relevant Section & Laws

➢ **Section 139(2) of the Companies Act 2013,**

No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint-

(a) an individual as auditor for more than one term of five consecutive years; and

(b) an audit firm as auditor for more than two terms of five consecutive years:

➢ **Proviso to Section 139(2)**

Provided further that as **on the date of appointment** no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

Part III – Case Discussion

➢ In the given case, CA. Rock is a common partner in M/s Ajay & Associates and M/s Vijay & Associates. The tenure of 10 years of M/s Ajay & Associates as an auditor has been expired in Sanjay Ltd. immediately preceding the current financial year.

Part IV – Conclusion

➢ Ajay & Associates shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term.

Therefore, M/s Vijay & Associates will also be disqualified to be appointed as auditor of Sanjay Ltd. for next 5 financial years as CA. Rock is a common partner in M/s Ajay & Associates and M/s Vijay & Associates.

(b)

Part I -- Relevant Section & Laws

▪ **As per 139(2) of the Companies Act, 2013read with the explanation given under Companies (Audit and Auditors) Rules, 2014**

Part II -- Requirements of Relevant Section & Laws

➢ **Section 139(2) of the Companies Act 2013,**

No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

(a) an individual as auditor for more than one term of five consecutive years; and

(b) an audit firm as auditor for more than two terms of five consecutive years:

➢ **Companies (Audit and Auditors) Rules, 2014**

For the purpose of rotation of auditors, if a partner, who is in-charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of 5 years.

Part III – Case Discussion

➢ In the given case, CA. Rock was in-charge of M/s Ajay & Associates and certifying authority of financial statements of Sanjay Ltd. who retires from the said firm and joins M/s Vijay & Associates. The tenure of 10 years of M/s Ajay & Associates as an auditor has been expired in Sanjay Ltd. immediately preceding the current financial year

Part IV – Conclusion

➢ The firm shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term.

Therefore, M/s Vijay & Associates will also be disqualified to be appointed as auditor of Sanjay Ltd. for next 5 financial years as newly joined partner CA. Rock has retired from M/s Ajay &Associates (who was in-charge of the audit firm and also certified the financial statements of the company) immediately preceding the current financial year whose tenure in Sanjay Ltd. has expired.

QNO 294.500	**Sec 139--Situations where reappointment is not possible** BHASKAR CNO—CA.180	**Old Course – (N20E)**
	Under which circumstances the retiring Statutory Auditor of a company cannot be reappointed?	
Answer	A retiring auditor cannot be re-appointed at an annual general meeting, if- (i) he is disqualified for re-appointment. (ii) he has given the company a notice in writing of his unwillingness to be re-appointed; and (iii) a special resolution has been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.	

QNO 295.000	Sec 140--Removal at AGM of Joint Auditor BHASKAR CNO—CA.220	Old Course – (M05E, N12E, N15R, P17M)
	M/s. PQR has been appointed the sole statutory auditor of a large company for 2014-15; where till last year M/s. LMN was also one of the joint auditors along with M/s. PQR. Mention the steps that should be taken by M/s. PQR before commencing the audit.	

Answer

Part I -- Relevant Section & Laws

- The provisions of section 140 of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Provisions of section 140 of the Companies Act, 2013,**

When one of the joint auditors of the previous year is considered ~~for ratification~~ by the members as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors.

The provisions of section 140 of the Companies Act, 2013 (hereinafter referred as the Act) relating to non-reappointment of the retiring auditor need to be considered.

As per sub-section 4 of section 140 of the Act, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139 of the Act.

Part III – Case Discussion

➢ M/s. PQR has been appointed the sole statutory auditor of a large company for 2014-15, where till last year M/s. LMN was also one of the joint auditors along with M/s. PQR.

Part IV – Conclusion

➢ The following steps should be taken care of by M/s. PQR before commencing the audit:

⩔ **Special Notice-**Ascertain that special notice under Section 140(4) of the Act was duly received by the company, from such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice, not earlier than three months but at least 14 days before the AGM date as per Section 115 of the Act read with the Companies (Management and Administration) Rules, 2014.

⩔ **Copy of Notice**- Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per Section 115 of the Act.

⩔ **Contents of Notice**-Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.

⩔ **Notice to Auditor**-Verify that the said notice is also sent to the retiring auditor as per Section 140(4) (ii) of the Act.

⩔ **Sending the representation**-Verify whether any representation received from the retiring auditor was sent to the members of the company to whom notice of the meeting was sent as per Section 140(4)(iii) of the Act.

⩔ **Representation whether considered**-Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.

⩔ Examine that proposed resolution was properly passed.

➢ **Professional Ethics**

⩔ **Clause (8)of Part I of the First Schedule to the Chartered Accountants Act, 1949,** provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant without first communicating with him in writing.

⩔ Moreover, **Clause (9) of Part I of the same Schedule**, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Sections 139 and

	140 read with section 141 of the Companies Act, 2013, in respect of such appointment have been duly complied with. M/s PQR is required to comply with all the above-mentioned provisions provided under Companies Act and Chartered Accountant Act before commencing the audit.
	Author's Note ⚠ **# Mistake point** **Why were clauses of professional ethics included in answer?** **It is important for an auditor before accepting an audit to make sure that acceptance does not amounts to misconduct. Clause (8) and Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, deals with such matter, hence students should also write such clauses as steps taken by auditor before commencing audit.**

QNO 298.000	**Sec 140--Removal by Tribunal Short Note BHASKAR CNO—CA.220**	**Old Course – (N17R, M17R, M18E, N19E, N19M,N19R,N21R)** **New Course – (M18M, M18E, N19R, N19M, S21M, N21R)**

Direction by Tribunal **in case auditor acted in a** fraudulent manner

OR

Elucidate the power of tribunal to change the auditor **of a company if found acted in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013**

OR

The Auditor of M/s Quick Limited succumbed to the pressure of the Management in Certifying the Financials with an over stated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the Auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal **in this respect including those** relating to making orders against the Auditor found to be guilty.

OR

On the advice of Management of Quick Ltd., the auditor of the Company overlooked and did not report on shifting of certain current year's sales transactions to the next year. The National Company Law Tribunal (NCLT) wants to take action against the auditor. Describe the powers of the NCLT **under Section** 140(5) **of the Companies Act, 2013 for** such action and consequences for the auditor**.**

Answer

Part I -- Relevant Section & Laws

As per section 140(5) of the Companies Act 2013.

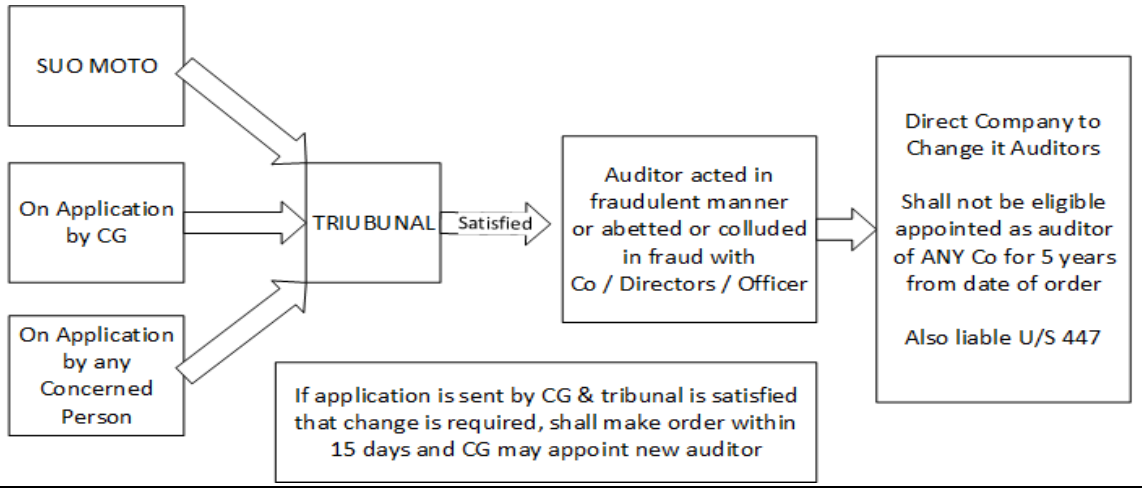
Part II -- Requirements of Relevant Section & Laws

- The Tribunal either Suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

  However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

- It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

➢ It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.



QNO 298.200	**Sec 140--Removal by Tribunal (Powers of Tribunal)** **BHASKAR CNO—CA.220**	**(M22M)**
	The Auditor of Rapid Limited succumbed to the pressure of the management in certifying the financials with an overstated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal in this respect including those relating to making orders against the Auditor found to be guilty.	
Answer	**Power of Tribunal in case Auditor acted in a Fraudulent Manner:** As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either Suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors. However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place. It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447 of the said Act. It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.	

QNO 298.700	**Sec 141--Disqualification (Buying & Selling Shares Before Appointment)** **BHASKAR CNO—CA.080**	**New Course -- (M22M)**
	Mr. Shripal, a practising Chartered Accountant, has been appointed as an auditor of Rani Ltd on 12th June 2021 for the year ended 31st March, 2022. The following persons have done following transactions in securities of Rani Ltd.: ➢ Daughter of Mr. Shripal Purchase of Securities on 10th September, 2021 of face value of ` 45,000 (market value ` 90,000). ➢ Husband of daughter of Mr. Shripal: Purchase of Securities on 10th December, 2021 of face value of `	

	90,000 (market value ` 1,90,000).  All the above securities were sold on 18th February, 2022 for ` 3,00,000. Discuss the implications of the above on the appointment of Mr. Shripal.
Answer	**Implications of relatives' securities holding on the Appointment of the Auditor:** According to Section 141(3)(d)(i) of the Companies Act, 2013, read with Rule 10, an auditor is disqualified to be appointed as an auditor if the auditor or his relative holds securities or interest in the company of face value exceeding ` 100,000.  Further the definition of relative also includes daughter and a daughter's husband. Both are covered in the definition of relative as defined by the Companies Act 2013.  Thus, the disqualifications will be applicable as the relative/s are holding securities of face value of more than ` 100,000 and market value is not important. It is also to note that in the event of acquiring any security or interest by a relative above the threshold prescribed, the corrective action to maintain the limits as specified above can be taken by the auditor within 60 days of such acquisition or interest. The same has however not been done. In the instant case, Daughter of Mr. Shripal purchased the securities on 10th September 2021 of face value of ` 45,000 and husband of daughter of Mr. Shripal purchased the securities on 10th of December, 2021 of face value of ` 90,000. Aggregating the value of holding of securities exceeds the limits mentioned in proviso to section 141(3)(d)(i) i.e., ` 1,00,000. Further, corrective action taken by Husband of Daughter of Mr. Shripal on 18th February, is also not in accordance with prescribed grace period of 60 days. Therefore, CA. Shripal will be disqualified for appointment as an auditor of Raja Ltd. as per section 141(3)(d)(i) and he shall vacate his office.

QNO 299.100	**Sec 141--Disqualification (Business relationship and its exemption)** **BHASKAR CNO—CA.080**	**New Course – (M19E)**
	PQ & Co. is an audit firm with P and Q as partners. For the financial year 2018-19, the firm has been appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. The audit firm is a regular customer Of the hotel and the partners usually stay in the same hotel at various locations in the course of travelling for their various professional assignments. Normally, payments for such stay are settled against quarterly bills raised by the company. Give your comment with respect to the Companies Act, 2013.	
Answer	**Part I -- Relevant Section & Laws** ▪ As per section 141(3)of the Companies Act, 2013 ▪ As per section 141(4) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Indebtedness to the Company:** ⩛ **According to the section 141(3) (d) of the Companies Act, 2013.** • a person who is indebted to the company for an amount exceeding ` 5,00,000 shall be disqualified to act as an auditor of such company and • Under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment. • However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment. ⩛ **Business Relationship as per section 141(3) (e) of the Companies Act, 2013.** Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company.	

- For the purpose of clause (e) of sub-section (3) of section 141,
  But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

Part III—Case Discussion

- In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company.

Part IV -- Conclusion

- Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii),
  - However In the absence of the above assumption the auditor
    - shall be disqualified to act as an auditor and
    - Shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.
- Since in term of section 141(3) (e) of Companies Act, 2013,PQ & Co. is not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

Author's Note:

- Auditor hasbusiness relationship with client and it is in ordinary course of business but such relationship is allowed only in some industries (**H2AT** - telecommunications, airlines, hospitals, hotels and such other similar businesses). Answer of ICAI is not highlighting the fact that it is allowed but only in some industries. So student write full Rule 10 as given below.
- **Rule 10**
  For the purpose of clause (e) of sub-section (3) of section 141, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, **except –**
  (ii) commercial transactions which are in the ordinary course of business of the company at arm's length price -like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

QNO 300.000	**Sec 141--Disqualification Celling Limit (ABC & Co)** **BHASKAR CNO—CA.080**	**Old Course – (N14R, M16R, P17M,M18M,N19R,M21E,M21M)** **New Course – (S17M,N18M, N19R, M21M)**

MSY & Co. is an Audit Firm having partners CA Mukti, CA Shakti and CA Yukti. CA Mukti, CA Shakti and CA Yukti are holding appointment as an Auditor in 4, 6 and 10 companies respectively.

(i) Provide the maximum number of audits remaining in the name of MSY & Co.

(ii) Provide the maximum number of audits remaining in the name of individual partner i.e. CA Mukti, CA Shakti, CA Yukti.

(iii) Can MSY & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the of the Companies Act with the Registrar, 2 small companies and 1 dormant company?

(iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ` 110 crore each?

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(g) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- A person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small

companies and private companies having paid-up share capital less than ` 100 crore private company (which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

- As per section 141(3) (g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits.
  Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Part III – Case Discussion

- In the given case, CA Mukti is holding appointment in 4 companies, whereas CA Shakti is having appointment in 6 Companies and CA Yukti is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Part IV – Conclusion { Part(i) & (ii) }

(i) Therefore, MSY & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm = 20*3 = 60
Number of Audits already taken by all the partners in their individual capacity = 4+6+10 = 20
Remaining number of Audits available to the Firm = 40

(ii) Maximum number of audits remaining in the name of individual partner

With reference to above provisions,
An auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) already holding appointments as an auditor.
Hence

(a) CA Mukti can hold: 20 - 4 = 16 more audits.
(b) CA Shakti can hold 20-6 = 14 more audits and
(c) CA Yukti can hold 20-10 = 10 more audits.

Part (iii)

Part III – Case Discussion

- MSY & Co. wants to accept the appointment as an auditor in :
  - 60 private companies having paid-up share capital less than ` 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the of the Companies Act with the Registrar,
  - 2 small companies and
  - dormant company

Part IV – Conclusion

- In view of above discussed provisions MSY & Co. can hold appointment as an auditor in
  - all the 60 private companies having paid-up share capital less than ` 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar),
  - 2 small companies and
  - 1 dormant company

as these are excluded from the ceiling limit of company audits given under section 141(3) (g) of the Companies Act, 2013.

Part (iv)

Part III – Case Discussion

- As per fact of the case, MSY & Co. is already having 20 company audits and they can also accept 40 more company audits.
  In addition, they can also conduct the audit of
  - one person companies, small companies, dormant companies and
  - private companies having paid up share capital less than rupees 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

In the given case, out of the 60 private companies, MSY & Co. is offered 45 companies having paid-up share capital of ` 110 crore each.

Part IV – Conclusion

- Therefore, MSY & Co. can also accept the appointment as an auditor for: -
  - 2 small companies, 1 dormant company,
  - 15 private companies having paid-up share capital less than ` 100 crore(private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.".) and
  - 40 private companies having paid-up share capital of ` 110 crore each in addition to above 20 company audits already holding.

QNO 300.200	Sec 141-- Disqualification Celling Limit (ABC &Co ,Private Company Focused) BHASKAR CNO—CA.800	New Course – (M18E)

M/s ABC and Co., a firm of Chartered Accountants, comprising of three partners A, B, and C are Statutory Auditors of 50 Companies as per details given below :
(i) Small Companies-10
(ii) Private Companies having paid up share capital of less than? 100 Crores-20
(iii) Private Companies having paid up share capital of more than? 100 Crores- 15
(iv) Public Companies- 5

Mr. A signs the Balance Sheet of 10 Small Companies and 10 Private Companies having paid up share capital of less than 100 Crores.

Mr. B signs the Balance Sheet of 10 Private Companies having paid up share capital of less than 100 Crores and 5 Private Companies having paid up share capital of more than 100 Crores.
Mr. C signs the Balance Sheet of 10 Private Companies having paid up share capital of more than 100 crores and 5 Public Companies.

What is the maximum number of audits that the firm as a whole can accept and what is the maximum number of audits each individual partner can accept?

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(g) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- A person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100 crore.

  As per section 141(3) (g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits.

- Some- times, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Therefore, maximum number of audits that the firm M/s ABC & Co. as a whole can accept is 60 and maximum number of audits each individual partner can accept is 20 i.e. other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100crore.

Part III – Case Discussion

- In this case
  - CA A is holding appointment in 20 companies i.e.10 small companies and 10 private companies having paid up share capital of less than ` 100 crore, whereas
  - CA B is having appointment in 15 Companies i.e. 10 private companies having paid up share capital of less than ` 100 crore and 5 private companies having paid up share capital of more than ` 100 crore and
  - CA C is having appointment in 5 public companies and 10 private companies having paid up share capital of more than ` 100 crore. In aggregate, all three partners are having 50 audits.

  As per section 141 (3) (g), applying the above provisions, an auditor can accept more appointments as auditor = ceiling limit as per section 141(3) (g) - already holding appointments as an auditor.

Part IV – Conclusion

- Hence
  - CA A can accept: 20 more audits.
  - CA B can accept 20-5 = 15 more audits and
  - CA C can accept 20-15 = 5more audits

  In addition, they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than `100crores.

- M/s ABC &Co. is already having20 company audits and theycan also accept 40 more company audits.

  As per section 141(3)(g) of the Companies Act, 2013, M/s ABC & Co. can accept appointment as an auditor of 40 more companies as under:
  Total Number of Audits available to the Firm=20*3=60
  Number of Audits already taken by all the partners in their individual capacity =0+5+15=20
  Remaining number of Audits available to the Firm =40

QNO 301.000	Sec 141--Disqualification Ceiling Limit (36 Public Co) BHASKAR CNO—CA.080	Old Course – (M16E)

KSY & Co. Chartered Accountants is an audit firm having two partners CA K and CA Y. KSY & Co. is already holding appointment as auditors of 36 public companies.

KSY & Co. seeks your advice in the following situations:

(i) KSY & Co. has been offered the appointment as Auditors of 7 more Private Limited Companies. Of the seven, one is a company with a paid up share capital of ` 150 crores, five are "Small companies" as per the Act and one is a "Dormant Company".

(ii) Would your answer be different, if out of those 7 Private Companies, 3 Companies have paid up capital of ` 90 crores each?

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(g) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- A person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than 100 crore.

Part (i)

Part III – Case Discussion

- In the instant case, KSY & Co. is an audit firm having two partners, namely, CA. K and CA. Y. The total number of company audits that can be accepted by the firm is 40 (2 partners x 20 companies each partner).
  However, the firm is already holding appointment as auditors of 36 public companies. Thus, the remaining number of audits that can be accepted by the firm is of 4 more companies.

  KSY & Co. has been offered appointment as auditors of 7 private limited companies out of which 1 is a private limited company with paid-up share capital of ` 150 crores, 5 are 'small companies' and 1 is 'dormant company'.

Part IV – Conclusion

- In view of above discussed provisions and explanations, KSY & Co. can hold appointment as an auditor in 5 'small companies' and 1 'dormant company' as these are excluded from the ceiling limit of company audits.
  In addition, the firm can also accept appointment as auditor of 1 private limited company with paid-up share capital of ` 150 crores which will be within the maximum ceiling limit of 40 company audits.
  Therefore, KSY & Co. can accept appointment for all the 7 private limited companies as asked in question.

	Part (ii) **Part III – Case Discussion** ➢ KSY & Co. has been offered appointment as auditors of 7 private limited companies out of which 3 companies have paid-up share capital of ` 90 crores. **Part IV – Conclusion** ➢ **No, answer will not be different in the given situation.** In view of above discussed provisions and explanations, where KSY & Co. can hold appointment as an auditor in all the private companies as 3 private companies are having paid-up share capital of ` 90 crores which are exempted as per the provisions of the Companies Act, 2013.Therefore, excluded from the ceiling limit of company audits and other 4 private companies will also be within the maximum ceiling limit of 40 company audits even if the paid-up share capital is ` 100 crore or more. *[**Note:** The answer has been given assuming none of the partners holds any company audits in their personal capacity or as partners with another firm.]*

QNO 302.000	**Sec 141--Disqualification Indebtedness Loan Squared Up** **BHASKAR CNO—CA.080**	**Old Course – (N15R, N16E, P17M, M18M)**
	CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of ` 6,00,000 as on 01.04.2015. However, CA Adroit having come to know that he might be appointed as auditor of the company, he squared up the amount on 10.7.2015. Later on, he was appointed as an auditor of the company for the year ended 31.3.2016 at the Annual General Meeting held on 16.07.2015. **Subsequently, one of the shareholders complains that the appointment of CA Adroit as an auditor is invalid because he incurred disqualification under section 141 of the Companies Act, 2013. Comment.**	
Answer	**Part I -- Relevant Section & Laws** Section 141(3)(d)(ii) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ A person who is indebted to the company for an amount exceeding ` 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment. However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment. **Part III – Case Discussion** ➢ In the given case, CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of ` 6,00,000 as on 01.04.2015. He was appointed as an auditor of the company for the year ended 31.03.2016 at the Annual General Meeting held on 16.07.2015. He also repaid the loan amount fully to the company on 10.7.2015 i.e. before the date of his appointment. **Part IV – Conclusion** ➢ Hence, the appointment of CA Adroit as an auditor is valid and the shareholder's Complaint is not acceptable**.**	

QNO 303.000	**Sec 141--Disqualification Indebtedness Car Finance** **BHASKAR CNO—CA.080**	**Old Course – (N14R, N16R, P17M,)** **New Course-- (S17M, S21M)**
	As an auditor, how would you deal with the following situations: **Mr. Amar, a Chartered Accountant, bought a car financed at ` 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be even after taking the loan**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(d)(ii) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ A person is not eligible for appointment as auditor of any company, if he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh. **Part III – Case Discussion** ➢ Mr. Amar, a Chartered Accountant, bought a car financed at ` 7,00,000 by Chaudhary Finance Ltd.,	

	which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be even after taking the loan
	Part IV – Conclusion
	➢ In the given case Mr. Amar is disqualified to act as an auditor of Das Ltd under section 141(3)(d)(ii) as he is indebted to M/s Chaudhary Finance Ltd. (holding of Das Ltd) for more than ` 5,00,000. Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd should appoint another auditor for the company.

QNO 304.000	**Sec 141--Disqualification Indebtedness Computers Bought on Credit** **BHASKAR CNO—CA.080**	**Old Course – (N12E, P17M)**
	Mr. E, proprietor of M/s. E & Co. is the statutory auditor of a Company which owns a store dealing in computer equipments. During the year 2014-15, E purchased a computer from the store costing ` 25,000 for his son. He did not make any payment for the same, but asked the company to adjust the same against the audit fees payable of ` 50,000	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(d)(ii) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ A person is not eligible for appointment as auditor of any company, If he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh. **Part III – Case Discussion** ➢ In the instant case, Mr. E, Proprietor of M/s E & Co. is the statutory auditor of a company which owns a store dealing in computer equipment's, purchased a computer from the store and adjusted the payment for the same against his audit fee. **Part IV – Conclusion** ➢ Therefore, the contention of Mr. E that he does not incur disqualification is correct as he has purchased a computer of the value of ` 25,000 which is not exceeding the prescribed limit of 5,00,000. Thus, Mr. E will not be held liable for guilty of contravention.	
	Author's Note: **Further computer us bought for son so it is not for business purpose. So no business relationship.** **Point is auditor has receivable of audit fees and payable of computer price, so we have to consider gross amount payable by auditor or net amount payable, answer is net amount payable. Which is this case is definitely less than 5,00,000.** **Final conclusion** **Not a business relationship** **We have to see net amount payable by auditor** **If net amount at any point of time exceeds 5,00,000 then disqualified**	

QNO 306.000	**Sec 141--Disqualification Indebtedness of Relative** **BHASKAR CNO—CA.080**	**Old Course – (M15R, P17M)**
	Navy and Cavy Associates, a Chartered Accountant firm, has been appointed as Statutory Auditor of Poor Ltd. for the financial year 2014-2015. Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, is indebted for ` 6,00,000 to Wealthy Ltd., a subsidiary company of Poor Ltd. Comment.	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141 (3)(d)(ii) of the Companies Act, 2013 ▪ Section 141 (4) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 141 (3)(d)(ii) of the Companies Act, 2013** A person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is indebted to the company, or its subsidiary, or it's holding or associate company or a subsidiary of such holding company, in excess of ` 5 lakhs.	

	➢ **Section 141 (4) of the Companies Act, 2013** Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor. **Part III – Case Discussion** ➢ In the present case, Mr. Savvy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd., a subsidiary company of Poor Ltd., for ` 6 lakhs. **Part IV – Conclusion** ➢ Therefore, the firm, Navy and Cavy Associates would be disqualified to be appointed as statutory auditor of Poor Ltd. as per section 141(3) (d) (ii), which is the holding company of Wealthy Ltd., because Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd. for an amount exceeding the minimum approved limit.

QNO 308.000	**Sec 141--Disqualification Partner is an Employee** **BHASKAR CNO—CA.080**	**New Course – (S17M)**
	Mr. A, a chartered accountant has been appointed as auditor of Laxman Ltd. In the Annual General Meeting of the company held in September 2013, which assignment he accepted. Subsequently in January 2014 he joined B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(c) of the Companies Act, 2013 ▪ Section 141 (4) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 141(3) (c) of the Companies Act, 2013** , prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. ➢ **Section 141 (4) of the Companies Act, 2013** An auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor. **Part III – Case Discussion** ➢ In the present case, A, an auditor of M/s Laxman Ltd., joined as partner with B, who is Manager Finance of M/s Laxman Limited. **Part IV – Conclusion** ➢ Section 141 (3) (c) of the Companies act has been attracted and, therefore, he shall be deemed to have vacated office of the auditor of M/s Laxman Limited.	

QNO 309.000	**Sec 141--Disqualification Prohibited Services (Actuarial& Investment Advisory)** **BHASKAR CNO—CA.080**	**Old Course – (N14R, M15R, M16M, N16R, P17M, N17M, N18M, N19M)** **New Course – (S17M, M18R, N19M, S21M)**
	C Ltd. appointed CA Innocent as a statutory auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking.	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(i) of the Companies Act, 2013 and ▪ Section 144 of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 144 of the Companies Act, 2013** It prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely: **(BAD-MAFIA)** ⩔ Investment **B**anking services; ⩔ Investment **A**dvisory services; ⩔ **D**esign and implementation of any financial information system;	

- Management services;
- Actuarial services;
- Rendering of outsourced Financial services;
- Internal audit
- Accounting and book keeping services; and
- Any other kind of services as may be prescribed.

➢ **Section 141(3)(i) of the Companies Act, 2013**
A person is disqualified for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Part III – Case Discussion

➢ In the given case, CA Innocent was appointed as an auditor of C Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.

Part IV – Conclusion

➢ The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

Author's Note

B- Investment Banking services; / A- Investment Advisory services/ D- Design and implementation of any financial information system/ M- Management services / A- Actuarial services/ F- Rendering of outsourced Financial services/ I-Internal audit / A- Accounting and book keeping services; and

QNO 310.000	Sec 141--Disqualification Prohibited Services (Designing & Implementing FIS) BHASKAR CNO—CA.080	New Course – (S17M)

CA. P is providing the services of Design and implementation of any financial information system to C Ltd. Later on, he was also offered to be appointed as an auditor of the company for the current financial year. Advise

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(i) of the Companies Act, 2013 and
- Section 144 of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Section 141(3)(i) of the Companies Act, 2013**
A person is disqualified for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

➢ **Section 144 of the Companies Act, 2013**
Certain services not to be rendered by the auditor which includes investment banking services.

Part III – Case Discussion

➢ In the above case, CA. P is providing the services of Design and implementation of any financial information system to C Ltd.Later on, he was also offered to be appointed as an auditor of the company for the current financial year.

Part IV – Conclusion

➢ Therefore, CA. P is advised not to accept the assignment of auditing as the service he is rendering is specifically notified in the list of services not to be rendered by him as per section 141(3) (i) read with section 144 of the Companies Act, 2013.

QNO 311.100	Sec 141--Disqualification Relative of Director BHASKAR CNO—CA.080	Old Course – (N10E, N12M, P17M) New Course -- (S17M)

Mrs X is a Director of ABC Pvt Ltd During the year 2015-16, the company appointed CA Mr Y, Mrs X's spouse, as its statutory auditor Mr Y used to deliver audit report without any comments or disclosures, thereupon. Comment

OR

Mr. Ram, a relative of a Director was appointed as an auditor of the company. Comment

OR

Mrs X is a Director of ABC Pvt Ltd. During the year 2015-16, the company appointed CA Mr Y, Mrs X's

	spouse, as its statutory auditor Mr Y used to deliver audit report without any comments or disclosures, thereupon Comment.
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(f) of the Companies Act 2013 ▪ Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 141(3)(f) of the Companies Act 2013** As per Section 141(3)(f) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a director or is in the employment of the company as director or key managerial personnel. The definition of 'Relative' includes husband and wife. ➢ **Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949** A member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013, in respect of such appointment have been duly complied with. **Part III – Case Discussion** ➢ In this case Mrs. X is a Director of ABC Pvt. Ltd. and the company has appointed Mr. Y, Chartered Accountant, Mrs. X's spouse, as its statutory auditor. Mr. Y should not accept the appointment as statutory auditor of the company, where his wife Mrs. X is a director. This is contravention of section 141 of the Companies Act, 2013. **Part IV – Conclusion** ➢ Therefore, Mr. Y is liable for misconduct under the said clause since he accepted the appointment without first verifying the compliance of statutory requirements.
	Author's Note **Answer provided by institute also includes reference to clause 9 of the First Schedule to the Chartered Accountants Act, 1949, however question does not requires to do so. Student should quote it only when specifically required.**

QNO 312.000	**Sec 141--Disqualification Securities CA Holding Shares** **BHASKAR CNO—CA.080**	**Old Course – (P17M, N18R)** **New Course – (S17M, S21M)**
	"Mr. A", a practicing Chartered Accountant, is holding securities of "XYZ Ltd." having face value of ` 900/- Whether Mr. A is qualified for appointment as an Auditor of "XYZ Ltd."? **OR** **Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2014-2015. Mr. Hanuman, a partner of the Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(d)(i) of the Companies Act 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ A person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. **Part III – Case Discussion** ➢ In the present case, Mr. A. is holding security of ` 900 in the XYZ Ltd, **Part IV – Conclusion** ➢ Therefore, he is not eligible for appointment as an auditor of "XYZ Ltd".	
	Author's Note. **Case two -Conclusion** Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd. as per section 141(3)(d)(i), which is the holding company of Shiva Ltd., because Mr. Hanuman one of the partner is holding equity shares of its subsidiary.	

QNO 313.000	Sec 141—Disqualification-Relative holding Securities at Face Value BHASKAR CNO—CA.080	Old Course – (N14R, M15R, M15E, N16R, P17M, M17R, M17M) New Course -- (S17M)

Dabloo Ltd. offered appointment as its auditor to Mr. Bee, a practicing Chartered Accountant. Later on, Mr. Dee, the stepbrother of Mr. Bee, purchased securities of the company having face value of Rs. 4,99,000. Comment, whether Mr. Bee may accept the offer of appointment as an auditor?

OR

Mr. XXX, a practicing Chartered Accountant, has been offered for appointment as an auditor of Z Ltd., a leading company. Later on, Mr. YYY, the stepbrother of Mr. XXX, purchased securities of the company having face value of ` 89,000. Comment, whether Mr. XXX may accept the offer of appointment as an auditor?

OR

Mr Pratiq, a practicing Chartered Accountant, has been appointed as an auditor of Opus Ltd He is holding securities of the company having face value of Rs 89,000 only
(i) You are required to state, whether Mr Pratiq is qualified to be appointed as an auditor of Opus Ltd
(ii) Would your answer be different, if instead of Mr Pratiq; Mr Quresh, the stepfather of Mr Pratiq, is holding the securities?

OR

"M/s BC & Co." is an Audit Firm having partners "Mr. B" and "Mr. C", and "Mr. A" the relative of "Mr. C", is holding securities of "MWF Ltd." having face value of ` 1,01,000/-. Whether "M/s BC & Co." is qualified from being appointed as an auditor of "MWF Ltd."?

OR

"Mr. P" is a practicing Chartered Accountant and "Mr. Q", the relative of "Mr. P", is holding securities of "ABC Ltd." having face value of ` 90,000/-. Whether "Mr. P" is Qualified from being appointed as an auditor of "ABC Ltd."? (S17M)

OR

R and M is an audit firm having partners CA. R, CA. M and CA. G. Mr. S is the relative of CA. R holding shares of STP Ltd. having a face value of ` 1,51,000. Whether CA. R and CA. M are qualified to be appointed as auditors of STP Ltd.?

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(d)(i) of the Companies Act, 2013
- Proviso to section 141(3)(d)(i) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Section 141(3) (d) (i) of the Companies Act, 2013.**
A person is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

➢ **Proviso to section 141(3)(d)(i) of the Companies Act, 2013**
However, as per the proviso to this section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of Rs. 1,00,000.
Further, the term "relative" as defined under the Companies Act, 2013 includes step- brother.

Part III – Case Discussion

➢ In the present situation, Mr. Dee, the step-brother(included in the definition of the term "relative" as per the Companies Act, 2013) of Mr. Bee, is holding the securities having face value of Rs. 4,99,000 in Dabloo Ltd.

Part IV – Conclusion

➢ Thus, holding of securities in Dabloo Ltd. by Mr. Dee having face value exceeding Rs. 1,00,000, will disqualify Mr. Bee from being appointed as an auditor of Dabloo Ltd.
Therefore, Mr. Bee may not accept the offer of appointment as an auditor of Dabloo Ltd.

Author's Note

Case two
Mr. XXX can accept the offer of appointment as an auditor of Z Ltd. as shares held by stepbrother (relative) are below the limit of 1,00,000 (face value)

Case three

(i) **Pratiq is holding securities in Opus Ltd., which is not allowed as per the provisions of section 141(3) (d) (i) of the Act.**
Therefore, Mr. Pratiq will be disqualified to be appointed as an auditor of Opus Ltd.

(ii) **Pratiq can accept the appointment as an auditor of *Opus Ltd*.as shares held by step father (relative) are below the limit of 1,00,000 (face value)**

Case four

M/s BC & Co, will be disqualified for appointment as an auditor of MWF Ltd as the relative of Mr. C (i.e. partner of M/s BC & Co.), is holding the security in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

Case five

Mr. P can accept the offer of appointment as an auditor of ABC ltd as shares held by Mr Q (relative) are below the limit of 1,00,000 (face value)

Case Six

R and M, audit firm along with its partners CA. R, CA. M and CA. G will be disqualified for appointment as an auditor as the relative of CA. R is holding the securities in STP Ltd. which is exceeding the limit mentioned in proviso to section 141(3) (d)(i).

QNO 319.000	Sec 141--Disqualification -Securities- Relative of CA R holding Shares- Reference to market value BHASKAR CNO—CA.080	Old Course – (M16M, M18M, M19E) New Course -- (S17M)

Mr. Y, a practicing Chartered Accountant, has been appointed as an auditor of M/s Z Ltd on 12th June, 2018 for the year ended 31st March, 2019. The following persons have done following transactions in securities of M/s Z Ltd.:

- **Daughter of Mr. Y: Purchase of Securities on 10th September, 2018 of face value of ` 45,000 (market value ` 90,000)**
- **Husband of daughter of Mr. Y: Purchase of Securities on 10th December, 2018 of face value of ` 90,000 (market value ` 1,90,000).**

All the above securities were sold on 10th March, 2019 for ` 3,00,000. Discuss the implications of the above on the appointment of Mr. Y.

OR

M/s RM & Co. is an audit firm having partners CA. R and CA. M. The firm has been offered the appointment as an auditor of Enn Ltd. for the Financial Year 2017-18.

Mr. Bee, the relative of CA. R, is holding 5,000 shares (face value of Rs. 10 each) in Enn Ltd. having market value of rupees 1,50,000. Whether M/s RM & Co. is disqualified to be appointed as auditors of Enn Ltd

Answer

Part I -- Relevant Section & Laws

- As per section 141(3)(d)(i) of the Companies Act, 2013
- **Rule 10 of Companies (Audit and Auditors) Rules, 2014**

Part II -- Requirements of Relevant Section & Laws

➢ **According to Section 141(3)(d)(i) of the Companies Act, 2013 ,**

A person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

➢ **Rule 10 of Companies (Audit and Auditors) Rules, 2014**

⩔ However, as per proviso to this section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of Rs. 1,00,000.

➢ **Corrective Action**

It is also to note that in the event of acquiring any security or interest by a relative above the threshold prescribed, the corrective action to maintain the limits as specified above can be taken by the auditor within 60 days of such acquisition or interest.

➢ **Relative**

Further the definition of relative also includes daughter and a daughter's husband. Both are covered in the definition of relative as defined by the Companies Act 2013.

Part III – Case Discussion

➢ **In the instant case, Daughter of Mr. Y purchased the securities on 10th September 2018 of face value of rupees 45,000 and husband of daughter of Mr. Y purchased the securities on 10th of December, 2018 of face value of rupees 90,000. Aggregating the value of holding of securities exceeds the limits mentioned in proviso to section 141(3) (d) (i) i.e. rupees 1,00,000.**

Part IV – Conclusion

➢ **Thus, the disqualifications will be applicable**

- **As the relative/s are holding securities of face value of more than ` 100,000 and market value is not important.**
- **Further, corrective action taken by Husband of Daughter of Mr. Y on 10th March, is also not in accordance with prescribed grace period of 60 days.**

➢ **Therefore, CA. Y will be disqualified for appointment as an auditor of M/s. Z Ltd. as per section 141(3)(d)(i) and he shall vacate his office**

Case (ii)

Part III – Case Discussion

➢ In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M.
Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of Rs. 50,000 only (5,000 shares x Rs. 10 per share).

Part IV – Conclusion

Therefore, M/s RM & Co. is not disqualified for appointment as an auditors of Enn Ltd. as the relative of CA. R is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013

QNO 319.010	**Sec 141--Disqualification Securities Sale from date of Appointment** BHASKAR CNO—CA.080	**Old Course – (N18E)**

Comment on the validity of the appointment of Mr. A as an auditor of ABC Ltd. in the following situations

(i) Mr. B, a partner of Mr. A held shares of face value of Rs 1,00,000 in DEF Ltd., the holding company of., ABC Ltd. Mr. B has sold the securities after a period of 45 days from the date of appointment of Mr. A as an auditor of ABC Ltd.

Answer

Part I -- Relevant Section & Laws

- Section 141(3)(d)(i) of the Companies Act, 2013
- Rule 10 of the Companies (Audit and Auditors) rule 2014

Part II -- Requirements of Relevant Section & Laws

➢ **Section 141(3) – Disqualification Holding Shares**

According to section 141(3) (d)(i) of the companies act 2013, a person is disqualified to be appointed as auditor of the company if he or his relative or partner holds securities in the company or its holding company or subsidiary company, associate company or the subsidiary of the holding company.

➢ **Exemption to Relatives**

Rule 10 of the Companies (Audit and Auditors) rule 2014 permits relative alone to hold shares in the company up to 1 Lakh. It also provides a time limit of 60 days to correct the situation where disqualification would otherwise incur from date of acquisition

Case Discussion & Conclusion

➢ As such when a partner holds securities in holding company of the company in which Mr. A is to be appointed as auditor, there is disqualification for Mr. A to be appointed as auditor. Subsequent disposal is of no relevance.

QNO 319.020	Sec 141--Disqualification Guarantee Given BHASKAR CNO—CA.080	Old Course – (N18E)
	Comment on the validity of the appointment of Mr. A as an auditor of ABC Ltd. in the following situations: **Mrs. A, wife of Mr. A had given a financial guarantee for the principal amount of a debt owed by Mr. X to ABC Ltd. for Rs 6 lakhs. Mr. X has repaid Rs 5 lakhs to ABC Ltd. 2 days before the date of appointment of Mr. A as an auditor of the company**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 141(3)(d)(i) of the Companies Act, 2013 ▪ Rule 10 of the Companies (Audit and Auditors) rule 2014 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 141(3) – Disqualification for giving guarantee** Section 141 (3) (d) (iii) of the Companies Act 2013 provides that a person is disqualified to be appointed as auditor of the company if he or his relative or partner has given guarantee or provided security for any 3rd person for his indebtedness with the company, its holding company, its subsidiary, associate company or subsidiary of its holding company for an amount the limit prescribed. ➢ **Rule 10 of the Companies (Audit and Auditors) Rule 2014 -** It prescribes a limit of amount that exceeds Rs 1 Lakh. As such, any guarantee or provision of security for an amount exceeding 1 Lakh will render a person to be disqualified ➢ **Case Discussion & Conclusion** In the present case, at the time of appointment, the guarantee subsists only for the remaining Rs 1 Lakh as Rs 5 lakhs out of Rs 6 Lakhs has been already discharged, no disqualification is attracted.	

QNO 323.100	Sec 143--Rights of Auditor to Access Books & Vouchers BHASKAR CNO—CA.280	New Course – (S17M)
	While conducting the audit of a limited company for the year ended 31st March, 2014, the Auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 143 of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ Section 143 of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit. In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. **Part III – Case Discussion** ➢ While conducting the audit of a limited company for the year ended 31st March, 2014, the Auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor. **Part IV – Conclusion** ➢ It is, therefore, essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company. In case the directors have refused to produce the Minute Books, the auditor may consider extending the audit procedure as also consider qualifying his report in any appropriate manner	

QNO 324.000	Sec 143--Inquiry Multiple Cases BHASKAR CNO—CA.300	Old Course – (N10E, M15R, P17M) New Course – (N19E)
	While doing the audit, X, the Statutory Auditor of ABC Ltd. observes that certain loans and advances were made without proper securities, certain trade receivables and trade payables were adjusted inter	

	se, and personal expenses were charged to revenue. Comment
Answer	**Part I -- Relevant Section & Laws** ▪ Section 143(1) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 143(1) of the Companies Act, 2013** It requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein. ➢ **Section 143(1), Clause (a) requires the auditor to inquire:** "Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members". If the auditor finds that the loans and advances have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of Part I of Schedule III to the Companies Act. Further the auditor to inquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report. ➢ **Section 143(1),Clause (b), requires the auditor should enquire:** "Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company". If trade receivables and trade payables are adjusted inter se, this amounts to merely book entries. This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards". ➢ **Section 143(1), Clause (e) requires the auditor to inquire:** "Whether personal expenses have been charged to revenue account". The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also. **Part III – Case Discussion** ➢ In the instant case, X, the Statutory Auditor of ABC Ltd. observes that certain loans and advances were made without proper securities, certain trade receivables and trade payables were adjusted inter se, and personal expenses were charged to revenue. **Part IV – Conclusion** ➢ Therefore, Mr. X, the statutory auditor of ABC Ltd., needs to enquire in light of above provisions, as a result of the enquiries if he is satisfied then there is no further duty to report on these matters.

QNO 326.000	Sec 143--Inquiry Personal Expenses Foreign Trip of Director BHASKAR CNO—CA.300	Old Course – (M11E, M14R, P17M) New Course-- (S17M)
	Director of T Ltd. draws an advance of US$ 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. T Ltd. books the entire expenses on the basis of such declaration. As the auditor of T Ltd. how do you deal with this?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 500 "Audit Evidence" ▪ Section 143(1) (e) the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** ➢ **SA 500 "Audit Evidence"** It states that an auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base his option. ➢ **Section 143(1)(e) the Companies Act, 2013** It requires an auditor to enquire whether personal expenses have been charged to revenue account. **Part III – Case Discussion** ➢ Director of T Ltd. draws an advance of US$ 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. T Ltd. books the entire expenses on the basis of such declaration **Part IV – Conclusion** ➢ In the context of the facts of case, ascertain whether the payment made by the company for the foreign trip form an "allowance" or "reimbursement". An allowance is a fixed sum of money allowed or the basis of specified criteria. No evidence supporting the expenditure is required for payment of allowance to the director. On the other hand, if the payment is reimbursement should be against actual expenditure. The director concerned should provide proof of expenditure. ➢ Since the director has given only a declaration, the auditor should ascertain other relevant facts as to whether the advance paid is pursuant to the policy of the company which is based on approximate estimation of the expenditure normally incurred by a person of the status of a director and the same is applicable to persons of a similar status within the company. If the auditor considers the advance taken is reasonable then the declaration can be considered adequate, otherwise he may have to call for additional documentary evidences.	

QNO 327.000	Sec 143--Inquiry Personal Reimbursement to Director BHASKAR CNO—CA.300	Old Course – (M07E, P17M, N20E)
	In the audit of ABC Private Limited, auditor came across cases of payments to Directors, whereby, expenses of a personal nature were reimbursed. As an auditor, how would you deal with the same?	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 143(1)(e) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ All payments to Directors as remuneration or perquisites whether in the case of a public or private company are required to be authorized both in accordance with the Companies Act and Articles of Association of the company? Articles may provide that such remuneration require sanction of the shareholders either by ordinary or special resolution while in some cases it may require only approval of Directors. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company; otherwise, no such expense can be incurred or reimbursed by the company. **Part III – Case Discussion** ➢ In the audit of ABC Private Limited, auditor came across cases of payments to Directors, whereby, expenses of a personal nature were reimbursed.	

Part IV – Conclusion

- In the instant case the auditor has to ensure that the above is complied with, without which, if such expenses are paid, he has to disclose the fact in his report, as also in the accounts.

  In this regard attention is invited to section 143(1) (e) of the Companies Act, 2013 wherein auditor has to inquire into whether personal expenses have been charged to revenue.

QNO 327.500	Sec 143-- Inquiry Multiple Case Studies BHASKAR CNO—CA.300	Old Course – (M21M) New Course – (M21M)

Mr. Raj, the engagement partner of R.O.K. & Co., in connection with statutory audit of Waria Ltd., had assigned the responsibility of enquiring into propriety matters of the Company as required by section 143(1) of the Companies Act, 2013, to Mr. Samay, an engagement team member. Mr. Samay while making such enquiries, was having following queries, as tabulated below, which he ought to get resolved from Mr. Raj, as follows:- Sr. No. Query of Mr. Samay

1 What documents to be seen in case of loan given by the company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?

2 What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?

3 Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of section 143(1) of the Companies Act, 2013?

Assuming that you are Mr. Raj the engagement partner, please provide answer to the queries of Mr. Samay?

Answer

Sr.No.	Query of Mr. Samay	Response to Query
1	What documents to be seen in case of loan given by the company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?	Mr. Samay should see deed of Hypothecation or other document creating the charge, together with a statement of stocks held at the balance sheet date in order.
2	What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?	For Debentures sold: Where the cost of debentures sold is not ascertainable, the book value thereof at the date of sale may be treated as the cost for the purposes of this clause. For Bonus Shares sold: When bonus shares are received, the number of shares in the portfolio would be increased by the bonus shares while the cost of the total portfolio would remain the same as before. The result would be that the average cost per unit of the total holding would come down proportionately. The usual accounting practice for apportioning the cost of a part of the total holding on the sale thereof is to take it at **its average cost.**
3	Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of	The law on the subject has hitherto been that, where the consideration for the issue of shares is an adjustment against a bona fide debt payable in money on

		section 143(1) of the Companies Act, 2013?	demand by the company, **the shares are deemed to have been subscribed in cash** (vide the decision in Spargo's Case – 1873, 8, Ch. A. 407). According to the legal opinion obtained by the ICAI, the expression "shares allotted for cash" may also include shares allotted against a debt. Therefore, in cases which are covered by the decision in Spargo's case, no comment is required by the auditor, even though the company may have in the Return of Allotment under Section 75, shown such shares as allotted against adjustment of a debt. Thus, the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash.

QNO 332.100	**Sec 143-- EMP having adverse effect on functioning of company** **UNIQUE**	**Old Course – (M18E)**
	Give examples of Emphasis of Matters which may have an adverse effect on the functioning of the company as well as those which may not affect the functioning of the company. ?	
Answer	**Examples of Emphasis of Matters which may have an Adverse Effect on the Functioning of the Company:**	
	➢ A **major Catastrophe** that has had, or continues to have, a significant effect on the entity's financial position.	*(E.g. Natural calamity)*
	➢ The Going concern assumption is appropriate but there are several factors leading to a **material uncertainty** that may cast a significant **doubt about the Company's ability to continue as a going concern: or**	(*E.g.* Sudden death of majority board members in an accident)
	➢ Early application (where permitted) of **a new Accounting standard** that has a material effect on the financial statements.	*(E.g. New Ind AS not yet mandatory but permits early application, entity is permitted, but not required, to apply that Ind AS in its first Ind AS FST.)*
	➢ A **Material uncertainty** regarding the **outcome of a litigation** wherein an unfavourable decision could result in a significant outflow of resources for the company, etc.	*(E.g. - Case Verdict - Johnson baby power causes cancer)*
	➢ An uncertainty relating to the future outcome of **Exceptional litigation or regulatory action**.	*(E.g. - new law may be passed against environmental pollution and would impose retrospective penalties on company)*
	➢ A **significant Subsequent event** that occurs between the date of the financial statements and the date of the auditor's report.	*(E.g. debtor whose financial condition was not good on the date financial statements went bankrupt before the date of the auditor's report)*
	Author's Note **C-GAMES to understand Examples of Emphasis of Matters which may have an Adverse Effect**	
	Examples of Emphasis of Matters which may not affect the Functioning of the Company are:	
	➢ When a financial reporting framework prescribed	*(E.g. FST of Space organisation does not*

	by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation	*contains detailed notes as government law to protect confidentiality)*
	➢ To alert users that the financial statements are prepared in accordance with a special purpose framework.	*(E.g.*T.R.A.I asked for circle wise P&L which is only suitable for decision making of license fees*)*
	➢ When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).	*(E.g. Revision of Audit report after BOD revised financial statement to include upward revaluation of Fixed asset)*
	➢ On managerial remuneration which is subject to the approval of the Central Government;	
	➢ relating to accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued	*(E.g. – Deferred tax Asset)*
	➢ on frauds that have been dealt with in the financial statements of the company and would not have any accounting effect on the financial statements.	*(E.g. – Fraud which was undetected by auditor but got recorded in the financial statement, inventory was stolen by employee and were also not included in stock taking)*

QNO 332.200	**Sec 143-- IFC Vs IFCFR** **BHASKAR CNO—CA.320**	**Old Course – (N18E)**
	Explain the terms: **(i) 'Internal Financial Control' and** **(ii) 'Internal Financial Controls over Financial Reporting'**	

Answer

(i) Internal Financial Control:

Part I -- Relevant Section & Laws

- Section 143 of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Definition**

The term Internal Financial Controls means the policies and procedures adopted by the company for ensuring:

- ⩔ Safeguarding of its assets,
- ⩔ Orderly and efficient conduct of its business, including adherence to Company' s policies,
- ⩔ Prevention and detection of frauds and errors,
- ⩔ Accuracy and completeness of the accounting records, and
- ⩔ Timely preparation of reliable financial information.

(ii) Internal Financial Control over Financial Reporting:

Part I -- Relevant Section & Laws

Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls Over Financial Reporting, "Internal Financial Controls Over Financial Reporting (ICFR)

Part II -- Requirements of Relevant Section & Laws

➢ **Definition**

"A Process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles".

➢ **Further elaboration**

A Company's internal financial control over financial reporting includes those policies and procedures:

- ⩔ Pertain to the maintenance of the records that, in reasonable detail, accurately and

fairly reflect the transactions and dispositions of the assets of the company

- It provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and those receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have material effects of the financial statement.

QNO 334.000	Sec 143--Audit of Government Company BHASKAR CNO—CA.340	Old Course – (N16E, M18M, N18M, M19M) New Course – (N18M, N19E, M19M, M23M)

What are the relevant sections of the Companies Act, 2013 and steps involved in auditor of Government Companies?

OR

"The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India." What are the relevant sections of the Companies Act, 2013 and steps involved in auditor of Government Companies?

Answer

Part I -- Relevant Section & Laws

- Section 143(5), 143(6) and 143(7) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

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

  - **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013 –**
    Statutory auditors of Government Company are appointed or re-appointed by the Comptroller and Auditor General of India. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or reappointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard.

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

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

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

company at the same time and in the same manner as the audit report.

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

QNO 335.100	**Sec 143--CAG Comments and supplementary audit report not circulated** **BHASKAR CNO—CA.340**	**New Course – (M19E)**

On receipt of statutory audit report on 30-03-2018 of M/S Sunlight. LTD , a government company, C&AG on 25-05-2018 appointed M/s Veeru & Associates to conduct supplementary audit u/s 143(6)(a) of the Companies Act, 2013 . They submitted their report to C&AG as per their scope of work. The Company held its AGM on 01-09 2018 but directors did not think it necessary to discuss supplementary auditor's report and comment of the C&AG. Is the approach of the directors of Sunlight Ltd. correct? Guide the company with the provisions related to supplementary audit.

Answer

Part I -- Relevant Section & Laws

- Section 143(6)(a) of the Companies Act , 2013

Part II -- Requirements of Relevant Section & Laws

- **The Comptroller and Auditor General of India shall within 60 days from the date of receipt of the audit report have a right to**:
  - Conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
  - **Comment upon or supplement such audit report under section 143(6)(b)**
    - It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Part III – Case Discussion

- **Supplementary audit of M/S Sunlight Ltd is conducted u/s 143(6)(a) of the Companies Act, 2013 Report has been submitted to C&AG. Company held its AGM on 01-09 2018 but directors did not think it necessary to discuss supplementary auditor's report and comment of the C&AG**

Part IV – Conclusion

- In view of above provisions, the approach of directors of Sunlight Ltd. is not correct. They are required to mandatory send the Supplementary Audit Report and comments of C&AG to every member of the company etc. as prescribed and also be placed before the annual general meeting of the company in the same manner as in case of audit report.
- Since in the given case neither the report has been distributed nor discussed in the Annual General Meeting, the directors of the company will be liable for contravention of aforesaid sections.

QNO 335.200	**Sec 143-- Case Study on Role of CAG** **BHASKAR CNO—CA.340**	**Old Course – (M21M)** **New Course – (M21M, M23R)**

VM Ltd., a company wholly owned by Central Government was disinvested during the previous year, resulting in 45% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results,

	submission of information to the BSE etc. **Gautam, the Finance Manager of the Company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the** auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.
Answer	Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. In the given scenario, VM Ltd., a company wholly owned by Central Government was disinvested during the previous year, resulting in 45% of the shares being held by public. Since, shares were listed on the BSE therefore all the listing requirements were applicable. Opinion of Finance Manager of the Company Mr. Gautam that since company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the Company and the C&AG will not have any role to play, is not correct as listing of company's shares on a stock exchange is irrelevant for this purpose.

QNO 336.000	**Sec 143--Branch Audit by Non CA** **BHASKAR CNO—CA.360**	**Old Course – (M16R)**
	Lakshya Ltd. has a branch office located outside India**. Company is in the process of appointment of non-Chartered Accountant as an auditor but otherwise qualified person from country where the branch office is situated.** Statutory auditor **is of the opinion that** non-Chartered Accountant cannot be appointed as branch auditor. Comment. **You are also required to** discuss the applicability of SA 600 **using the work of another auditor by the head office auditor in regard to branch located outside India, if non-Chartered Accountant is appointed.**	
Answer	**Part I -- Relevant Section & Laws** ▪ SA 600, "Using the Work of another auditor" ▪ Section 143(8) of the Companies Act, 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 143(8) of the Companies Act, 2013** Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company under this Act or by any other person qualified for appointment as an auditor of the company. Where the **branch office is situated in a country outside India,** the accounts of the branch office shall be audited either by the company's auditor or by an accountant **or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country** and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed. ➢ **SA 600** Using the Work of Another Auditor: When the accounts of the branch are audited by a person other than the company's auditors, there is **need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of accounts of the branch and the audit of the company as a whole**. Also, there is great necessity for a **proper rapport** between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another auditor". It makes clear that in certain situations, the **statute** governing the entity **may confer the right on the principal auditor to visit a component and examine the books of accounts and other records of the said**	

component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, **the principal auditor would normally** be entitled to **rely upon the work of such auditor unless there are special circumstances** to make it **necessary for him to visit the component** and/or to **examine the books of accounts and other records** of the said component.

Further, it requires that the principal auditor should perform **procedures to obtain sufficient appropriate audit evidence**, that the **work of the other auditor is adequate for the principal auditors'** purpose, in context of the specific assignment

Part III – Case Discussion

- In the instant case, Lakshya Ltd. has a branch office located outside India. Company is in the process of appointment of non-Chartered Accountant as an auditor but otherwise qualified person from country where the branch office is situated. Statutory auditor is of the opinion that non-Chartered Accountant cannot be appointed as branch auditor.

Part IV – Conclusion

- Thus, a non- Chartered Accountant can be appointed as an auditor of branch office located outside India provided he is qualified for appointment as an auditor in that country.

QNO 337.000	**Sec 143--Branch Auditor Appointed Without Consent** **BHASKAR CNO—CA.360**	**Old Course -- (N09R, N19R)** **New Course – (N19R)**

Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts for the year 2018-19. The decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2018, subject to shareholders' approval in AGM of the company scheduled to be held in June 2018. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Advise, whether the objection raised by company auditor is valid.

Answer

Part I -- Relevant Section & Laws

- Section 143(8) of the Companies Act, 2013
- Section 139(1) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- **Who can do Branch Audit?**

  Section 143 (8) of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

- **Appointment of Subsequent Auditor**

  In case of subsequent appointment of auditor, section 139(1) of the Act provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting.

Part III – Case Discussion

- In the instant case, Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts and the decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company subject to shareholders' approval in AGM of the company.

Part IV – Conclusion

- Thus, objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.

Author's Note

- **No permission of principal auditor is required, however appointment of branch auditor is not final till approved is taken by shareholders.**
- **Question says that board has appointed auditor subject to approval of shareholders but better wordings are board proposes the appointment and shareholders appoint branch auditor by approving it**

QNO 338.000	Sec 143--Branch No Audit Conducted BHASKAR CNO—CA.360	Old Course – (M05E, M14E, M16M, N16R, P17M, N17M)

Alappa Ltd. is a Chennai based company. The total turnover of the company is Rs. 10 crores for the year 2016-17. The company has a branch office at an area which was recently affected by tsunami. The transportation services are not available due to destruction caused by tsunami. The branch office recorded turnover of Rs. 2,50,000 in the Financial Year 2015-16. No audit of branch has been carried out. The statutory auditor of the company has made no reference of the above branch in his report. Comment.

OR

A company has a branch office which recorded a turnover of Rs 1,90,000 in the financial year 2004-05 No audit of the branch has been carried out The statutory auditor of the company has made no reference of the above branch in his report The total turnover of the company is Rs 10 crores for the year 2004-05 Comment

Answer

Part I -- Relevant Section & Laws

- SA 600, "Using the Work of another auditor"
- Section 143(8) of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

- If a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (i.e. company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

Part III – Case Discussion

- In the given situation, Alappa Ltd. is a Chennai based company having total turnover of Rs. 10 Crore. The company is having a branch office at an area which is recently affected by tsunami.

Part IV – Conclusion

- Therefore, the company has to get its branch audited. In case no branch audit has been carried out, company's auditor is required to mention this fact in the audit report and deal appropriately. Thus, no mention of reference of above branch in statutory auditor's report is not correct.

Author's Note

We are not happy with the ICAI answer. Here in this answer it is written that "auditor is required to mention this fact in the audit report and no mention of the fact statutory auditor's report is not correct. "Institute has not considered materiality of the unaudited branch and by doing so institute has clearly ignored one of the announcements. As per the announcement-

Component/s is/ are unaudited and such component/s is/ are not material to the financial statements of the entity/ consolidated financial statements of the Group	The principal auditor may or may not disclose the fact of such component/s in the Principal Auditor's report. In case the Principal Auditor decided to make such disclosure, the same would be done under the "Other Matters" paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report.	In short, in case if – Component unaudited is not material, principal auditor may or may not disclose the fact Auditor's report. under the "Other Matters" paragraph, pursuant to SA 706

Component/s is/ are unaudited and such component/s is/ are material to the financial statements of the entity/ consolidated financial statements of the Group	The Principal Auditor needs to consider its/ their impact on the auditor's opinion on the financial statements of the entity/ consolidated financial statements of the group, in terms of the principles laid down in SA 705, Modifications to the Opinion in the	In short, in case if – Component unaudited is material, principal auditor needs to consider its impact on the auditor's opinion (Q /DOM) on the financial statements of entity/CFS pursuant to SA 705.

	Independent Auditor's Report.	

Students on a safer side should mention both the things with the help of assumptions.

QNO 339.000	Sec 143--Branch Records Destroyed BHASKAR CNO—CA.360	Old Course – (N17E)

D Ltd., a Delhi based company having turnover of ` 25 crores, has a branch at USA having a turnover of `10 lakhs (as converted from US dollars). The area where the branch office is located in USA was severely affected by storms and the office along with all accounting records was completely destroyed. Due to the unavailability of records, the financial statements of D Ltd. for the financial year 2016-17 did not include the figures pertaining to the said branch. As the statutory auditor of D Ltd., how will you report on the same?

Answer

Part I -- Relevant Section & Laws

Section 143(8) of the Companies Act

Part II -- Requirements of Relevant Section & Laws

- If a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

Part III – Case Discussion

- In the given situation, D Ltd. is a Delhi based company, having total turnover of `25 crores. The company is having a branch office in USA (having a turnover of rupees 10 lakhs i.e. as converted from US dollars) in an area which is recently affected by storm and the office along with all accounting records was completely destroyed. Due to unavailability of records, the financial statements of D Ltd. for the financial year 2016-17 did not include the figures pertaining to the said branch.

Part IV – Conclusion

- Under such a circumstance beyond the control of the entity when the entity's accounting records have been destroyed the auditor's opinion has to be modified.

  The auditor has also to mention in his report the effect on the financial statements due to non-inclusion of financial data pertaining to the branch.

Author's Note
-Refer note on QNO 338.000

QNO 340.000	Sec 143--Fraud Reporting Short Note BHASKAR CNO—CA.420	Old Course – (N15E, M16M, N16M, N16E, N17E, M18M, M19R)

An auditor observed a fraud committed by an employee of the company. State the manner and timing of reporting of the fraud by the auditor.

OR

In the course of audit of Kishan Ltd. for the financial year 2015-16, its auditor M/s Zen & Co. observed that the management has passed certain forged transactions against the company amounting to Rs. 50 lakh at the year end. Suspecting fraud, the auditors requested explanations and documentary supporting, for which the management remained silent. You are required to guide the auditor of the company stating the fraud reporting requirements as provided under the Companies Act, 2013.

OR

QNO 341.000 Sec 143--Fraud Reporting Case of General Manager

Q You have been appointed statutory auditor of a company for the financial year ended 31st March 2017 in place of the retiring auditor. During the course of audit, you observe that a fraud had been committed by a general manager who retired in March 2017. While going into further details, it was found that the fraud was going on since last 2-3 years and the total amount misappropriated was likely to exceed ` 100 lakhs. As statutory auditor, what would be your reporting responsibilities to the government?

OR

QNO 341.100 Sec 143--Fraud Reporting Cost Accountant Didn't Not Report to Government;

Q RX Ltd. is a sugar manufacturing company. The company appointed Mr. Suresh, a practicing cost accountant, to conduct cost audit of its cost records under section 148 of the Companies Act, 2013. While conducting audit, Mr. Suresh found some misstatement resulting into fraud committed by the officers of the company amounting rupees 1.5 crore. However, he did not report the matter to the Central Government believing that liability for such reporting lies only with statutory auditor of the company. Advise.

Answer

Part I -- Relevant Section & Laws

- As per Section 143(12) of the Companies Act, 2013 to be read with Rule 13,Companies (Audit and Auditors)Rules, 2014.

Part II -- Requirements of Relevant Section & Laws

➢ **Section 143(12) of the Companies Act, 2013 to be read with Rule 13,Companies (Audit and Auditors)Rules, 2014.**

If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the audit committee (in case amount involved in is less than ` 1 crore) within 2 days of his knowledge and he shall report the matter specifying the Nature of Fraud with description, Approximate amount involved; and Parties involved.

Further, if the offence of fraud, which involves or is expected to involve individually an amount of ` 1 crore or above, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

- The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
- On receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;
- In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same
- the report shall be on the letterhead of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- the report shall be in the form of a statement as specified in Form ADT-4.

The provisions of this section shall *mutatis mutandis* apply to—

(a) cost accountant conducting cost audit under section 148; or

(b) the company secretary in practice conducting secretarial audit under section 204

➢ **Clause 11 of CARO 20**

The auditor is required to report - Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

Part III – Case Discussion (Case 1 & 2)

- Auditor observed a fraud committed by an employee of the company.

Part IV – Conclusion (Case 1 & 2)

- Therefore, reporting of fraud should be done in accordance with section 143(12) of the Act and under Clause 11 ,CARO 20

Author's Note

(Case 3)

Part III – Case Discussion

- In the given case, a statutory auditor appointed by company for the financial year ended 31st March 2017 in place of the retiring auditor. During the course of audit, you observe that a fraud had been committed by a general manager who retired in March 2017. While going into further details, it was found that the fraud was going on since last 2-3 years and the total amount misappropriated was likely to exceed ` 100 lakhs.

Part IV – Conclusion

- In the instant case, a fraud had been committed by a general manager and the amount involved for such misappropriation is exceeding 100 Lakh rupees i.e. 1 crore.
  Therefore, reporting of fraud should be done to Central Government in accordance with section 143(12) of the Act and under Clause 11 ,CARO 20

(Case 4)

CARO reporting will not be applicable as Mr. Suresh is a Cost auditor. But reporting to central government will be required under Sec 143(12).

Part III – Case Discussion

- In the instant case, RX Ltd. is a sugar manufacturing company. The company appointed Mr. Suresh, a practicing cost accountant, to conduct cost audit of its cost records under section 148 of the Companies Act, 2013. While conducting audit, Mr. Suresh found some misstatement resulting into fraud committed by the officers of the company amounting rupees 1.5 crore. However, he did not report the matter to the Central Government believing that liability for such reporting lies only with statutory auditor of the company.

Part IV – Conclusion

- In the given case, Mr. Suresh, being the cost auditor of RX Ltd., found misstatement resulting into fraud amounting 1.5 crore committed by the officers of the company, was required to report the fraud to the Central Government which he failed to do so.

QNO 342.100	Sec 148--Applicability (Exports) BHASKAR CNO—COST.020	Old Course – (M15R, N15R) New Course – (M19E, S21M, N21M)

Mithas Ltd is a top sugar manufacturer and exporter in India operating from Noida Specific Economic Zone, Uttar Pradesh Its revenue from sale/export for the current year is given below:
Sale within India Rs 153 Lakhs
Sale outside India (Export) Rs 357 Lakhs
Total Revenue Rs 510 Lakhs

Mr X, the statutory auditor of Mithas Ltd, is of the view that the company is mandatorily required to include cost records in their books of account and consequently conduct cost audit He also suggested the name of his friend, who is a Cost Accountant in Practice, for the purpose of such cost audit However, the management is of the view that the company neither required including cost records in their books of account nor conduct cost audit Being an expert in cost records and audit rules, you are required to guide the management in this regard

OR

Pearl Ltd. is an exporter of precious and semi -precious stones. The turnover of the company is 150 crore, out of which? 105 crore is from export business and remaining? 45 crore from domestic sales. Amount received from export business is all in foreign currency. Directors of Pearl Ltd. is of the opinion that cost audit is not applicable to their company as maximum revenue has been generated from export business. Give your opinion.

Answer

Part I -- Relevant Section & Laws

- Section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.

Part II -- Requirements of Relevant Section & Laws

➢ **Applicability of Provisions related to Cost Records and Audit:** The provisions relating to cost records and audit are governed by section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.The audit conducted under this section shall be in addition to the audit conducted under section 143.

➢ **Rule 3 of the Companies (Cost Records and Audit) Rules, 2014**

It provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account. The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Company belonging to sugar industry is one of the types of companies prescribed under the regulated sectors.

➢ **Exception**

However, the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds 75 per cent of its total revenue; or

(ii) which is operating from a special economic zone.

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant?

Case I

Part III – Case Discussion

In the given case, Mithas Ltd., a sugar manufacturer and exporter in India, is operating from Noida Specific Economic Zone, Uttar Pradesh.

Part IV – Conclusion

Therefore, Mithas Ltd. is required to include cost records in their books of account in accordance with Rule 3 of the Companies (Cost Records and Audit) Rules, 2014.

However, the company is not required to conduct cost audit as it is operating from a special economic zone. The facts given on revenue are not relevant here.

Case II

Part III – Case Discussion

In the instant case, Pearl Ltd. is an exporter of precious and semi-precious stones and the turnover of the company is rupees 150 crore out of which rupees 105 crore i.e. 70% is from export business and remaining rupees 45 crore i.e. 30% from domestic sales. It is neither operating from SEZ nor involved in captive power generation.

Part IV – Conclusion

Thus, opinion of director is not tenable as revenue from exports in foreign exchanges is below prescribed limit. Therefore, cost audit is applicable on Pearl Ltd. as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. Pearl Ltd. has to appoint cost auditor to get the cost accounts of the company audited.

Author's Note:

- **The 1st case is taken directly from RTP. There is printing mistake in RTP. In RTP figures are in lakhs.** If we take it in lakhs, then **cost records won't get applicable and whole case and its data will become useless.**
  In PARAM we have assumed it as a mistake done by ICAI and have considered it as 'Crores' rather than 'Lakhs' on the basis of answer provided by ICAI. No change is made to original question.
- **In the 2nd case, Pearl Ltd. is an exporter only. The company is not engaged in the production of goods or providing services. Then how the provisions of maintenance of cost records and cost audit are applicable for the company?**
  - **They have mentioned company is exporter but exporter can be producer also of goods they are silent whether company is producer or not in such circumstances we generally assume in such a manner that things get applicable to entity so it is reasonable to assume they must be producing also**

QNO 342.200	Sec 148--Applicability of Cost Audit BHASKAR CNO—COST.020	Old Course – (M17R, N20R) New Course – (N20R)

Electro Ltd. is engaged in generation of electricity for captive consumption through Captive Generating Plant. The Company also maintain cost records in their books of account as required under Cost Records and Audit Rules. Mr. X, friend of Managing Director of the company, suggested name of his brother, who is a Cost Accountant in Practice, for the purpose of cost audit. However, the statutory auditor of the company, is of the view that the company is not legally required to conduct cost audit. Now, the Managing Director is in dilemma about the requirement of cost audit.

Being an expert in cost records and audit rules, you are required to guide in this regard.

Answer

Part I -- Relevant Section & Laws

- Section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.
- Section 143 of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.**

- ∀ The provisions relating to cost records and audit are governed by section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.
- ∀ The audit conducted under this section shall be in addition to the audit conducted under section 143.
- ∀ Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account.
- ∀ However, the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,
  - (i) whose revenue from exports, in foreign exchange, exceeds 75 per cent of its total revenue; or
  - (ii) which is operating from a special economic zone.
  - (iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant?

Part III – Case Discussion

➢ In the Instant case, Electro Ltd. is engaged in generation of electricity for captive consumption through Captive Generating Plant. The Company also maintain cost records in their books of account as required under Cost Records and Audit Rules. Mr. X, friend of Managing Director of the company, suggested name of his brother, who is a Cost Accountant in Practice, for the purpose of cost audit. However, the statutory auditor of the company is of the view that the company is not legally required to conduct cost audit. Now, the Managing Director is in dilemma about the requirement of cost audit.

Part IV – Conclusion

➢ In the given case, Electro Ltd. is engaged in generation of electricity for captive consumption through Captive Generating Plant.

Therefore, Electro Ltd. is not required to conduct cost audit as it is falling under the exemption criteria.

Hence, the opinion of statutory auditor of the company regarding non-applicability of cost audit is correct and the management should follow the same.

QNO 342.300	Sec 148—Appointment BHASKAR CNO—COST.040	Old Course – (M16R)

Expro Ltd. is engaged in the production of steel. A Chartered Accountant Firm 'M/s Manan & Co.' was appointed as the statutory auditor of Expro Ltd. for the current financial year. During the year, the management of the company realised that the company is required to maintain cost records in their books of account and get it audited. Therefore, in a general meeting, the members of the company appointed M/s Manan & Co. as the cost auditor of the company. You are required to examine the validity of appointment of M/s Manan & Co. as the cost auditor

Answer

Part I -- Relevant Section & Laws

- According to section 148(3) of the Companies Act, 2013 read with Companies (Audit & Auditors) Rules, 2014

Part II -- Requirements of Relevant Section & Laws

(i) In the case of companies which are required to constitute an audit committee, the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee;

(ii) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor.

It is also provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

Part III – Case Discussion

➢ In the given case, the members of Expro Ltd. appointed M/s Manan & Co., a practicing Chartered Accountant Firm and the statutory auditor of the company, as the cost auditor.

Part IV – Conclusion

➢ Therefore, the appointment of the CA firm as cost auditor made by the company is not valid. The Board shall appoint a cost accountant in practice or a firm of cost accountants in practice to conduct such cost audit.

PART - 2 COMPANIES AUDITOR REPORT ORDER (CARO) 2020

QNO 379.000	Applicability (Computation of TO) BHASKAR CNO—CARO.040	Old Course – (S17M) New Course – (S21M)

T Pvt. Ltd.'s paid up Capital & Reserves are less than ₹ 50 lakhs and it has no outstanding loan exceeding ₹ 25 lakhs from any bank or financial institution. Its sales are ₹ 6 crores before deducting Trade discount ₹ 10 lakhs and Sales returns ₹ 95 lakhs. The services rendered by the company amounted to ₹ 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020
- Schedule III

Part II -- Requirements of Relevant Standards & Laws

➢ **CARO 2020**

The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company,

- having a paid-up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and
- which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and
- which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

➢ **Schedule III**

As per Schedule III, revenue from operations shall consist of revenue from sale of products, sale of services, and other operating revenues.

While computing total revenue, trade discount as well as sales returns are required to be deducted.

Part III – Case Discussion

➢ In the given case, paid up capital and reserves of T Pvt. Ltd. is less than one crore and has no loan outstanding exceeding one crore from any bank or financial institution. Further, its total revenue as disclosed in Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements.

Part IV – Conclusion

➢ Thus CARO 2020 will not be applicable to T Pvt. Ltd.

QNO 380.000	Applicability (2 Loans Outstanding & Default) BHASKAR CNO—CARO.040	Old Course – (M07E, N15R, P17M)

E-Tech Pvt. Ltd., which has an aggregate outstanding loan of ₹ 20 lakhs from Banks and ₹ 30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies (Auditor's Report) Order, 2020 is not applicable. You are required to state the list of companies to which CARO is applicable and state how would you deal with the given situation as an auditor of the company.

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Applicability of Companies (Auditor's Report) Order, 2020 [CARO, 2020]:**

The CARO,2020 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013.

The order applies to every company including a foreign company as defined in clause (42) of

section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies

(i) a **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
(ii) an **insurance company** as defined under the Insurance Act,1938;
(iii) a **company licensed to operate under section 8** of the Companies Act;
(iv) a **One Person Company** as defined under clause (62) of section 2 of the Companies Act;
(v) a **small company as defined** under clause (85) of section 2 of the Companies Act; and
(vi) a **private limited company, not being a subsidiary or holding of a public company**, with a
- paid up capital and reserves not more than one crore and
- which does not have total borrowings exceeding one crore from any bank or financial institution and
- does not have a turnover exceeding rupees ten crore at any point of time during the financial year.

Part III – Case Discussion

➢ In the given case, E-Tech Pvt. Ltd. has outstanding loan of ₹ 50 lakhs (20 lakhs + 30 lakhs) from Banks and Financial Institutions together, which is not exceeding the limit prescribed under Order for applicability of exemption.

Part IV – Conclusion

➢ Therefore, CARO, 2020 will not be applicable to E-Tech Pvt. Ltd. Thus, the period and amount of default need not to be reported for default in repayment of dues to bank or financial institution under clause (viii) of Para 3 of CARO, 2020.

Author's Note
Here, even if CARO is not applicable, default in repayment of loan should be disclosed, as schedule III requires such disclosure in the notes

QNO 381.000	**Applicability (Consolidated FST)** **BHASKAR CNO—CARO.040**	**Old Course – (S17M)**
	Whether CARO is Applicable to the auditor of consolidated financial statement	
Answer	➢ CARO shall not apply to consolidated financial statements except clause (xxi) of paragraph 3. This is done to avoid repetitive information in annual report. Further CARO is designed for individual companies and not for group as a whole.	

QNO 382.000	**Applicability (Loan)** **BHASKAR CNO—CARO.040**	**Old Course – (M13E)** **New Course – (S17M)**
	H Private Ltd had taken overdrafts from two banks with a limit of ₹ 10 lacs each against the security of fixed deposit it had with those banks and an unsecured overdraft from a financial institution of ₹ 9 lacs The said loans were outstanding as at 31st March 2019. The paid-up capital and reserves of the company as at that date was ₹ 40 lacs and its turnover during the financial year ended on 31st March 2019 was ₹ 3 crores The management of the company is of the opinion that CARO, 2020 is not applicable to it because turnover and paid up capital were within the limits prescribed and loans taken against the fixed deposits cannot be considered The company further contended that loan limit is to be reckoned per bank or financial institution **OR** **For the purpose of availing exemption from CARO what kind of loan to be considered?**	
Answer	**Part I -- Relevant Standards & Laws** ▪ CARO, 2020 and its Guidance Note **Part II -- Requirements of Relevant Standards & Laws** ➢ **Applicability of Companies (Auditor's Report) Order, 2020 [CARO, 2020]:** The CARO,2020 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013 The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class	

of companies-

(i) a **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
(ii) an **insurance company** as defined under the Insurance Act,1938;
(iii) a **company licensed to operate under section 8** of the Companies Act;
(iv) a **One Person Company as** defined under clause (62) of section 2 of the Companies Act
(v) a **small company as defined** under clause (85) of section 2 of the Companies Act; and
(vi) a **private limited company, not being a subsidiary or holding of a public company,**
- with a paid-up capital and reserves not more than one crore and
- which does not have total borrowings exceeding one crore from any bank or financial institution and
- does not have a turnover exceeding rupees ten crore at any point of time during the financial year.

➢ **Guidance Note of CARO, 2020**

As per Guidance Note of CARO, 2020 issued by ICAI, while computing total borrowings from banks and financial institutions, loans against Fixed deposits are to be taken into consideration. Further loans from banks and financial institutions are to be taken cumulatively not individually.

Part III – Case Discussion

➢ In the given case, H Pvt. Ltd has paid up share capital and reserves less than ₹ one crore, its revenue is less than ₹ 10 crores and its total borrowings from banks and financial institution is ₹ 29 lacs which does not exceed ₹ one crore.

Part IV – Conclusion

➢ Hence CARO, 2020 is not applicable to H Pvt. Ltd.

Author's Note

⚠ **# Mistake point**

As per Guidance Note of CARO, 2020 issued by ICAI, while computing total borrowings from banks and financial institutions, all loans (secured or unsecured) are to be taken into consideration.
Further loans from banks and financial institutions are to be taken cumulatively not individually

QNO 382.010	**Applicability (Loan)** **BHASKAR CNO—CARO.040**	**Old Course – (N17R)**

Evolution Pvt. Ltd. borrowed a sum of ₹ 110 lakh from Banks and Financial Institutions, subsequently, the company defaulted in repayment of its loans, to the extent of 50%. The management of the company contends that that it being a private limited company, the Companies (Auditor's Report) Order [CARO], 2020 is not applicable. You are required to state the list of companies to which CARO is not applicable and state whether it will be applicable on Evolution Pvt. Ltd.

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Applicability of Companies (Auditor's Report) Order [CARO], 2020:**

The CARO,2020 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013.

The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies-

(i) **a banking company** as defined in clause (c) of section 5 of the Banking Regulation Act,1949 (10 of 1949)
(ii) an **insurance company** as defined under the Insurance Act,1938 (4 of 1938);
(iii) a **company licensed to operate under section 8** of the Companies Act;
(iv) a **One Person Company** as defined under clause (62) of section 2 of the Companies Act and a **small company** as defined under clause (85) of section 2of the Companies Act; and
(v) a **private limited company, not being a subsidiary or holding company of a public**

company,

- having a paid-up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and
- which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and
- which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

➢ **Clause (viii) of Para 3 of CARO, 2020,**

The auditor is required to comment whether the company has defaulted in repayments of loans or borrowings to a financial institution, bank, government or debenture holders? If yes, the period and amount of default is to be reported.

Part III – Case Discussion

➢ In the given case, Evolution Pvt. Ltd. has outstanding loan of ₹ 110 lakhs from Banks and Financial Institutions together, which is exceeding the limit prescribed under Order for applicability of exemption.

Part IV – Conclusion

➢ Therefore, CARO, 2020 will be applicable on Evolution Pvt. Ltd. And auditor is required to report the period and amount of default in repayment of dues under clause (viii) of Para 3 of CARO, 2020.

Author's Note

As per clause (ix) of Para 3 of CARO, 2020, other than the requirements specified above the lender wise details are also required to be given.

QNO 383.000	Applicability (Pvt Company All Conditions) BHASKAR CNO—CARO.040	Old Course – (P17M)

T Pvt. Ltd.'s paid up Capital & Reserves are less than ₹ 50 lakhs and it has no outstanding loan exceeding ₹ 25 lakhs from any bank or financial institution. Its sales are ₹ 6 crores before deducting Trade discount ₹ 10 lakhs and Sales returns ₹ 95 lakhs. The services rendered by the company amounted to ₹ 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Applicability of CARO, 2020:**

The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company,

• having a paid-up capital and reserves and surplus not more than ₹ 1 crore as on the balance sheet date and

• which does not have total borrowings exceeding ₹ 1 crore from any bank or financial institution at any point of time during the financial year and

• which does not have total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements.

Part III – Case Discussion

In the given case, paid up capital and reserves of T Pvt. Ltd. is less than rupees one crore and has no loan outstanding exceeding rupees one crore from any bank or financial institution, the only other condition is whether turnover exceeds rupees ten crores.

The term "turnover" has been defined under section 2(91) of the Companies Act, 2013 which means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.

Part IV – Conclusion

For ascertaining turnover, though trade discount and sales returns should be deducted, the inclusion of services rendered would result in a turnover of ₹ 5.05 crores (i.e. 6 - 0.10 - 0.95 + 0.10 crore). Hence CARO, 2020 will not be applicable to T Pvt. Ltd.

QNO 385.000	Applicability (Pvt Company Focus on Holding Company) BHASKAR CNO—CARO.040	Old Course – (M10E, N13R, N14E, N16M) New Course – (S17M)

Ansh Pvt. Ltd. is a private limited company, not being a subsidiary or holding company of a public company, having fully paid capital and reserves and surplus of ₹ 50 lakh. During the financial year, the company had borrowed ₹ 80 lakh from a financial institution. It has the revenue of ₹ 8 crore from normal operations and ₹ 3 crore from discontinuing operations as disclosed in Scheduled III to the Companies Act, 2013. Will Companies (Auditor's Report) Order, 2020 (CARO, 2020) be applicable to Ansh Pvt. Ltd.?

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ ***Applicability of CARO, 2020:***

The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company,

- having a paid-up capital and reserves and surplus not more than ₹ 1 crore as on the balance sheet date and
- which does not have total borrowings exceeding ₹ 1 crore from any bank or financial institution at any point of time during the financial year and
- which does not have total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements.

Part III – Case Discussion

➢ In the given case, Ansh Pvt. Ltd. is a private limited company, not being a subsidiary or holding company of a public company. It has paid capital and reserves and surplus of ₹ 50 lakh i.e. less than ₹ 1 crore, outstanding loan of ₹ 80 lakh i.e. less than ₹ 1 crore. However, it has total revenue of ₹ 11 crore (₹ 8 crore from normal operations + ₹ 3 crore from discontinuing operations) i.e. exceeding ₹ 10 crore as disclosed in Scheduled III to the Companies Act, 2013.

Part IV – Conclusion

➢ Therefore, it fails to fulfil the condition relating to total revenue. Thus, CARO, 2020 will be applicable to Ansh Pvt. Ltd. Accordingly.

QNO 386.000	Applicability (Pvt Company Focus on Turnover) BHASKAR CNO—CARO.040	Old Course – (N07E, P17M) New Course – (S17M, S21M)

Astha Pvt. Ltd. has fully paid capital of 40 lakh. During the year, the company had borrowed ` 75 lakh from a bank and 15 lakh from financial institution independently. It has the turnover (Net of excise ` 50 lakh which is credited to a separate account) of `975 lakh. Will Companies (Auditor's Report) Order, 2020 be applicable to Astha Pvt. Ltd.?

Answer

Part I -- Relevant Standards & Laws

- CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ Applicability of CARO, 2020: The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than ₹ 1 crore as on the balance sheet date and which does not have total borrowings exceeding ₹ 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements.

Part III – Case Discussion

➢ In the case of Astha Pvt. Ltd., it has paid capital of ` 40 lakh i.e. less than` 100 lakh, turnover is ` 9.75 crore i.e. less than 10 crore since excise duty is not taken into account if it is credited separately to excise duty account. However, it has outstanding loan of ` 90 lakh (` 75 lakh + `15 lakh) collectively from bank and financial institution.

Part IV – Conclusion

➢ Thus, CARO, 2020 will not be applicable to Astha Pvt. Ltd. As it fulfills the condition relating to

	applicability of CARO 20.
	Author's Note ⚠ **# Mistake point** Since excise duty is credited separately to excise duty account it shall not be considered for calculation of total turnover .If the entire amount (net + tax) was accounted in books collectively in a single account than it would have been considered in calculation of total turnover As per Guidance Note of CARO, 2020 issued by ICAI, while computing total borrowings from banks and financial institutions, loans from banks and financial institutions are to be taken cumulatively not individually.

QNO 386.010	Applicability (Pvt Company Focus on Turnover) BHASKAR CNO—CARO.040	Old Course – (N12E)
	Under CARO, 2020, how, as a statutory auditor would you comment on the following: **X Pvt Ltd is a subsidiary of a listed entity incorporated outside India The management of the company believes that since, X Pvt Ltd is a Private Company and satisfies all condition under the Companies (Auditor's Report) Order, 2020, reporting under CARO is not applicable**	
Answer	**Part I -- Relevant Standards & Laws** ▪ CARO, 2020 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Applicability of CARO, 2020:** The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, • having a paid-up capital and reserves and surplus not more than ₹ 1 crore as on the balance sheet date and • which does not have total borrowings exceeding ₹ 1 crore from any bank or financial institution at any point of time during the financial year and • which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements. **Part III – Case Discussion** ➢ X Pvt Ltd is a subsidiary of a listed entity incorporated outside India .The management of the company believes that since, X Pvt Ltd is a Private Company and satisfies all condition under the Companies (Auditor's Report) Order, 2020, reporting under CARO is not applicable. **Part IV – Conclusion** ➢ Since X Pvt Ltd is a subsidiary of a listed entity incorporated outside India, CARO, 2020 will not be applicable X Pvt Ltd.	
	Author's Note ⚠ **# Mistake point** **A public holding changes the status of private company to public company however if such public holding is a foreign company the status of private company remains unchanged.** **Here in this case if X Pvt Ltd was a subsidiary of a listed entity incorporated in India the status of X Pvt Ltd would have got changed to public company and exemption would have not been available ,however since the holding company is a foreign company , status of private company remains unchanged and exemption shall be available to X Pvt Ltd.**	

QNO 388.000	Cl 1--Documents in Title Deeds BHASKAR CNO—CARO.080	Old Course – (S17M)
	What documents Constitute Title Deed	

Answer

➢ Following constitute title deeds of the immovable property:-

- Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee), etc. purchased, allotted, transferred by any person including any Government, government authority / body/ agency / corporation, etc. to the company.

QNO 389.000	**Cl 1--Material Discrepancy** **BHASKAR CNO—CARO.080**	**Old Course – (M13E, N16R, P17M)**

CCE Ltd closed its manufacturing operations and sold all its manufacturing fixed assets during the financial year ended 31st March, 2020. However it intends to continue its operations as a trading company. In respect of other fixed assets, the company carried out a physical verification as at the end of 31st March,2020 and found a material discrepancy to the tune of ` 1 lac, which was written off and is disclosed separately in the Statement of Profit and Loss. Kindly incorporate the above in your audit report.

Answer

Part I -- Relevant Standards & Laws

- SA 570 "Going Concern"
- Clause (i)(b) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **SA 570 "Going Concern"**

Disclosure in Audit Report: As per SA 570 "Going Concern", when the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements-

- Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
- Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The auditor is further required to specifically include certain matters as per CARO,2020 under section 143 of the Companies Act, 2013.

➢ **Clause (i)(b) of Para 3 of CARO, 2020**

According to clause (i)(b) of Para 3 of CARO, the auditor has to comment whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account

Part III – Case Discussion

➢ In the given case, CCE Ltd. has sold out its manufacturing fixed assets during the year. However, it intends to continue its operations as a trading company.

Part IV – Conclusion

➢ Therefore, selling of manufacturing fixed assets does not affect the going concern assumption of the company. Additionally, while carrying out physical verification of fixed assets, a material discrepancy to the tune of ` 1 lac was found, which was written off and disclosed separately in the Statement of Profit and Loss. Hence, this fact needs to be disclosed in the Audit Report as follows:

➢ **Para in the Audit Report-**

We have made our viewpoint from the facts of the case and on the basis of guidance drawn from AS 1. We report as under-

- As per Accounting Standard (AS) 1, "Disclosure of Accounting Policies", "the enterprise is normally viewed as a going concern that is as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations. "
- Although the company has disposed off its manufacturing fixed assets during the financial year ending on 31-03-2020, it is still a going concern in the form of a trading company.
- We also report that on physical verification of other fixed assets, a material discrepancy to the tune of ` 1 Lac was noticed and that the same has been properly dealt with in the books of account.

Author's Note

 # Mistake point

Here students normally will only quote the relevant clause of CARO 20.However here institute has also considered going concern issue while answering the question. Students should consider both the aspect i.e. relevant Clause of CARO 20 and going concern while answering the question to get maximum marks.

QNO 391.000	Cl 1--Title Deed Not in Name of Company BHASKAR CNO—CARO.080	Old Course –(N17M, M17R, N19R, M19R, N21M) New Course – (N19R, M19R, N21M)

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020: -

The Company is in the process of selling its office along with the freehold land available at Pune and is actively on the lookout for potential buyers. Whilst the same was purchased at` 20 Lakh in 2006, the current market value is ` 200 Lakh. This property is pending to be registered in the name of the Company, due to certain procedural issues associated with the Registration though the Company is having a valid possession and has paid its purchase cost in full. The Company has disclosed this amount under Fixed Assets though no disclosure of non-registration is made in the notes forming part of the accounts.

OR

NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of one of its directors who was overlooking the manufacturing activities.

Answer

Part I -- Relevant Standards & Laws

- Clause (i)(c) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (i)(c) of Paragraph 3 of the CARO, 2020,**

- The auditor is required to report on whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the following details:

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company*
-	--	-	-	-	*also indicate if in dispute

Part III – Case Discussion

➢ In the present case, the Company has office along with freehold land in Pune. Though company has paid its purchase cost in full however, this property is pending to be registered in the name of the company i.e. title deed is not in the name of Company since 2006.

Therefore, the auditor is required to report the same in accordance with clause (i)(c) of para 3 of CARO 2020.

Part IV – Conclusion

➢ The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise in case of land:-

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

QNO 392.000	Cl 1--Title Deeds With Bank BHASKAR CNO—CARO.080	Old Course – (M17E, M18M)

ABC Ltd. owns a piece of Land and Building situated at IP road, Mumbai which was purchased before 30 years. The title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company. As the statutory auditor of the company for the year ended 31st March 2017, what are the

audit procedures to be followed and what is the reporting under CARO 2020?

Answer

Part I -- Relevant Standards & Laws

- Clause (i)(c) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Title deeds of Immovable Property in the name of Bank:**

The auditor is required to report on whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the following details:

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company*
-	--	-	-	-	*also indicate if in dispute

This clause shall cover the immovable properties which are covered under the **PPE,** as reporting under Clause (i) (a) and (i) (b) of Para 3 of CARO, 2020.

The auditor should verify the title deeds available and reconcile the same with the PPE register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the PPE register and the details available in the title deeds.

Accordingly, the auditor should carry out a detailed examination of the Registered sale deed and related documents of Land and Building.

Where the title deeds of the immovable property have been mortgaged with the Banks/Financial Institutions, etc., for securing the borrowings and loan raised by the company, a confirmation about the same should be sought from the respective institution to this effect. The auditor may also consider verifying this information from the online records, if available, of the relevant State.

Part III – Case Discussion

➢ In the given case, ABC Ltd. owns a piece of land and building situated at IP road Mumbai and title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company.

Part IV – Conclusion

➢ Thus, the auditor needs to follow the audit procedure as mentioned above and shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2020.

In case the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are not held in the name of the company, the auditor should ascertain the following information for the purpose of reporting under this clause:

- Description of property
- Gross carrying value
- Asset held in name of
- Whether held in name of promoter, director or their relative or employee
- Period during which it was not held in name of the Company
- Reason for not being held in name of company
- Where ownership of the Asset is in dispute, details of such dispute

QNO 392.010	**Cl 1(a) & 1(b)—Physical verification of Fixed Assets** **BHASKAR CNO—CARO.080**	**Old Course – (N18M, M20M, M21M)** **New Course – (M20M, M21M)**
	The Property, Plant and Equipment of Amir Ltd. included Rs.25.75 crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern in view of CARO, 2020 on matters specified above?	

Answer

Part I -- Relevant Standards & Laws

- Clause (i)(a) & (i)(b) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Disclosure in Audit Report:**

The auditor is required to specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.

- Whether the company is maintaining proper records showing full particulars
  - including quantitative details and situation of Property, Plant and Equipment;
  - intangible assets;
- Whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

Part III – Case Discussion

➢ In the given case, Amir Ltd. has intention to sale its earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down and these assets are appearing at residual value. Further, inspection of such machines (though it is a retired machine, however value is 25.75 crores which is material amount) was done 10 years back, is not in compliance with CARO, 2020.

Part IV – Conclusion

➢ Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2020.

Author's Note

Clause (i) (b) of Paragraph 3 of CARO 2020 requires to comment whether Property, Plant and Equipment have been physically verified by the management at reasonable intervals.

What does reasonable interval mean?

In case of Property, Plant and Equipment reasonable interval means 3 years, which means it is acceptable if management does physical verification once in every 3 years however reporting is required to be done if physical verification interval is more than 1 year.

In case of inventory (clause ii) reasonable interval means 1 years, which means it is not acceptable if management does not perform physical verification each year.

QNO 392.200	**Cl 1 & Cl 2 -- Revaluation & Loan Taken Against Current Asset** **BHASKAR CNO—CARO.080**	**(M22R)**

Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company.

Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said Order: -

Sr. No.	Observations
(a)	One of the Plant and Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from ` 4 crore to ` 4.45 crore.
(b)	During the year under consideration, cash credit limit of ` 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to ` 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Accounts.

You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO 2020.

Answer

Matters to be reported by Mr. Brijesh as per CARO, 2020 are as follows:-

(a) According to Clause (i) (d) of Para 3 of CARO 2020, the auditor is required to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if the change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

In the given situation, Sinwar Ltd. has revalued one of the Plant and Equipment taken on a lease ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant and Equipment is ` 45 lakh. As the net carrying value of Plant and Equipment in aggregate was changed from ` 4 crore to ` 4.45 crore i.e. change was 10% or more.

Thus, the auditor is required to report the amount of change of ` 45 lakh in accordance with Clause (i) (d) of Para 3 of CARO 2020.

(b) As per Clause (ii) (b) of Para 3 of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

In the instant case, Sinwar Ltd. has been sanctioned a cash credit limit of ` 5.5 crore by DMC Bank during the year under consideration, which is exceeding the prescribed limit of ` 5 crore based on the security of current assets. Further, quarterly returns have also been filed by the company with the DMC bank in this connection which is in agreement with Books of Accounts.

In view of the above, the auditor is required to report the same in accordance with Clause (ii) (b) of Para 3 of CARO 2020

QNO 393.000	**Cl 2--Physical Verification (50%)** **BHASKAR CNO—CARO.090**	**Old Course – (M05E, M11R, M16R, N16M, P17M, N19M)** **New Course – (S17M, N19M, S21M)**
	Physical verification of only 50% of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.	

Answer

Part I -- Relevant Standards & Laws

Clause (ii) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

Requirements of Clause (ii) of Para 3 of CARO, 2020

- **Physical Verification of Inventory:**

  Clause (ii) of Para 3 of CARO, 2020 requires whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.

  Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases.

  The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

Part III – Case Discussion

- Company conducted physical verification of only 50% of items of inventory and balance 50% will be conducted in next year due to lack of time and resources.

Part IV – Conclusion

- In the given case, the above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory

	verification is not reasonable. He may consider the impact on financial statement and report accordingly.

QNO 397.000	Cl 3--Loan to Related Party Outstanding BHASKAR CNO—CARO.100	Old Course – (N11E, N13R,N15R,M16M, P17M,N18E)
	ABC Private Ltd. has granted loan of ` 20 crores to XYZ Ltd. a sister concern and it remains outstanding at the year end. How would you report the fact?	

Answer

Part I -- Relevant Standards & Laws

- IND AS 24 "Related Party Disclosures"
- Clause (iii) of Para 3 of CARO, 2020.

Part II -- Requirements of Relevant Standards & Laws

➢ **Reporting of "Loan to Related Party":**

If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:

- the amount of the transactions.
- the amount of outstanding balances, including commitments, and:
  - their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
  - details of any guarantees given or received;
- provisions for doubtful debts related to the amount of outstanding balances; and
- the expense recognised during the period in respect of bad or doubtful debts due from related parties**.**

➢ **Clause (iii) of Para 3 of CARO, 2020**

Whether during the year the company has made **investments** in, provided any **guarantee or security or granted any loans or advances** in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so**,-**

- whether during the year the company has provide **loans** or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate
  - the **aggregate amount** during the year, and balance **outstanding at the balance sheet date** with respect to such loans or advances and guarantees or security to **subsidiaries, joint ventures and associates**
  - the **aggregate amount** during the year, and balance **outstanding at the balance sheet date** with respect to such loans or advances and guarantees or security **to** parties **other than subsidiaries, joint ventures and associates;**
- whether the **investments made, guarantees provided, security given and the terms and conditions** of the grant of all loans and advances in the nature of loans and guarantees provided are **not prejudicial to the company's interest;**
- in respect of loans and advances in the nature of loans, whether the **schedule of repayment of principal and payment of interest** has been stipulated and whether the **repayments or receipts are regular.**
- if the amount is overdue, state the total amount **overdue for more than ninety days, and whether reasonable steps** have been taken by the company for recovery of the principal and interest.
- whether the company has granted any loans or advances in the nature of loans either repayable **on demand or without specifying any terms or period of repayment,** if so, specify the **aggregate amount, percentage** thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013

Part III – Case Discussion

- In the instant case, ABC Pvt. Ltd. Has granted a loan of ` 20 crores to XYZ Ltd., a sister concern, and it remains outstanding at the year end. The case is squarely covered by IND AS 24.Further, SA 550 on "Related Parties", also prescribes the auditor's responsibilities and audit procedures regarding related party transactions.

Part IV – Conclusion

- Auditor should insist to make proper disclosure as per the IND AS and report as per CARO, 2020. If management refuses, the auditor shall have to modify his report

Author's Note

⚠ **# Mistake point**

Whenever clause (iii) of Para 3 of CARO, 2020 is applicable, reporting under IND AS 24/AS 18 for old course or new course as the case may be will also be applicable and to do audit SA 550 shall also be applied

QNO 397.100	Cl 4—Intercorporate Loan BHASKAR CNO—CARO.110	Old Course – (N18E)

As a Company auditor you notice that there is an inter-corporate loan granted by the company. What are the reporting requirements as regards the matters concerning terms of interest on the inter corporate loan?

Answer

Part I -- Relevant Standards & Laws

- Section 185 & 186 of Companies Act 2013
- Clause (iv) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

- **Reporting Requirements for terms of Interest on the Inter corporate loan:**
  - **As per clause (iv) of Para 3 of CARO, 2020**,
    The auditor is required to report in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.
  - For this purpose, the auditor should obtain the details of, loans given to any person or other body corporate, guarantee given, or security provided in connection with a loan to any other body corporate or person and securities acquired of any other body corporate by way of subscription, purchase or otherwise, made during the year as well as the outstanding balances as at the beginning of the year in accordance with section 186.
  - As per Clause (iv) of CARO, 2020, with respect to matters concerning terms of interest on the inter corporate loan the auditor is required to:
    - Check whether rate of interest is not lower than the prevailing yield of one year, three-year, five year or ten year government security closest to the tenor of the loan granted.
    - Check if the company is in default in the repayment of any deposits accepted or in payment of interest thereon, then the company is not allowed to give any loan or guarantee or any security or an acquisition till such default is subsisting.
  - Non-compliance with respect to interest on the inter corporate loan may be reported incorporating following details: -

S. No.	Non-compliance of Section 186				
		Name of Company/ Party	Amount Involved	Balance as at Balance Sheet Date	Remarks, if any
	Loan given at rate of interest lower than prescribed				
	Any other default				

QNO 399.000	Cl 6—Cl 6 Theory BHASKAR CNO—CARO.130	Old Course – (M17R, N17M) New Course -- (S17M)

CARO, 2020 requires the auditor of the company to report whether maintenance of cost records has been specified by the Central Government under section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
You are required to briefly explain the audit procedure to be followed by the auditor and suggest the reporting pattern.

OR

As per Paragraph 3(vi) of CARO, 2020, auditor is required to report whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained. Explain audit procedure and reporting in relation to this clause.

Answer

Part I -- Relevant Standards & Laws

Clause (vi) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

- **Reporting of Cost Records under CARO, 2020:**

  The auditor is required to report as per clause (vi) to Paragraph 3 of the CARO, 2020, "Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained."

- **Audit Procedures and Reporting-**

  Made vs Maintained – Purchase, Contractor Bills etc are received & maintained whereas Cost Accounts, Statements are made and maintained

  The Order requires the auditor to report whether cost accounts and records have been made and maintained. The word "made" applies in respect of cost accounts (or cost statements) and the word "maintained" applies in respect of cost records relating to materials, labour, overheads, etc. The auditor has to report under the clause irrespective of whether a cost audit has been ordered by the central government.

- **Written representation – Applicability & Compliance of Section 148 & Rules**

  The auditor should obtain a written representation from the management stating:

  (a) whether cost records are required to be maintained for any product(s) or services of the company under section 148 of the Act, and the Companies (Cost Records and Audit) Rules, 2014; and

  (b) whether cost accounts and records are being made and maintained regularly. The auditor should also obtain a list of books/records made and maintained in this regard.

- **Detail vs General – Only general review**

  The Order does not require a detailed examination of such records. The auditor should, therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should, of course, make such reference to the records as is necessary for the purposes of his audit.

- **Reporting – Broad review and prima facie opinion**

  It is necessary that the extent of the examination made by the auditor is clearly brought out in his report. The following wording is, therefore, suggested:

  "We have broadly reviewed the books of account maintained by the company pursuant to the Rules made by the Central Government for the maintenance of cost records under section 148 of the Act, and are of the opinion that prima facie, the prescribed accounts and records have been made and maintained."

  Where the auditor finds that the records have not been written or are not prima facie complete, it will be necessary for the auditor to make a suitable comment in his report.

QNO 399.500	Statutory Dues - Multiple Issues BHASKAR CNO—CARO.140	Old Course – (N20E)
	As an auditor, how will you report under CARO in each of the following situation? **(i) Since more than seven months, payment of electricity bills to company established under statue is outstanding.** **(ii) The company had imported goods 5 years back and were placed in bonded warehouse till the end of financial year under Audit. The company has not paid import duty as goods have not been removed from such warehouse. The company has also not paid rent and interest expenditure payable on the amount of custom duty.** **(iii) The company has received income tax assessment order along with demand notice from Assessing officer. The company has not paid dues payable as the same is not acceptable to the company. The company has neither preferred appeal against the order nor an application for rectification of mistake has been made. The company has just merely represented to the Assessing Officer.** **(iv) The company in view of voluminous pay-roll data consistently follows the method of making lump sum deposit of estimated amount of ESI collections and adjust the excess or deficit against next following months' deposit and the difference of the said amount always remains insignificant.**	
Answer	**Clause (vii) (a) of Para 3 of CARO, 2020** requires the auditor to state in his report Whether the company is **regular in depositing undisputed statutory dues** including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the **extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months** from the date they became payable, shall be indicated It is important to mention that any sum, which is to be regularly paid to an appropriate authority under a **statute (whether Central, State or Local or Foreign) applicable to the company, should be considered as a "statutory due"** for the purpose of this clause. In other words, obligation to pay a statutory due is created or arises out of a statute, **rather than being based on an independent contractual or legal relationship.** (i) Any sum payable to an electricity company as electricity **bill would not constitute statutory due** despite the fact that such a company has been established under a statute. This is so because the **due has arisen on account of contract of supply of goods or services** between the parties. Thus, **reporting under CARO is not required** for electricity dues. (ii) In the given situation, payment of import duty where the goods had been imported five years back and were placed in the bonded warehouse and even till the end of the financial year under audit, the goods have not been removed from such warehouse. It may be noted that when the imported goods are lodged in a bonded warehouse, **the payment of import duty is to be made when the goods are removed from the bonded warehouse.** However, till the time the importer opts to remove the goods from the warehouse**, the importer is required to incur the rent and interest expenditure on the amount of customs duty payable.** Since **the payment of the custom duty is not due in the current case, the question of regularity does not arise in respect of custom duty.** However, it may be noted that the **interest and rent that are required to be incurred** under section 61 of the Customs Act, 1962 **would come under other statutory dues and the auditor would have to examine and comment upon the regularity of the company in depositing such interest and rent.** (iii) In the given situation, the company has received income tax assessment order along with demand notice from Assessing Officer and company has not paid such demand and is also not in agreement for the same. Further, the company has just merely represented before the Assessing Officer. The auditor is required to check whether time limit for filing the appeal is expired /	

application for rectification of mistake or not. In case time limit, for filing the appeal or application for rectification of mistake, **has expired disputed amount will become undisputed statutory due (as mere representation to the concerned Department shall not be treat ed as a dispute).**

Further, the auditor is also required to ascertain whether such dues are outstanding for a period of **more than six months** from the date they became payable. Accordingly, after ensuring the above, **if the statutory dues are outstanding for more than six months the auditor is required to report the same under clause (vii)(a) of CARO, 2020.**

However, in case the statutory dues are not outstanding for a period of more than six months from the date they became payable the auditor is not required to report the same under CARO.

(iv) It is possible that in a large company where there are a number of departments with separate payrolls and where payments are spread over a number of days, the collection of data regarding the provident fund/employees' state insurance collections and the company's contribution thereto may take some time. In order to ensure that deposit of the dues is made in time, the company may make lump-sum deposits of estimated amounts and adjust the excess or deficit against the following month's
deposit. If this method is **consistently followed and the difference between the total dues and the lump-sum deposit is not significant, it need not be considered that dues have not been regularly deposited and no unfavourable comment is necessary. Thus, no reporting is required for the same under CARO.**

QNO 400.000	Cl 7--Statutory Due (Pending Disputes) BHASKAR CNO—CARO.140	Old Course – (M11E, M13R, M14R, N16R, P17M, M18M) New Course – (N18M, M19M)

Shahjahan Pvt. Ltd. has submitted the financial statements for the year ended 31-3-13 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:
Income Tax relating to Assessment Year 2007-08 ` 157 lacs - Appeal is pending before Hon'ble ITAT since 30-9-10.
Customs duty ` 65 lakhs - Demand notice received on 15-9-12 but no action has been taken to pay or appeal.
As an auditor, how would you bring this fact to the members?

Answer

Part I -- Relevant Standards & Laws

- SA 250 "Consideration of Laws and Regulations"
- Clause (vii)(b) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (vii)(b) of Para 3 of CARO, 2020**

Where statutory dues referred to in sub clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

➢ **Requirements of SA 250 "Consideration of Laws and Regulations"**

- **Responsibility of Management –**

  As per SA 250"Consideration of Laws and Regulations in an Audit of Financial Statement", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

- **Responsibility of Auditor**

  During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.

  Then the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in

compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

This show cause notice may be an alert or indication of non-compliance for the auditor. So auditor need to discuss with management and apply additional procedure.

In case, if the auditor concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

- **Inherent limitations-**
  Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

Case Discussion

- In the present case, there is –
  - Income Tax demand of 157 Lacs and the company has gone for an appeal,
  - Demand notice received for Customs duty of 65 lakhs on 15-9-12 but no action has been taken to pay or appeal
    It needs to consider as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis.

Conclusion

- Therefore, As per AS 29 partly to the extent the company considered that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability.

  Further, it should be brought to notice of members by reporting under **Clause (vii)(b) of Para 3 of CARO, 2020**

Author's Note

- In the question instead of Custom duty had there been GST then it would also have attracted reporting under clause (vii) (a) since GST being a periodical payment.
- **Clause (vii)(a)** includes statutory dues related to Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities

QNO 401.000	**Cl 7--Statutory Due (PF Not Deposited)** **BHASKAR CNO—CARO.140**	**Old Course – (M04E, M08E, N11R, M12R, N15R, M16E, P17M, N17M, N18M)** **New Course – (M18M, N18M)**

During the course of audit of CT Ltd. for the financial year 2016-17, it has been noticed that Rs. 2.00 lakhs of employee contribution and Rs. 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas it was found that Rs. 4.00 lakhs only have been deposited with ESIC department during the year ended 31st March 2017. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor.

Answer

Part I -- Relevant Standards & Laws

- SA 250 "Consideration of Laws and Regulations"
- Clause (vii)(a) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

- **Clause (vii)(a) of Para 3 of CARO, 2020**
  Whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated

	➢ **Requirements of SA 250 "Consideration of Laws and Regulations"** **Refer from QNO 399.000**
	Part III– Case Discussion
	➢ Rs. 2.00 lakhs of employee contribution and Rs. 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts but only Rs. 4.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2017.
	Conclusion
	➢ In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 7.50 lakhs in his report.

QNO 402.000	**Cl 7--Statutory Due Dispute Show Cause Notice** **BHASKAR CNO—CARO.140**	**Old Course – (M11E, M14R, N14E, P17M)**
	Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of ` 25 lakhs in December 2014. The company replied to the above notice in January 2015 contending that it is not liable for the levy. No further action was initiated by the central excise department up to the finalization of the audit for the year ended on 31st March 2015. As the auditor of the company, what is your role in this?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 250 "Consideration of Laws and Regulations" ▪ Clause (vii)(b) of Para 3 of CARO, 2020	
	Part II -- Requirements of Relevant Standards & Laws	
	➢ **Clause (vii)(b) of Para 3 of CARO** The auditor's report under section 143 of the Companies Act, 2013 has to specifically include certain matters specified in Para 3 of CARO, 2020. One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii)(b) of Para 3 of CARO, 2020, where statutory dues referred to in sub clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).	
	➢ **Requirements of SA 250 "Consideration of Laws and Regulations"** Refer from above - QNO 399.000.	
	Part III– Case Discussion	
	➢ **In** the present case of Big and Small Ltd., issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In so far as the Company has replied to the notice and no further correspondence was received from the Department.	
	Part IV- Conclusion	
	➢ **On** the basis of above facts prima facie, **it cannot be said that there exist any dispute. Hence no reporting required under CARO.** But if the auditor after performing audit procedures **is of the opinion that there exists a dispute** then **as** per AS 29 "Provisions, Contingent liabilities and Contingent Assets"**/ (IND AS 37),** future events that may affect the **amount required to settle an obligation should be reflected in the amount of a provision** where there is sufficient objective evidence that the event will occur. If the **auditor concludes that there is non-compliance, then provision for the same should be made as per AS 29./(IND AS 37)** The auditor **should also report the amount of dues not deposited on account of dispute and the forum where dispute is pending, in his audit report.** **If the management does not accept the request, the auditor should qualify the audit report accordingly or vice versa.**	

QNO 402.500	Cl 8 & 18 Case Study BHASKAR CNO— CARO.250, CARO.150	New Course – (N22E)
	You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2021-22 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All the compliances under Sections 139 and 140 are made by the company with regard to resignation and appointment. **During the course of audit, it came to your notice that a survey has been conducted on December 7, 2021 by the Income Tax Department and department has unearthed unrecorded sales of ` 5 lakhs which had been made in cash on different dates during the year 2020-21. XMP Pvt. Ltd. has purchased gold from such collections and these transactions are not recorded. Company surrendered and disclosed these transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities.** **You want to report the above matters in CARO, but the management requested you not to report them. Comment with respect to auditor's response to the management and his reporting requirements to the shareholders.**	
	Clause (xviii) of Paragraph 3 of CARO, 2020: In the given situation of XMP Pvt Ltd, the auditors RS & Co. resigned due to concerns on the accounting matters of the company. However, all the compliances regarding resignation and appointments discussed in section 139 and 140 of the Companies Act, 2013 are also being complied with. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020 given hereunder: Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors. **Clause (viii) of Paragraph 3 of CARO, 2020:** Further, the auditors noticed that a survey was conducted by the Income Tax Department and unrecorded sales of Rs 5 Lakhs were unearthed which had been made in cash on different dates during the year. XMP Pvt Ltd. has also purchased gold and the transactions remained unrecorded. Though Company surrendered and disclosed these transactions before the Assessing Officer and paid taxes thereon. The auditor would be required to report in CARO as per Clause (viii) of Paragraph 3 of CARO, 2020. Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report -whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year. Since it is a statutory obligation on the part of the auditor to report in terms of CARO, 2020 as given above and consequently management's request to the auditor that not to report the above transactions is not tenable.	

QNO 403.000	Cl 9--Default in Repayment (Amount Repaid after Year End) BHASKAR CNO—CARO.160	Old Course – (M13E, N14E, M16M, P17M) New Course – (M18R)
	C Limited has defaulted in repayment of dues to a financial institution during the financial year 2016-17 and the same remained outstanding as at March 31, 2017. However, the Company settled the total outstanding dues including interest in April, 2017 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Schedule III to the Companies Act, 2013 ▪ Clause (ix) of Para 3 of CARO,2020 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Schedule III to the Companies Act, 2013** **Reporting for Default in Repayment of Dues**: As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of	

term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

➢ **Clause (ix) of Para 3 of CARO**

Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as below:

- Nature of borrowing, including debt securities
- Name of lender (Lender wise details to be provided in case of defaults to banks, financial institutions and Government)
- Amount not paid on due date
- Whether principal or interest
- No. of days delay or unpaid
- Remarks, if any

Part III – Case Discussion

➢ In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2016-17 which remain outstanding as at March 31, 2017.

However, the company has settled the total outstanding dues including interest in April 2017 but, the dues were outstanding as at March 31, 2017.

Part IV – Conclusion

➢ Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:

"The company has taken a loan during the year, from a financial institution amounting to` XXXX @ X% p.a. which is repayable by monthly instalment of ` XXXX for XX months.

The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2015-16 amounting to` XXXX which remained outstanding as at March 31, 2017.

The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2017."

Author's Note

⚠ **# Mistake point**

Students may forget to write on the reporting aspect. Question specifically asks to draft a suitable Auditor's Report.

QNO 404.000	**Cl 9--Default in Repayment (Re schedulement)** **BHASKAR CNO—CARO.160**	**Old Course – (M11E, M14R, M15R , P17M)** **New Course-- (S17M**

K Ltd. has taken a term loan from a nationalized bank in 2010 for ` 200 lakhs repayable in five equal instalments of ` 40 lakhs from 31st March 2011 onwards. It had repaid the loans due in 2011 & 2012, but defaulted in 2013, 2014 & 2015. As the auditor of K Ltd. what is your responsibility assuming that company has sought re schedulement of loan?

Answer

Part I -- Relevant Standards & Laws

- Clause (ix) of Para 3 of CARO

Part II – Requirements of Relevant Standards & Laws

➢ **Requirements of Clause (ix) of Para 3 of CARO**

Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as below:

- Nature of borrowing, including debt securities
- Name of lender (Lender wise details to be provided in case of defaults to banks, financial institutions and Government)
- Amount not paid on due date
- Whether principal or interest

- No. of days delay or unpaid
- Remarks, if any

Part III – Case Discussion

➢ In this case, K Ltd. has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position.

Part IV – Conclusion

➢ Hence the auditor has to report in his audit report that the Company has defaulted in its repayment of dues to the bank to the extent of `120 lakhs.

QNO 404.500	**Cl 9--Default in Repayment (Re-schedulement Case Study)** **BHASKAR CNO—CARO.160**	**New Course –(N22R)**

Gautam Limited had borrowed ` 1000 crore from XYZ Bank, the principal of which was repayable after 5 years and interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5th instalment of interest payment and principal which was due on June 30, 2021. On March 31, 2021, Gautam Limited approached XYZ bank and MNO bank to restructure the existing liability. As a result, the existing principal and outstanding and overdue interest was restructured into a new loan amounting to ` 1,100 crore. The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist and the new loan has maturity after 5 years.
During the statutory audit for the financial year 2021-22, KP & Co. identified this transaction and obtained the relevant documents and understanding. Based on the underlying documents, it was identified that the said restructuring agreement was approved and signed on April 8, 2022, by both of the banks. As a result, on March 31, 2022, the restructuring was still not approved.
In the light of the above scenario, kindly guide the statutory auditors in the reporting of this transaction.

Answer

As per Clause 3(ix) of CARO 2020, the auditor is required to report whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below.

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions and Government.				

In the given case, the company Gautam Limited defaulted in payment of the principal amount of the loan due of ` 1000 crore on 30 June 2021 and the interest instalment of ` 100 crore. The said default continued till the end of the year and on 8 April 2022, a restructuring agreement was signed by the banks and company for re-structuring the outstanding loan. Moreover, no disclosure was provided by the company with respect to the said matter.

Hence the auditor is required to report the same matter under Clause (ix) of Para 3 of CARO 2020, i.e., whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, then provide the details of the period and the amount of default. Also, the auditor needs to consider the impact of such non-disclosure and the non-compliance with the financial reporting framework and accordingly the auditor needs to either issue a qualified opinion or an

	adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

QNO 406.000	Cl 9--Money Raised Miss-Applied (Loan for R&D) BHASKAR CNO—CARO.160	Old Course – (N05E, M12M, N12R, N12E ,M16R, P17M, N17M, M18M, N18M) New Course – (S17M, S21M)

Under CARO, 2020, as a statutory auditor, how would you report on the following:
A Term Loan was obtained from a bank for ` 80 lakh for acquiring R&D equipment, out of which ` 15 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities.

OR

A term loan was obtained from a bank for ` 80 lakhs for acquiring R&D equipment, out of which ` 15 lakh was used to buy a car for use of the concerned director who was looking at the R&D activities. As a statutory auditor, how would you report under CARO 2020?

Answer

Part I -- Relevant Standards & Laws

- Clause (ix) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (ix) of Para 3 of CARO, 2020**

According to clause (ix) of Para 3 of CARO, 2020, the auditor is required to report "whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported"

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

Part III – Case Discussion

➢ In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car for the use of the director who was involved in the R&D activities.

Part IV – Conclusion

➢ Car though used by R&D Director does not fall within the meaning of R&D equipment. The auditor is required to state the fact in his report as per Paragraph 3 clause (ix) of the CARO 2020, that out of the term loan taken for R&D equipment, ` 15 lakh was not utilised for the purpose of acquiring R&D equipment.

QNO 406.010	Cl 9--Money Raised Miss-applied (Loan for P&M) BHASKAR CNO—CARO.160	New Course – (N18E)

During the financial year ended on 31/03/2018, LM Private Limited had borrowed from a Nationalized Bank, a term loan of Rs 120 lakhs consisting of Rs 100 lakhs for purchase of machinery for the new plant and Rs 20 lakhs for erection expenses. As on the date of 31st March 2018, the total of capital and free reserves of the Company was Rs 50 lakhs and turnover for the year 2017-18 was Rs 750 lakhs. The Bank paid Rs 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2017. The machinery had reached the yard of the Company. On 28/02/2018, the Company had drawn the balance of loan viz. Rs 20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31/03/2018, in this respect.

Answer

➢ **Applicability of CARO, 2020 and Utilization of Term Loan:**

- Exemptions from CARO for private companies
  - CARO ,2020 specifically exempts a private limited company,
  - not being a subsidiary company of a public company,
  - having a paid-up capital, reserves & surplus not more than rupees one crore as on balance sheet date and
  - which does not have total borrowing exceeding rupees one crore from any bank or financial institution at any point of time during the year and
  - which does not have a total revenue as disclosed in Schedule III to the companies Act 2013 exceeding Rs 10 crore during the financial year as per financial statements.

- **Case Discussion & Conclusion on Exemption**
  In the case of LM Pvt. Ltd, it has paid up capital of rupees 50 lacs which is below the specified limit of rupees 1 crore and turnover is rupees 7.5 crore which is also less than specified rupees 10 crore. However, there is total borrowing of rupees 1.20 crore which is more than rupees 1 crore and exceeding the specified limits of rupees 1 crore. Hence CARO, 2020 will be applicable to LM Pvt. Ltd.

➢ **CARO Clause (ix) & Audit Procedures**

- **Clause**
  According to clause (ix) of Para 3 of CARO, 2020, the auditor is required to report "whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported"

- **Audit Procedures**
  The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the lender. Normally the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. The auditor should ascertain the purpose for which term loans were sanctioned. The auditor should also compare the purpose for which term loans were sanctioned with the actual utilization of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilization of the amounts raised. If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact.

Case Discussion on Utilization

➢ In the present case, the term loan obtained by LM Private Ltd. amounting rupees 20 lakh have not been utilized for erection expenses instead its utilized for renovating its administrative office building. Further, assuming that erection work has not been done and machinery is not being installed, disclosure of the same as Capital Stock under construction is in order.

Conclusion on Utilization

➢ Here, the auditor should report the fact in his report that pending utilization of the term loan for erection expenses, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2020.

QNO 407.000	Cl 9--Money Raised Temporary Investment BHASKAR CNO—CARO.170	Old Course – (M08E , P17M) New Course -- (S17M)

LM Ltd. had obtained a Term Loan of ` 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.

Answer

Part I -- Relevant Standards & Laws

- Clause (ix) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Term Loan Invested in Short Term Deposits:**
According to clause (ix) of Para 3 of CARO, 2020, the auditor is required to report "whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported"

Part III – Case Discussion

➢ In the present case, the term loan obtained by LM Ltd. have not been put to use for construction activities and temporarily invested the same in short term deposit.

Part IV – Conclusion

➢ Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2020.

QNO 407.010	Cl 11--Fraud Reporting (Noticed or Reported) BHASKAR CNO—CARO.180	Old Course – (N18R, M19R, M19M) New Course – (M19R, N21M)
	Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020: - **(ii) The Internal Auditor of the Company has identified a fraud in the recruitment of employees by the HR department wherein certain sums were alleged to have been taken as kick -back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The amount of such kickbacks is expected to be in the range of 13.50 Lakh.** **OR** **Paragraph 3(xi) of CARO, 2020 requires the auditor to report whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. The clause does not require the auditor to discover such frauds. The scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the year. Comment.**	
Answer	➢ **Paragraph 3(xi) of CARO, 2020 states that :** Whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, • the nature and • the amount involved is to be indicated; The clause does not require the auditor to discover such frauds. The scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the year. The use of the words "noticed or reported" indicates that the management of the company should have the knowledge about the frauds by the company or on the company that have occurred during the period covered by the auditor's report. In the instant case, a fraud has been identified in recruitment of employees by the HR Department wherein certain sums were alleged to have been taken as kickback from the company of amounting rupees approx. 13.50 lakh. The auditor is required to report on the same in accordance with clause (xi) of para 3 of CARO 2020.	

QNO 407.020	Cl 11--Cl 11--Fraud Reporting (Reporting on Cases) BHASKAR CNO—CARO.180	Old Course – (N18E) New Course – (S21M)
	What are the reporting requirements in the audit report under the Companies Act, 2013 / CARO, 2020 for the following situations? **(i) A fraud has been committed against the company by an officer of the company.** **(ii) A fraud has been committed against the company by a vendor of the company.** **(iii) The company has committed a major fraud on its customer and the case is pending in the court.** **A fraud has been reported in the cost audit report but not noticed by statutory auditor in his audit.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (xi) of Para 3 of CARO, 2020 ▪ Section 143(12) **Part II -- Requirements of Relevant Standards & Laws** ➢ **CARO Clause (xi)** • Whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, • the nature and • the amount involved is to be indicated. • Whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government; ➢ **Section 143(12)** Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the	

course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is rupees 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than rupees 1 crore) within such time and in such manner as may be prescribed.

- **Fraud Committed against the Company:**
  Fraud committed against the company. has to be reported in accordance with Clause (xi) of Para 3 of CARO 2020, and as per section 143(12) of the Companies Act, 2013.
- **Fraud committed against the company by a vendor of the Company:**
  In case employees or management are involved in fraud committed by vendor, reporting has to be done in accordance with CARO 2020 and as per section 143 (12) of the Companies Act, 2013. Suspected fraud by vendors, customers and other third parties should be dealt with in accordance with SA 240. Therefore, reporting has to be done in accordance with SA 240, "The Auditor's Responsibilities relating to Fraud in an audit of Financial Statements".
- **Company has committed major fraud on its customer of which case is pending in the court:**
  Major fraud committed by the company on its customer has to be reported in accordance with Clause (xi) of Para 3 of CARO 2020.

➢ **Fraud reported in Cost Audit Report but not noticed by Statutory Auditor:**
As per Clause (xi) of Para 3 of CARO 2020, all frauds noticed or reported during the year shall be reported indicating the nature and amount involved as specified the fraud by the company or on the company by its officers or employees are only covered.

Here in the given scenario, a fraud has been reported in the cost audit report but not noticed by Statutory Auditor in his audit. Hence the statutory auditor has to report the nature and amount involved in the audit report as per section 143 of the Companies Act, 2013

QNO 409.010	Cl-13-- Loan taken from parent company BHASKAR CNO—CARO.200	Old Course – (M19R, M19M) New Course – (M19R, M19M)
	Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020: - **The long-term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far.**	

Answer

Part I -- Relevant Standards & Laws

- Clause (xiii) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ As per clause (xiii) of para 3 of CARO 2020 the auditor is required to report, "whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards".

Part III – Case Discussion

➢ In the present case, the long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far

Part IV – Conclusion

➢ The auditor is required to report as per clause xiii of para 3 of CARO 2020 regarding receipt of long-term borrowing from Parent Company which qualifies as a transaction with the related party.

QNO 409.020	Cl-13-- Non-Disclosure of RPT BHASKAR CNO—CARO.200	Old Course – (M19R, N19M) New Course – (M19R, N19M, N19M, N20E)
	An amount of ` 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services	

	rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ` 0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts' paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a 'related party' transaction. **OR** **In the course of audit of MM Ltd. for the financial year ended 3 March 2019, your audit team has identified the following matter:** **An amount of Z 4 Lakh per month for the marketing services rendered is paid to M/s. MG Associates, a partnership firm in which Director of MM Ltd. is also a managing partner, with a profit-sharing ratio of 30%. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by 1.50 Lakh per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts.** **Give your comments for reporting under CARO 2020.**
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause(xiii) of para 3 of CARO 2020 **Part II -- Requirements of Relevant Standards & Laws** ➢ As per clause (xiii) of para 3 of CARO 2020, the auditor is required to report, "whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;" Therefore, the duty of the auditor, under this clause is to report • Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 ("Act"); • Whether related party disclosures as required by relevant Accounting Standards (AS 18/IND AS 24, as may be applicable) are disclosed in the financial statements. **Part III – Case Discussion** ➢ In the Instant case, MG Associates is a related party and also rendering marketing services to MM Ltd. in return of Consideration of ` 4 Lakhs which is related party transaction. No separate disclosure has been made in the notes to accounts in this context, which was required to be made. **Part IV Conclusion** ➢ In view of above, **Auditor shall report under the above clause as under** 1. Nature of the related party relationship and the underlying transaction-**MG Associates is a partnership firm in which Director of MM Ltd is also a managing partner**, with a profit sharing ratio of 30 %. Payment of ` 4 Lakhs to MG Associates is a related party transaction. 2. Amount involved is Consideration for the Marketing services rendered by MG Associates (4 Lakhs p.m.) is higher than the arm's length pricing by 1.50 Lakh p.m. (18 Lakhs p.a.)

QNO 411.000	**Cl 15--Non-Cash Transaction (Son of Director)** **BHASKAR CNO—CARO.220**	**Old Course – (M17R, M17M, N17M, M18M, N19R)** **New Course – (N19R)**
	RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director, which is an arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (xv) of Para 3 of CARO, 2020 ▪ Section 192 of the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Non-cash Transactions with Relative of Director:** As per Clause (xv) of paragraph 3 of CARO, 2020, the auditor is required to report • "whether the company has entered into any non-cash transactions with directors or persons connected with him and • if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with".	

➢ **Section 192 of the Companies Act, 2013**

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

Part III – Case Discussion

➢ In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is an arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash and falls within the meaning of section 192 of Companies Act, 2013.

Part IV – Conclusion

➢ The reporting has to be two-fold.

- **first part**

  It requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s.

- **Second part**

  It requires the auditor to report whether the provisions of section 192 of the Act have been complied with.

  Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

  In the given situation, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2020, thus, reporting is required for the same.

➢ **Draft report is given below.**

- According to the information and explanations given to us, the Company has entered into non-cash transactions with Mr. Rahul, son of one of the directors during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.

QNO 412.000	**Cl 16--Theory of Cl 16** **BHASKAR CNO—CARO.230**	**Old Course – (M17R, N17R, N17M, M19M, N20E, N21M)** **New Course – (M18R, M19M, S21M)**

In the case of companies carrying on the business of a non-banking financial institution, the auditor needs to report under CARO, 2020 whether the registration has been obtained under section 45-IA of the Reserve Bank of India Act, 1934, if required.

You are required to state in brief the audit procedure to be followed while reporting under above mentioned circumstances.

OR

The RBI restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration, therefore, obtaining registration under section 45-IA of the Reserve Bank of India Act, 1934 is necessary Additionally, new clause has been inserted under CARO, 2020 for commenting whether the registration has been obtained, if required.

Being an expert in latest provisions under CARO, 2020, you are required to state in brief the audit procedure and reporting to be followed under above mentioned circumstances

Answer

Part I -- Relevant Standards & Laws

- Clause (xvi) of Para 3 of CARO, 2020

Part II -- Requirements of Relevant Standards & Laws

➢ **Reporting under CARO, 2020 for Registration under RBI Act, 1934:**

As per Clause(xvi) of paragraph 3 of the CARO, 2020, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

➢ **Audit Procedures and Reporting-**

- The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.

- The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- Whether the company has net owned funds as required for the registration as NBFC.
- Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
- The auditor should report incorporating the following: -
    - Whether the registration is required under section 45-IA of the RBI Act, 1934.
    - If so, whether it has obtained the registration.
    - If the registration not obtained, reasons thereof

QNO 412.500	Cl 16--CIC (Case Study) BHASKAR CNO— CARO.230	New Course – (N22E)

What is a Core Investment Company (CIC) under the Reserve Bank of India regulations? What are the specific reporting requirements to be considered by an auditor in respect of CIC under CARO 2020?

Core Investment Companies: As per RBI Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016, (Reference may be made to aforesaid Master Direction), these directions shall apply to every Core Investment Company (CIC), that is to say, a non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

i it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

ii its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets as mentioned in clause (i) above;

Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

iii it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

iv it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934 except

a) investment in
    i bank deposits,
    ii money market instruments, including money market mutual funds and liquid mutual funds
    iii government securities, and
    iv bonds or debentures issued by group companies,

b) granting of loans to group companies and

c) Issuing guarantees on behalf of group companies.

As per CARO 2020, the auditor is required to report that –

i. Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria; [Paragraph 3(xvi) (c)]

ii. Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group; [Paragraph 3(xvi) (d)]

QNO 415.000	Cl 17--& Other Clauses case studies BHASKAR CNO— CARO.240	New Course – (M23R)

LIU Private Limited is a company based out of Mumbai. The company had an authorised capital of ` 200 lakh and paid-up capital plus reserves of ` 95 lakh as of 31st March. During the audit for the year ended 31st March 202X, the auditor M/s Y&S Associates noted the following points:

(i) On 15th December, the company had total bank borrowings of ` 75 lakh. On the said date, the company received a new loan of ` 30 lakh for a new project that was to be developed. However, the project was shelved on 17th December due to technical reasons, and the whole loan was paid on the same date.

(ii) During the financial year, a new proceeding was initiated against the company for holding a benami property worth ` 2.5 crore. However, the company's legal team had advised that the case would not withstand the law and would be dismissed during the hearing in April of next financial year.

(iii) The company had incurred a cash loss of ` 39 lakh during the financial year compared to a cash profit of ` 15 lakh in the previous financial year. The total turnover of the company for the financial year was ` 45 Crore.

During the year, the Y&S Associates had offered to resign from acting as the company's auditors. However, they later decided to postpone their resignation to the following year. At the conclusion of the audit, there was a difference of opinion between two articled assistants (Jack & Jill), who were assigned to the engagement, concerning disclosing the points mentioned above in the Companies (Auditor's Report) Order 2020. Jack was of the opinion that the proceeding initiated under Benami Property Act need not be disclosed since the expert legal team had informed them that the case would not withstand the law. However, he insisted that the cash loss shall be disclosed along with the amount. Jill was of the opinion that CARO is not at all applicable to the company, hence nothing needs to be reported. They both approached the firm's partners (Mr. Y & Mr. S) to resolve their argument. Mr Y supported Jack's viewpoint & Mr S supported Jill's viewpoint. Now, both partners approached their Senior Partner to get clarification on the same. As a Senior Partner, kindly clarify the correct disclosure requirement

Answer

As per para 1 of Companies (Auditor's Report) Order 2020, CARO 2020 is applicable to every company, including a foreign company, as defined in clause (42) of section 2 of the Companies Act 2013, except,

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements

In the given case, though LIU is a private company, and its paid-up capital is less than 1 crore as on the balance sheet date, it is to be noted that for the period 15th December to 17th December, the total borrowings of the company had exceeded 1 crore (75 lakh + 30 lakh). The borrowings are less than 1 crore as of the balance sheet date and the authorised capital is 200 lakh, are irrelevant to the current scenario. Also, the turnover of the company was greater than 40 crore. Hence, CARO 2020 is applicable to LIU Private Limited.

(i) As per clause (i) (e) of para 3 of CARO 2020, the auditor shall include a statement on: whether any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

In the given situation, a new proceeding was initiated against the company for holding a benami property worth ` 2.5 crores during the financial year. However, the company's legal team had

	advised that the case would not withstand the law and would be dismissed during the hearing, which would be held in April of the next financial year. Therefore, the above observation of a new proceeding initiated against the company for holding a benami property worth ` 2.5 crores need to be disclosed as per clause (i) (e) of para 3 of CARO 2020. **(ii)** As per clause (xvii) of para 3 of CARO 2020, the auditor shall include a statement on whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses. In the given situation, the company incurred a cash loss of ` 39 lakh during the financial year. Hence, a cash loss of ` 39 lakh during the financial year need to be reported as per clause (xvii) of para 3 of CARO 2020 **(iii)** As per clause (xviii) of para 3 of CARO 2020, the auditor shall include a statement on whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors. In the instant case, there has been no resignation made by the statutory auditors during the financial year. The mere fact that Y&S Associates were thinking of resigning does not matter in the current scenario, and hence this clause shall not be applicable in the given situation

PART - 3 DIVIDEND

QNO 365.000	Sec 123--Dividend Verification BHASKAR CNO—DIV.220	Old Course – (N08R, N08E, M13R, P17M, M19R) New Course – (M19R)
	AARK Ltd is a large-sized listed company having annual turnover of INR 4000 crores. The company also has a plan to get listed on New York Stock Exchange next year. The company has paid good amount of dividend during the year to its shareholders which is significantly higher as compared to earlier years. The statutory auditors would like to focus on this aspect at the time of their statutory audit. **Please advise the relevant procedures that the statutory auditors should perform in respect of this area.** **OR** **As Auditor of Act Fast Ltd. what steps will you take to ensure that the dividend has been paid only out of profit?**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 123(2) of the Companies Act, 2013. **Part II -- Requirements of Relevant Section & Laws** ➢ The auditor may take the following steps to ensure that the dividend has been paid only out of profits ⩔ Check whether the dividend was declared out of profits arrived at after providing for depreciation as per Section 123(2) of the Companies Act, 2013 (herein after referred as the Act). ➢ **Check whether-** ⩔ The depreciation was provided according to provision of Schedule II to the Act ⩔ A board resolution recommending dividend was passed. ⩔ The dividend was declared only in the Annual General Meeting. ⩔ No dividend declared in general meeting exceeds the amount recommended by the Board ⩔ Amount paid or credited as paid on a share in advance of calls is not treated for the purpose of this regulation as paid on the share. ⩔ Register of members was closed as per the provisions of section 91 of the Act. ⩔ Dividend has been paid in the prescribed manner within 30 days of time to the registered holder or their order for the compliance of Section 127 of the Act. ⩔ Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend. ⩔ Intimation sent to Stock Exchange in the case of listed company ⩔ Were there any complaints of non-payment/delayed payment of dividend? If so, whether corrective action was taken.	

QNO 366.000	Sec 123--Interim Dividend No Transfer of Profit BHASKAR CNO—DIV.060	Old Course – (N04E, M08E, N16E, P17M) New Course – (S17M, S21M)
	As a Statutory Auditor, how would you deal with the following: **While adopting the accounts for the year, the Board of Directors of Sunrise Ltd. decided to consider the Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.**	
Answer	**Part I -- Relevant Section & Laws** ▪ Section 123 of the Companies Act, 2013. ▪ Section 2(35) of the Companies Act 2013 **Part II -- Requirements of Relevant Section & Laws** ➢ **Section 123(3) of the Companies Act, 2013** It provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Statement of Profit and Loss and out of profits of the financial year in which such interim dividend is sought to be declared.	

➢ **Section 123(4) of the Companies Act, 2013**
The amount of dividend including interim dividend should be deposited in a separate bank account within five days from the declaration of such dividend

➢ **Section 2(35) of the Companies Act, 2013**
Based on Section 2(35) of the said Act, it can be said that since interim dividend is also a dividend, companies should provide for depreciation as required by Section 123 before declaration of interim dividend.

➢ **First proviso to Section 123(1)**
However it provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company irrespective of the size of the declared dividend i.e. the company is not mandatorily required to transfer the profit to the reserves, it is an option available to the company to transfer such percentage.

Part III – Case Discussion

➢ In the given case, The Board of Directors of Sunrise Ltd. decided to consider the Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.

Part IV – Conclusion

➢ In the instant case, the Board has decided to pay interim dividend @15% of the paid-up capital. Assuming that the company has complied with the depreciation requirement, the interim dividend can be declared without transferring such percentage of its profits as it may consider appropriate to the reserves of the company.

Author's Note
In old company's act there was requirement for compulsory transfer to general reserves at the time of declaring dividend, but now such requirement is removed, we can transfer any amount we want or we may not transfer any amount to general reserve. So, in this case even if there is no transfer it is absolutely fine

QNO 367.000	Sec 123--Proposed Dividend, Maximum Transfer of Profit BHASKAR CNO—DIV.040	Old Course – (M14E, P17M)

For the year ended on 31st March 2015, P Ltd. proposed to pay a dividend of 25% on its equity shares and it further proposed to transfer 20% of Net profit for that year after tax to its reserves. Its auditor objected to the same stating that 10% is the maximum permissible limit to transfer to reserves

Answer

Part I -- Relevant Section & Laws

- Section 123 of the Companies Act, 2013.

Part II -- Requirements of Relevant Section & Laws

➢ **Section 123 of the Companies Act, 2013.**
Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or out of the profits or the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or out of both.

➢ **First Proviso to section 123(1) of the Companies Act, 2013.**
It provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company irrespective of the size of the declared dividend i.e. the company is not mandatorily required to transfer the profit to the reserves, it is an option available to the company to transfer such percentage.

Part III – Case Discussion

➢ In the instant case, P Ltd. has proposed to pay a dividend of 25% on its equity shares and it further proposed to transfer 20% of Net profit for that year after tax to its reserves.

Part IV – Conclusion

➢ Therefore, from the above facts and provisions, it may be concluded that P Ltd. is under no violation of law i.e. the company is free to transfer any amount of its profit to the reserves, without any compulsion or restriction, before declaration of any dividend.

QNO 368.000	Sec 123--Reversal of Proposed Dividend BHASKAR CNO—DIV.040	Old Course – (M16E, N18M)

The Board of Directors of ACP Ltd. has recommended the dividend of 15% on paid up share capital of ` 450 crore for the year ended 31st March 2015, at their meeting held on 1st of May 2015 when the accounts for the financial year 2014-15 were approved. The Board of Directors when they met on 7th July 2015 for the review of first quarter accounts, they realized that results were negative for the first quarter. Therefore, the Board has decided to rescind their decision to recommend dividend.
The notice for AGM to be held on 14.8.2015 was sent on 15th July 2015 without any recommendation for dividend.

At the AGM, the members asked the management how they can rescind the declaration of dividend once recommended. Comment

Answer

Part I -- Relevant Section & Laws

- Section 123 of the Companies Act, 2013.

Part II -- Requirements of Relevant Section & Laws

➢ Dividend is firstly recommended by the Board. Thereafter, the members in the Annual General Meeting (AGM) may declare the dividend by passing ordinary resolution. The members may reduce the rate or amount recommended by the Board, but they cannot increase it.

⩔ Section 123 of the Companies Act, 2013
It provides that the dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in prescribed manner.

⩔ Further, as per section 127 of the Act
Dividends once declared become the liability of the company and must be paid within 30 days from the date of declaration. Any failure to do so attract a penalty for the various persons associated with the management.

Part III – Case Discussion

➢ Here in the instant case, Board of Directors of ACP Ltd. has recommended the dividend in their meeting. Such dividend is not declared in AGM. Further, Board has decided to rescind the decision before the date of Annual General Meeting. Thus, the dividend which is only recommended and not declared does not attract penal provisions.

Part IV – Conclusion

➢ Therefore, Board of Directors may rescind their decision to recommend dividend.

QNO 369.010	Full depreciation not charged BHASKAR CNO—DIV.160	Old Course – (N20M) New Course -- (N18E, N20M, S21M)

ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. The Financial year 2017-18 was so very bad for the Company that it was not possible for the Company to maintain the payment of consistent dividend as above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet- 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be in fair practice of accounting if the depreciation for asset is charged before the expiry of the life's of assets and the amount parked in asset code as above would unfailingly be adjusted to Revenue before the close of next financial year anyway. Analyze the issues involved and state how the Auditor should decide on this matter.

Answer

Part I -- Relevant Section & Laws

- Section 123 of the Companies Act, 2013.

Part II -- Requirements of Relevant Section & Laws

➢ **Sec 123**
Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or out of the profits or the company for any previous financial year or years arrived at **after providing for depreciation**

in the manner aforementioned and remaining undistributed, or out of both.

- **AS 10 / Ind AS 16 / Schedule II**
  Further, it is the duty of auditor to check whether the depreciation was provided according to provision of AS 10 / IND AS 16/Schedule II to the Act.

Part III – Case Discussion

- In the instant case, ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. Due to bad financial condition, company has not provided for dividend for the year 2017-18. In addition to this management has also taken decision to charge75% of the depreciation in the statement of Profit and Loss whereas 25% of the depreciation amount kept in a separate account code in the Balance Sheet – 'Debit Balances Adjustable against Revenue Account'.

  Contention of management that it would be in fair practice of accounting where the depreciation of asset is charged before the expiry of the life of assets and the amount parked in asset code would unfailingly be adjusted to revenue before the close of next financial year is not tenable.

Part IV – Conclusion

- The practice of the company in not charging the depreciation and accumulating 25% of it in a debit balance for being written off in the next year is not an acceptable accounting treatment. If dividend is declared in such situation, it would mean payment out of capital.
- Therefore, the auditor of the company should ensure the compliance of provisions of section 123 and Schedule II. In case the management does not comply with the provisions and does not charge the 100% depreciation the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

QNO 344.000	Sec 52--Securities Premium (Adjustment of Loss) UNIQUE	Old Course – (N04E, N13R, N15R, P17M, N18R) New Course – (N18R)

Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of ` 10 crores. The company has ` 12 crores in its share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance. Advise the company giving your reasons.

OR

Comment on the following situations:

Pirana Ltd. issued 10,000 shares of face value of ` 10 each at a premium of ` 490 each in May 2015. The company received the stated minimum amount in the prospectus and transferred a sum equal to the aggregate amount of the premium received on shares (i.e. ` 49 lakhs) to the 'Securities Premium Account'.

Unfortunately, in the month of July, the godown of the company caught fire and stock worth ` 45 lakhs burnt to ashes.

Now, the management desires to adjust the loss due to fire against the said premium account.

Answer

Part I -- Relevant Section & Laws

Section 52 of the Companies Act, 2013- Application of Share Premium Account

Part II -- Requirements of Relevant Section & Laws

➢ **Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares.**

- Sub-section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to an account called "Securities Premium Account" and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company.

- Sub-section (2) of the said section provides that notwithstanding anything contained in sub-section (1), securities premium account may be applied by the company
  - for issue of bonus shares;
  - writing off the preliminary expenses;
  - writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
  - in providing for the premium payable on redemption of any redeemable preference shares or any debentures of the company;
  - for the purchase of its own shares or other securities.

Part III – Case Discussion

➢ In the given case, Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of ` 10 crores. The company has ` 12 crores in its share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance.

Part IV – Conclusion

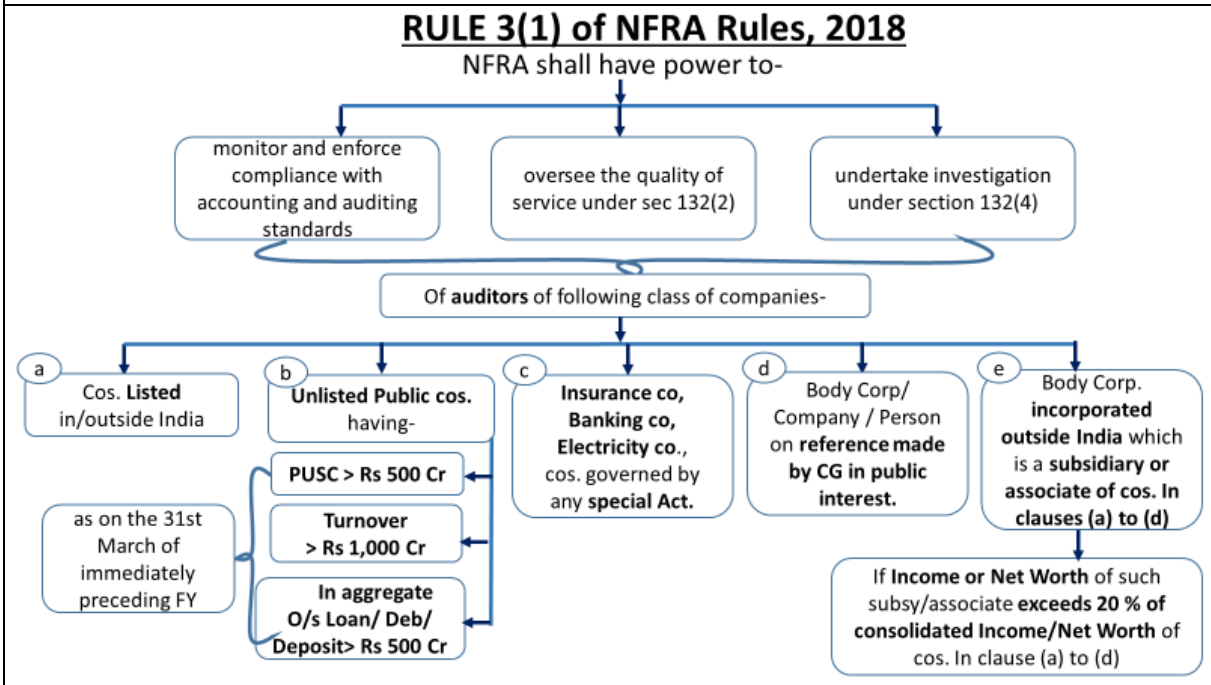
➢ In view of these provisions of the Companies Act, 2013, it is not permitted to adjust its accumulated losses against the securities premium account.

QNO 349.500	Sec 130(3)--Revision of Accounts on Order of Court BHASKAR CNO—COACC.060	New Course – (M21E,N22M)
	M/s ALM Ltd. is into the business of trading of toys since 2001. The company was performing well till year 2015 and after that sales started showing downward trend. The Company had borrowed working capital funds from LP Bank Ltd on 01.08.2020, account of the borrower was classified as NPA. Bank appointed forensic auditor, to identify, if any diversion of funds is there or not. Forensic auditor confirmed the diversion of funds. Matter went to the court of law and company was asked to recast its financial statements for the last 5years. Management contended that **Companies Act, 2013 does** not allow recasting for more than three preceding financial years**. Do you agree with the views of the management?**	
Answer	**Part I -- Relevant Standards & Laws** Section 130 of the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** **Re-opening of accounts on Court's or Tribunal's orders:** **Section 130** of the Companies Act, 2013 states that a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board of India (SEBI), any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that— (i) the relevant earlier accounts were prepared in a fraudulent manner; or (ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements. The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless and until Government has, under Section 128(5) , issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period. However, a notice shall be given by the Court or Tribunal in this regard and shall take into consideration the representations, if any. **Part III – Case Discussion** Bank appointed forensic auditor, to identify, if any diversion of funds is there or not. Forensic auditor confirmed the diversion of funds. Matter went to the court of law and company was asked to recast its financial statements for the last 5years. **Part IV – Conclusion** Management contention that Companies Act,2013 does not allow recasting for more than three preceding financial years is not valid.	

QNO 350.000	Section 132 - Applicability of NFRA rules BHASKAR CNO—COACC.120	Old Course – (M21E) New Course – (N20E)
	M/s PC & Co., Chartered Accountants are the statutory auditors of various categories of companies and bodies corporate. In exercise of the powers conferred under sub-sections (2) and (4) of section 132, of the Companies Act, 2013 the Central Government made the National Financial Reporting Authority Rules, 2018 (NFRA Rules) (MCA Notification dated 13 November 2018). The audit firm seeks your guidance on the applicability of those categories of companies and bodies corporate which are covered by NFRA Rules.	
	➢ **Rule 3, NFRA Rules 2018 Classes of companies and bodies corporate governed by the Authority** • The Authority shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate: • companies whose securities are listed on any stock exchange in India or outside India. • unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than	

rupees five hundred crores as on the 31st March of immediately preceding financial year.

- insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of section 1 (4) of the Companies Act, 2013.
- anybody corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the NFRA by the Central Government in public interest; and
- a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d) above, if the income or net-worth of such subsidiary or associate company exceeds 20% of the consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d) above.



QNO 350.500	Section 134 -- Signing Financial Statement Case Study BHASKAR CNO—COACC.160	New Course -- (M22M)
	Dharam & Karam Company Ltd. had prepared its financial statements for the financial year 2021-22 which were approved by the Board of Directors of the company and thereafter they were signed by the Chairperson of the company as authorized by the Board, as well as by its CEO, CFO and CS, respectively. Also, its board report was signed by its Managing Director as well as by an Executive Director. You are required to comment whether financial statements and the Board's report of the company have been signed by the persons mandatorily required to sign, as prescribed by the relevant Act.	
Answer	As per section 134 of the Companies Act, 2013, the financial statements, including consolidated financial statements, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the Chairperson of the Company where he is authorized by the Board or by two directors out of which one shall be Managing Director, if any, and the Chief Executive Officer, the Chief Financial Officer and the Company Secretary of the Company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon. The Board's report shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a Managing Director. Here, Dharam and Karam Company Ltd. had prepared its financial statements for the financial year 2021-	

22 which were approved by the Board of Directors of the company and thereafter they were signed by the Chairperson of the company as authorised by the Board, as well as by its CEO, CFO and CS, respectively. Also, its board report was signed by its Managing Director as well as by an Executive Director.

Hence, it can be said that the financial statements and the Board's report of the Dharam and Karam Company Ltd. have been signed are in accordance with section 134 of the Companies Act, 2013.

QNO 351.200	Sec 135--Business Related UNIQUE	New Course – (M18E)

Beneath minerals Limited is a Public Sector Company engaged in extraction of minerals from land. It has to pump out water in the first layer of the soil if the minerals are to be excavated. The Company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. The cost of construction of water course amounted to Rs 5.25 crores and the Company had disclosed this amount as CSR expenses in the Statement of Profit and Loss. Comment.

Answer

Part I -- Relevant Section & Laws

- Company (Corporate Social Responsibility Policy) Rules, 2014

Part II -- Requirements of Relevant Section & Laws

- Company (Corporate Social Responsibility Policy) Rules, 2014mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business.
  If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Part III – Case Discussion

- In the instant case,
  - Beneath minerals Limited is a public sector company which is engaged in extraction of mineral from land, for that it has to pump out water in the first layer of the soil if the minerals are to be excavated.
  - The company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes.
  - Company has disclosed the cost of construction of water course as CSR expenses in the statement of Profit and Loss.

Part IV – Conclusion

- It is not correct as this expenditure incurred for the construction of water course is included in the ordinary course of activities of business. Therefore, the treatment done by showing the cost of construction of water course as CSR expense is not correct.

Author's Note
In august 2020 CSR rules were amended, and the phrase "normal course of business" was removed, so now this answer will change, and now given activity will be counted under CSR activity.

QNO 352.000	Sec 138--Applicability (Average Turnover of Past 3 Years) BHASKAR CNO—COACC.180	Old Course – (N08R, M15R, P17M, N17E) New Course – (S17M, M18M, N22M)

JKH Pvt Ltd. who is into the business of imparting coaching to CA students did not appoint any internal auditor for the year ended 31st March 2017. As on 31st March 2016, the company had paid up capital of ` 50 lakhs and reserves of ` 10 crores. Its turnover for the 3 years preceding the year ended 31st March 2017 was ` 75 crores, ` 145 crores and ` 260 crores respectively. As an auditor of the company for the year ended 31st March 2017, how would you deal with the above?

OR

PQR Ltd., a listed company and having an average annual turnover of more than ` 5 crores has no Internal Audit System. Give your views.

OR

ABC Pvt Ltd was involved in the business of manufacturing pipes and holdings. For financial year 2020-21 the company had the following turnover from its various segments and product: Segment Name

Turnover Profit Steel / Iron Pipe Manufacturing 140 Crore 10 Crore Holdings and Civil Structure Accessories 25 Crore 50 Lakh PVC / Yellow Pipe Manufacturing 65 Crore 8 Crore During Financial Year 2021-22, the company's performance was considerably lower compared to FY 2020-21 due to competition and high prices. Turnover and Profit of the company for FY 2021-22 is given hereunder: Segment Name Turnover Profit Steel / Iron Pipe Manufacturing 60 Crore 2 Crore Holdings and Civil Structure Accessories 15 Crore 35 Lakh PVC / Yellow Pipe Manufacturing 35 Crore 3 Crore The company was fully financed through its own capital during both years. Kindly assess whether the company was required to appoint internal auditor as per section 138 read with Rule 13 of the Companies (Accounts) Rules, 2014 for FY 2021-22.

Answer

Part I -- Relevant Section & Laws

- As per section 138 of the Companies Act, 2013, read with Rule 13 of Companies (Audit and Auditors) Rules, 2014

Part II -- Requirements of Relevant Section & Laws

- As per section 138 of the Companies Act, 2013, the following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely-
  a. **every listed company;**
  b. **every unlisted public company having**
     (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or
     (ii) turnover of two hundred crore rupees or more during the preceding financial year; or
     (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
     (iv) outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year; and
  c. **Every private company, having –**
     (i) turnover of two hundred crore rupees or more during the preceding financial year; or
     (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

Case 1

Part III – Case Discussion

- In the instant case, JKH Pvt. Ltd. is having turnover of 260 crores during the preceding financial year which is more than two hundred crore rupees.

Part IV – Conclusion

- Hence, the company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit

Case 2

Part III – Case Discussion

- In the instant case, PQR Ltd is a listed company and having an average annual turnover of more than ` 5 crores.
  As the company is a listed company, the provisions related to internal audit shall be applicable to the company. The turnover limit given has no relevance here.

Part IV – Conclusion

- Therefore, the auditor will have to mention in his report the fact of not having such internal audit system by the

Author's Note

Only turnover of last year is important. Turnover of previous years other than that is of no use. Earlier previous three turnover was important as average of last three year was calculated to for CARO reporting on internal audit. Now there is no such requirement.

QNO 353.000	Sec 138--Applicability (Borrowing) BHASKAR CNO—COACC.240	Old Course – (M15E, P17M) New Course – (S17M, S21M)

AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor. Please guide him who can be appointed as internal auditor and what would be reviewed by him.

Answer

Part I -- Relevant Section & Laws

- Section 138 of the Companies Act, 2013

Part II -- Requirements of Relevant Section & Laws

➢ **Section 138 of the Companies Act, 2013**

Every private limited company is required to conduct internal audit if it's outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

➢ **Who can be appointed as Internal Auditor-**

The internal auditor shall either be a chartered accountant, or a cost accountant, whether engaged in practice or not or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.

The internal auditor may or may not be an employee of the company.

➢ **Work to be reviewed by Internal Auditor-**

Each of the managerial functions should constantly be viewed by the internal auditor. The scope of internal auditor's work should include a review of:

- I - **Internal control system** and procedures
- A- system regarding the custodianship and **safeguarding of Assets** - monetary and non-monetary of enterprise.
- C-**Compliance** by the various segments with the policies, plans and procedures of the enterprise as well as with the relevant regulations and laws.
- D & R- system of collecting **Data** both monetary and non-monetary - to ensure that the information given to management and to external agencies is **Relevant and reliable**.
- O-**Organisational structure** of the enterprise and its congruence with its objectives.
- E-**Efficient and economical use** of available resources tangible as well as intangible.
- O-various **Operations.**

Part III – Case Discussion

➢ In the given case, AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor.

Part IV – Conclusion

➢ In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.

Author's Note

I will review everything from **ROAD** to **CEO.**

QNO 354.500	Sec 138--Applicability (Multiple Companies) BHASKAR CNO—COACC.180	New Course -- (M22R)

One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below:

Figures are in ` crore and correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
AADI Ltd.	Listed	100	190	50	24
AJIT Ltd.	Unlisted Public	60	190	50	24
NEMI Ltd.	Unlisted Private	60	190	50	-

	You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss.
Answer	Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:- **(A)** every listed company; **(B)** every unlisted public company having- **(1)** paid up share capital of fifty crore rupees or more during the preceding financial year; or **(2)** turnover of two hundred crore rupees or more during the preceding financial year; or **(3)** outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or **(4)** outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and **(C)** every private company having- **(1)** turnover of two hundred crore rupees or more during the preceding financial year; or **(2)** outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year. In the given case, AADI Ltd. is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, AADI Ltd. is required to appoint an internal auditor. Further, AJIT Ltd. is unlisted public company. The company is having ` 60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. Thus, AJIT Ltd. is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.  NEMI Ltd. is unlisted private company and having ` 60 crore as equity share capital, ` 190 crore as turnover and ` 50 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, NEMI Ltd. is not required to appoint an internal auditor. It can be concluded that AADI Ltd. and AJIT Ltd. is required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas NEMI Ltd. is not required to do the same.

QNO 414.020	**Additional Disclosure Apart from Sch III, Division II** **BHASKAR CNO—COACC.200**	**New Course -- (N21E)**
	Mr. Khanna has been appointed as statutory auditor of RST Ltd. for the financial year ended 31st March 2021. The financial statements of RST Ltd. are to be drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The Chief financial officer is of the view that the disclosure requirements specified under Division II of Schedule III of the Companies Act, 2013 are complete and no other additional disclosures shall be made in the Notes or by way of additional statements. Advise on the General instructions to be considered by RST Ltd. while preparing its financial statements.	
Answer	**General Instructions for Preparation of Financial Statement of a Company required to comply with Ind-AS:** **1**. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances. **2.** Where compliance with the requirements of the Act including Indian Accounting Standards (except the	

option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirement under this Schedule shall stand modified accordingly.

3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.

4. (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required-

(a) narrative description or disaggregation of items recognised in those statements; and

(b) information about items that do not qualify for recognition in those statements.

(ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.

5. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.

6. Financial Statements shall disclose all 'material' items, i.e. the items if they could. Individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.

7. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

QNO 414.025	**Sch III -- Stock Statement Doesn't Agree With Books** BHASKAR CNO—COACC.200	**New Course -- (M22E, M23M)**

Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for 10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:

Period of Quarter	**tock Value as per Books of Account as at the end of the quarter (in crores)**	**Stock Value as per quarterly statement submitted to ABC Bank Limited as at the end of quarte (in crore)**
Q1-2021-22	11.50	14.00
Q2-2021-22	14.75	17.00
Q3-2021-22	11.50	14.00
Q4-2021-22	15.25	15.25

The management of Jam Private Limited did not disclose the above variations in notes to accounts forming part financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered.
Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO, 2020.

Answer

As per clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following :
(a) whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts.
(b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Further, as per para 3(ii) (b) of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ` 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ` 10 crores which is apparently in excess of ` 5 crores.
Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid.

CA. Roy should report the differences as per the Companies Act, 2013 and CARO 2020 as follows:

	Stock value as per Book Accounts (` in Crore)	**Stock value as per quarterly statement Submitted to ABC Bank Ltd. (` in Crore)**	**Variation**
Q – 1	11.50	14.00	Excess reporting of stock to Bank by 2.50 crore
Q – 2	14.75	17.00	Excess reporting of stock to Bank by 2.25 Crore
Q – 3	11.50	14.00	Excess reporting of stock to bank by 2.50 crore

QNO 507.250 | **Aspects (Audit and A/cs Maintenance of LLP)- BHASKAR CNO—LLP.040/LLP.060** | **New Course – (M19R, M22R)**

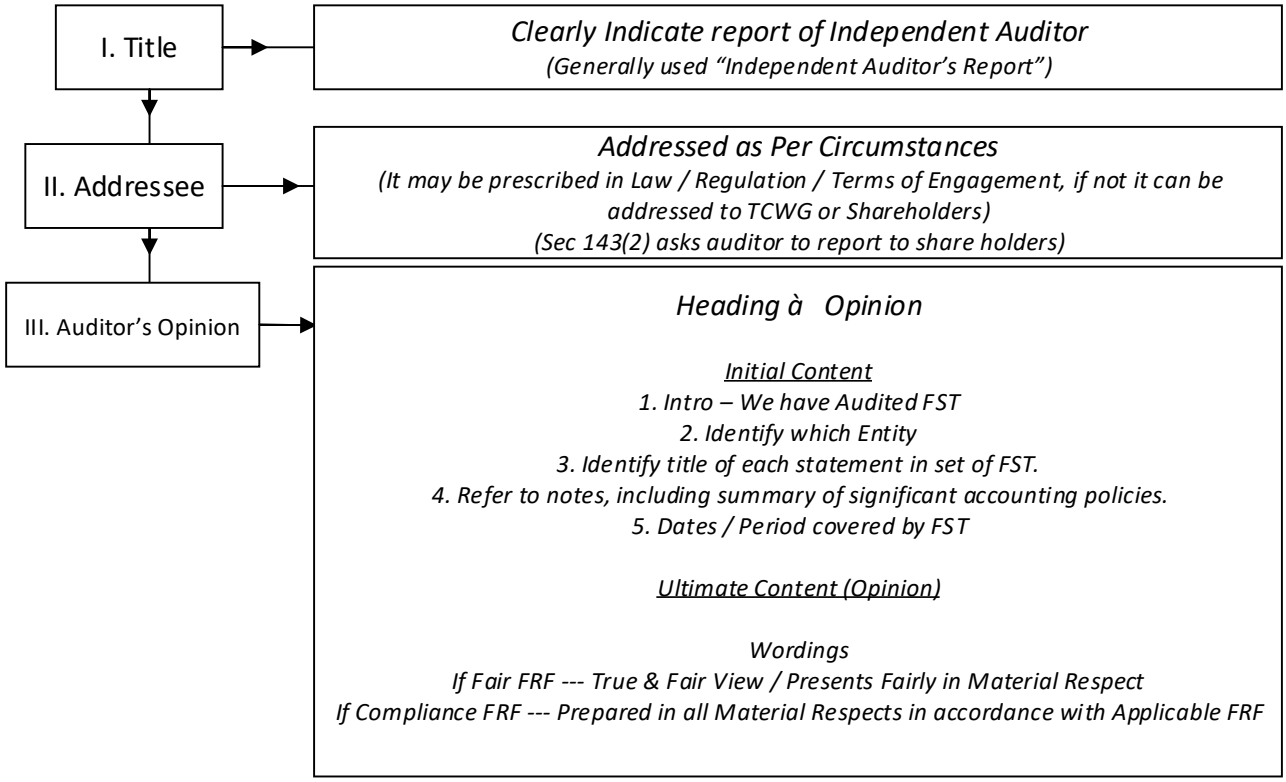
MKc LLP is a newly set up LLP (Limited Liability Partnership). The operations of the LLP have been picking up and management is currently in the process of setting up processes and procedures in place. As per the understanding of the management of the LLP, its accounts would not be required to be audited mandatory because of its operations but still the management has decided that they would get the

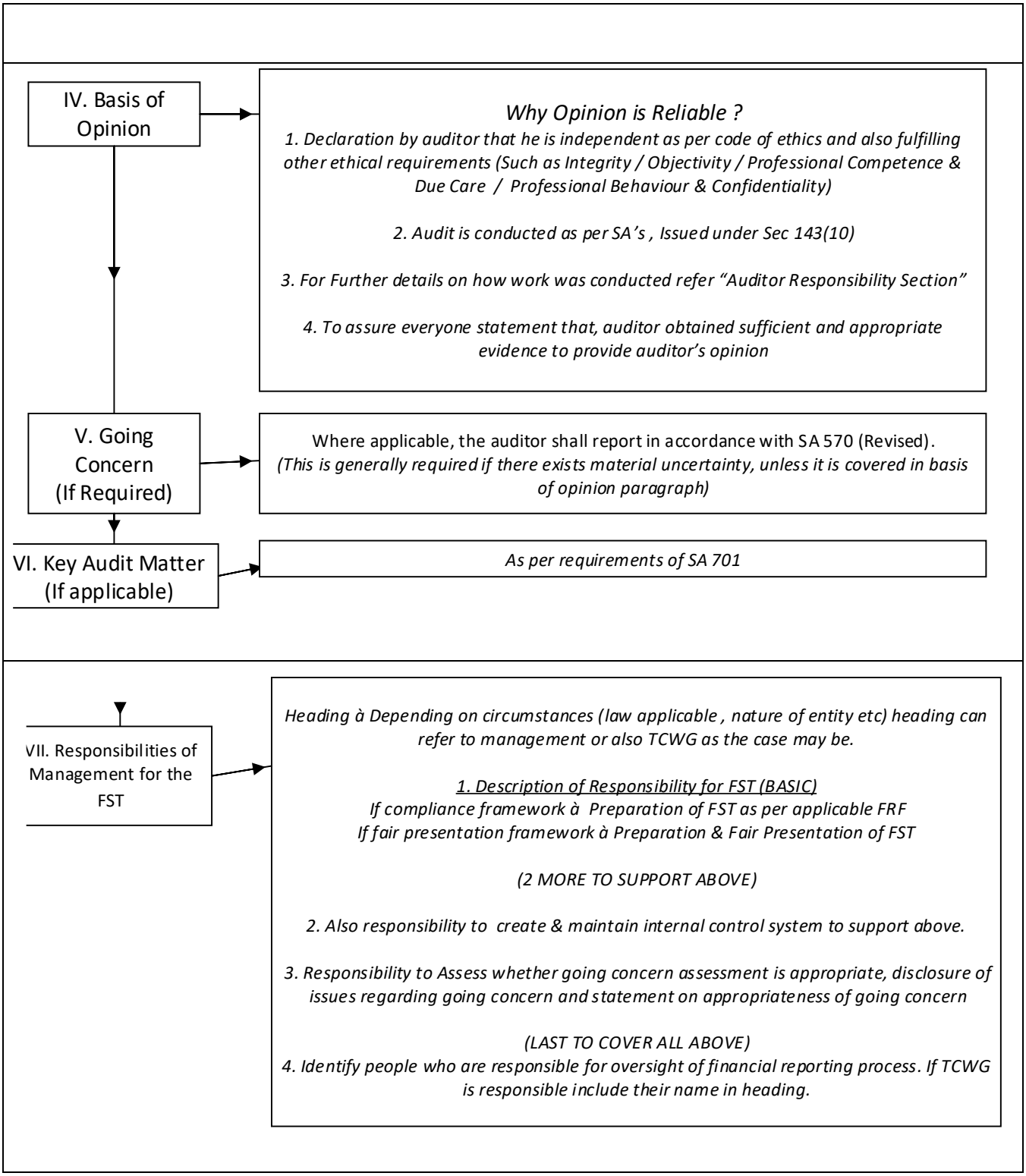
	accounts audited voluntarily. In this regard, the management would like to understand some of the aspects which they should consider not only limited to audit but also about the maintenance of books of accounts as per the relevant laws. Please advise.
Answer	➢ An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule. ➢ **Appointment of Auditor**: The auditor may be appointed by the designated partners of the LLP • At any time for the first financial year but before the end of first financial year, • At least thirty days prior to the end of each financial year (other than the first financial year), • To fill the causal vacancy in the office of auditor, • To fill the casual vacancy caused by removal of auditor. The partners may appoint the auditors if the designated partners have failed to appoint them. ➢ **LLPs are required to maintain books of accounts which shall contain -** • Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place, • A record of the assets and liabilities of the LLP, • Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold, • Any other particulars which the partners may decide. ➢ **The auditor should read the LLP agreement & note the following provisions.** • Nature of the business of the LLP • Amount of capital contributed by each partner. • Interest – in respect of additional capital contributed. • Duration of partnership • Drawings allowed to the partners. • Salaries, commission etc payable to partners • Borrowing powers of the LLP • Rights & duties of partners

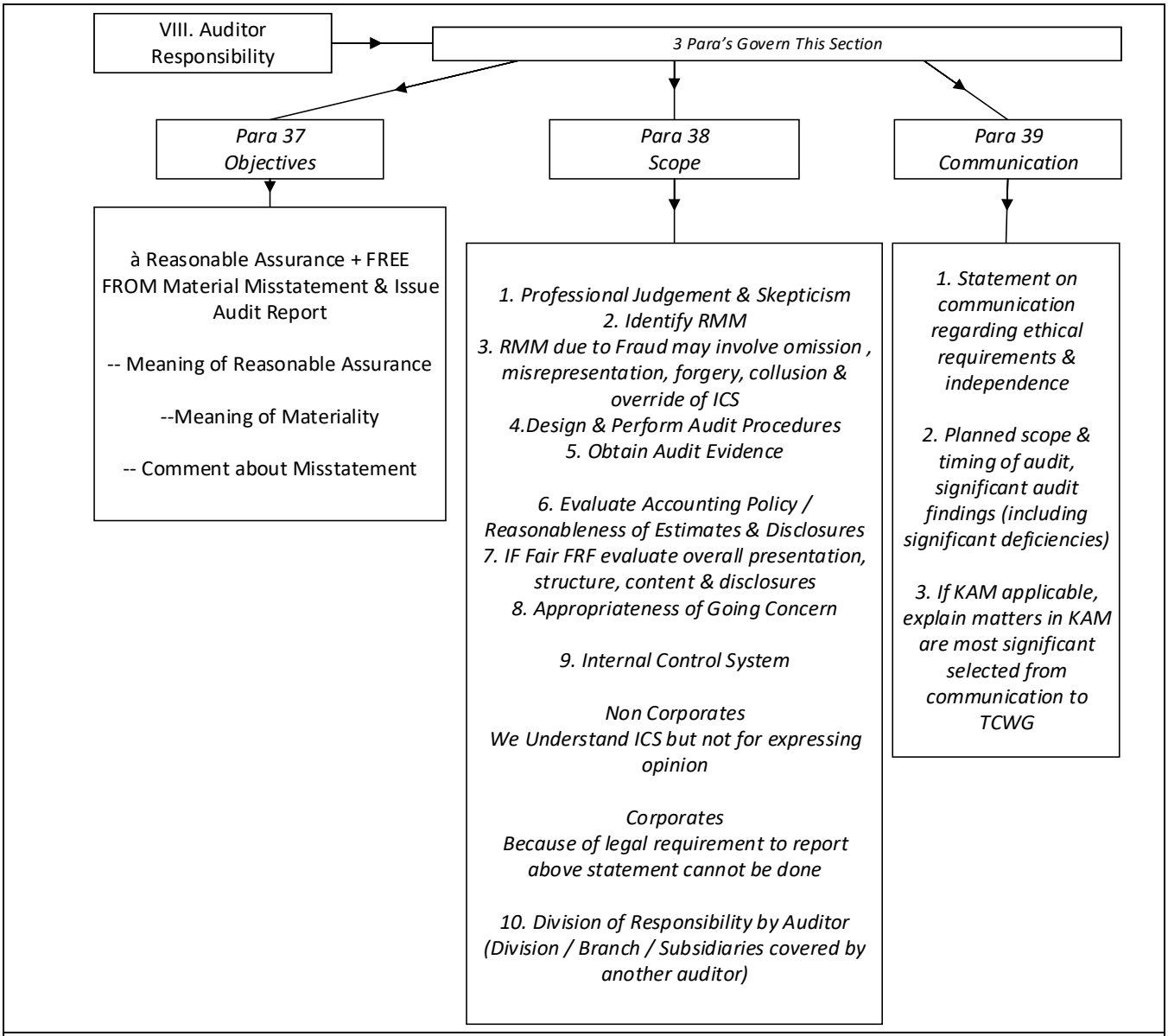
06 Audit Reports

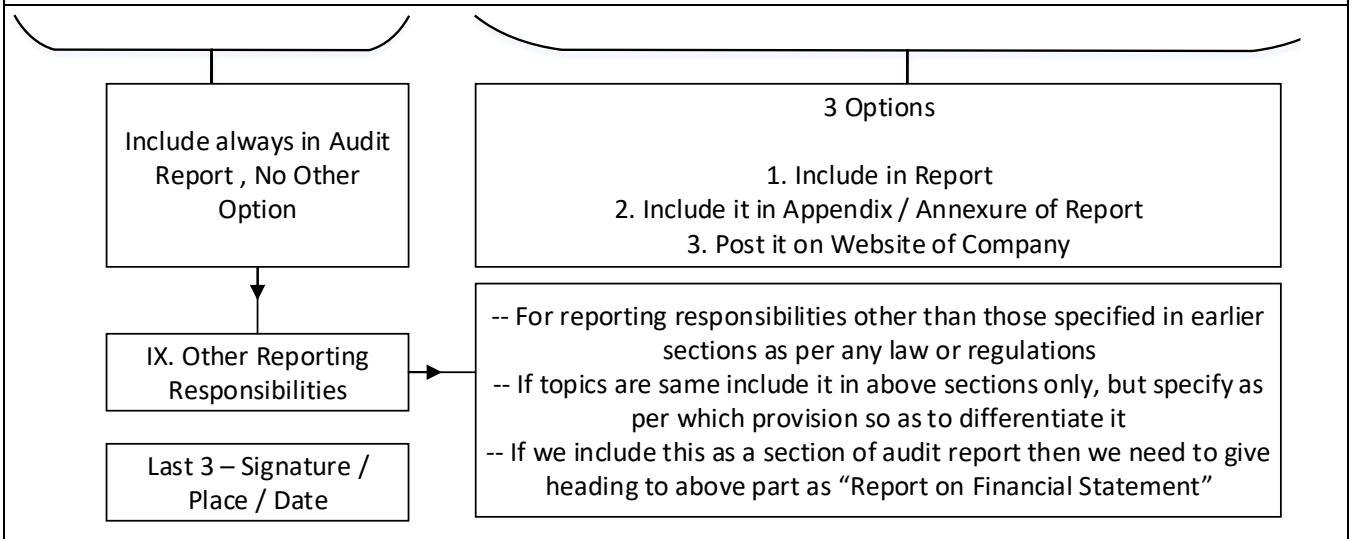
Part 1 - [SA 700 Revised] FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

QNO 108.000	AR (Basic Elements) BHASKAR CNO—SA700.040	Old Course – (N04E, M12M, P17M)
	Enumerate the 'Basic Elements of Audit Report' as enshrined in SA 700	
	Part I -- Relevant Standards & Laws ▪ SA 700 – "Forming An Opinion And Reporting On Financial Statements"	
	Part II -- Requirements of Relevant Standards & Laws	




IV. Basis of Opinion
Why Opinion is Reliable ?
1. Declaration by auditor that he is independent as per code of ethics and also fulfilling other ethical requirements (Such as Integrity / Objectivity / Professional Competence & Due Care / Professional Behaviour & Confidentiality)
2. Audit is conducted as per SA's , Issued under Sec 143(10)
3. For Further details on how work was conducted refer "Auditor Responsibility Section"
4. To assure everyone statement that, auditor obtained sufficient and appropriate evidence to provide auditor's opinion
V. Going Concern (If Required)
Where applicable, the auditor shall report in accordance with SA 570 (Revised).
(This is generally required if there exists material uncertainty, unless it is covered in basis of opinion paragraph)
VI. Key Audit Matter (If applicable)
As per requirements of SA 701
VII. Responsibilities of Management for the FST
Heading à Depending on circumstances (law applicable , nature of entity etc) heading can refer to management or also TCWG as the case may be.
1. Description of Responsibility for FST (BASIC)
If compliance framework à Preparation of FST as per applicable FRF
If fair presentation framework à Preparation & Fair Presentation of FST
(2 MORE TO SUPPORT ABOVE)
2. Also responsibility to create & maintain internal control system to support above.
3. Responsibility to Assess whether going concern assessment is appropriate, disclosure of issues regarding going concern and statement on appropriateness of going concern
(LAST TO COVER ALL ABOVE)
4. Identify people who are responsible for oversight of financial reporting process. If TCWG is responsible include their name in heading.





Author's Note

No Need to Explain Management Responsibility / Auditor Responsibility / Other Reporting Responsibilities in Detail if all elements are asked as answer will become very bulky and PM has not included much details in this regard.

QNO 108.500	Draft Opinion & Basis of Opinion Para UNIQUE	(M22R)
	You have been appointed as an auditor of Dharmnath & Sons for FY 2020-21, as entity other than a company incorporated under the Companies Act, 2013, using a fair presentation framework. Appointment had been made in the month of April, 2021 The financial statements have been prepared by the management in accordance with the Accounting Standards. The management had introduced the new computerized accounts receivable system from November 2020 and still in the implementation phase and thus management is in the process of rectifying system deficiencies and correcting the errors. At the time of implementation of a new system, the earlier system of accounting of receivables had been discarded. The auditor was unable to obtain sufficient appropriate audit evidence about the entity's accounts receivable and inventories. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Write the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's Report.	
Answer	**(a) Opinion Paragraph** Disclaimer of Opinion We were engaged to audit the financial statements of Dharmnath & Sons ("the entity"), which comprise the balance sheet as at March 31, 2021, the statement of Profit and Loss, (the statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. Basis for Disclaimer of Opinion We were not appointed as auditors of the Company until after March 31, 2021, and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 2020, and 2021, which are stated in the Balance Sheets at ` xxx and ` xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in November 2020 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ` xxx as at March 31, 2021. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and account receivable, and the elements making up the statement of Profit and Loss (and statement of cash flows)	

112

QNO 109.000	Auditor Responsibility Para. BHASKAR CNO—SA700.040	Old Course – (M17E)
	What is included in an Auditors' Responsibility paragraph?	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 700 – "Forming An Opinion And Reporting On Financial Statements" **Part II -- Requirements of Relevant Standards & Laws** **Auditors responsibility:** Refer Point VIII from QNO 108 above.	

QNO 110.000	Certificate Vs Audit Report BHASKAR CNO—SA700.120	Old Course – (N04E, M08R, M13M, P17M, M17E) New Course – (S17M, S21M)

Differentiate between audit report and audit certificate.

Answer

Audit Report	Audit Certificate
➢ A report is a formal statement made after an enquiry of matter specified.	➢ Certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
➢ The 'report' involves expression of opinion which may differ from one professional to another	➢ The term 'certificate' is used where the auditor verifies the accuracy of facts stated therein.
➢ He is responsible for ensuring that the report is based on factual data. Example : However, the report under Section 143 of the Companies Act, 2013, is an opinion-based report and is not a certificate	➢ He is responsible for the factual accuracy of what is stated therein. Example : As per Section 66 of the Companies Act, 2013, an auditor is required to file a certificate in the tribunal where company is proposing for the reduction of capital.

QNO 111.000	Sh Vs TCWG BHASKAR CNO—SA700.140	New Course – (S17M)

Reporting to Shareholders vs Reporting to those Charged with Governance.

Answer

Part I -- Relevant Standards & Laws

- SA 700 – "Forming An Opinion And Reporting On Financial Statements"
- SA 260 – Communication with Those Charged With Governance

Part II -- Requirements of Relevant Standards & Laws

Reporting to Shareholders	Reporting to Those Charged with Governance.
Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	SA 260 deals with the provisions relating to reporting to those Charged with Governance.
Statutory Audit Report is on true and fair view and as per prescribed Format.	It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
Statutory Audit Reports are in public domain.	Reporting to those Charged with Governance is an internal document i.e. private report.

QNO 111.050	Other Standards on Auditing in addition to Standard on Auditing issued by the ICAI BHASKAR CNO—SA700.080	Old Course – (N19R) New Course – (N19R, S21M)

"KPI Ltd. is a company on which International Standards on Auditing are applicable along with Standard on Auditing issued by the ICAI. The company appointed new auditors for the audit of the financial statement's year ended 31 March 2019 after doing all appointment formalities. Therefore, the auditor's report referred the International Standard on Auditing in addition to the Standard on Auditing issued by the ICAI.

As an expert, you are required to advise the auditor regarding auditor's report for audits conducted in accordance with both the Standards."

Answer

➢ An auditor may be required to conduct an audit in accordance with, in addition to the **Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction.** If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

	• There is **no conflict between the requirements** in the ISAs or such auditing standards of other jurisdiction and those in SAs **that would lead the auditor.**
	  • **to form a different opinion, or**
	  • **not to include an Emphasis of Matter paragraph or Other Matter paragraph** that, in the particular circumstances, is required by SAs; and
	• The auditor's report includes, at a minimum, each of the elements set out for audit report as per law.
	➢ When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

QNO 111.060	**Supplementary Information--Additional P&L is given in Financial Statements which is not required by FRF** **BHASKAR CNO—SA700.100**	**New Course – (M21E, M23R)**
	CA. S has been appointed as Statutory Auditor of SRT Ltd. for the financial year 2020-2021. The Company while preparing financial statements for the year under audit prepared one additional profit and loss account that disclosed specific items of expenditure and included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit and loss account is not covered under applicable financial reporting framework. **Guide him as to how he should deal with this issue while reporting on the financial statements of SRT Ltd.**	
Answer	**If supplementary information that is not required by the applicable financial reporting framework** is presented with the audited financial statements, the auditor shall evaluate **whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements** due to its nature or how it is presented. **When it is an integral part of the financial statements**, the supplementary information shall be covered by the auditor's opinion. **If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements**, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited. When an additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule, included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements. Thus, additional profit and loss account is not considered an integral part of the audited financial statements and the auditor shall evaluate that supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements.	

QNO 111.080	**True & Fair View** **Unique**	**New Course- (N22M)**
	"What constitutes a 'true and fair view' is the matter of an auditor's judgement in particular circumstances of a case." Do you agree? Enlist the requirements you as an auditor will observe to ensure true and fair view."	
Answer	Significance of True and Fair: SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted	

	in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date. In the context of audit of a company, the accounts of a company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Schedule III to that Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements. Therefore, the auditor will have to see that the accounts are drawn up in conformity with the provisions of Schedule III of the Companies Act, 2013 and whether they contain all the matters required to be disclosed therein. In case of companies which are governed by special Acts, the auditor should see whether the disclosure requirements of the governing Act are complied with. It must be noted that the disclosure requirements laid down by the law are the minimum requirements. If certain information is vital for presenting a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so. Thus, what constitutes a 'true and fair' view is the matter of an auditor's judgment in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see: (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles, (ii) no material asset is omitted; (iii) the charge, if any, on assets are disclosed; (iv) material liabilities should not be omitted; (v) the statement of profit and loss discloses all the matters required to be disclosed by Part II of Schedule III (vi) the balance sheet has been prepared in accordance with Part I of Schedule III; (vii) accounting policies have been followed consistently; and (viii) all unusual, exceptional or non-recurring items have been disclosed separately.

Part 2 - [SA 701] COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

QNO 111.100	Purpose of KAM UNIQUE	New Course – (N18R)
	The purpose of communicating key audit matters	
Answer	The purpose of communicating key audit matters is to **enhance the** communicative value **of the auditor's report by providing** greater transparency **about the audit that was performed**. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance **in the audit of the financial statements of the current period.** Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.	

QNO 112.000	No need to communicate KAM BHASKAR CNO—SA701.060	Old Course – (M18M, N18M) New Course – (M18R)
	Key Audit Matters and Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report.	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 701 – Communicating Key Audit Matters In The Independent Auditor's Report **Part II -- Requirements of Relevant Standards & Laws** ➢ **Key Audit Matters— As per SA 701,** "Communicating Key Audit Matters in the Independent Auditor's Report **(New)",** those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. ➢ **Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report:** The auditor shall describe each key audit matter in the auditor's report unless: • Law or regulation precludes public disclosure about the matter; or • In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter. **No Communication of some KAM items** 1. Law / Regulations Prohibits (Eg SFIO) 2. Adverse Consequences more than Public Interest (Eg Cyrus Mistry Vs TAT A) ↓ If there is No Key Audit Matter or Key Audit Matters Exist but not Reported as per reasons given above then include a statement under heading "key Audit Matter" and explain this fact.	

QNO 112.100	Determining Key Audit Matters BHASKAR CNO—SA701.040	Old Course – (M18M, N19M) New Course – (M18M,N19M)

AKY Ltd. is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is Rs. 40,000 crores with profits of Rs. 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. The company's contracts with its various customers are quite complicated and different**. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion.** This matter was also discussed with management at various stages of audit**. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner. After completion of audit for the year ended 31 March 2019, the** audit partner was discussing significant matters **with the management wherein they also** communicated to the management **that he plans** to include revenue recognition as key audit matter **in his audit report.** The management did not agree with revenue recognition to be shown as key audit matter in the audit report. Comment**.**

OR

"The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the key factors".

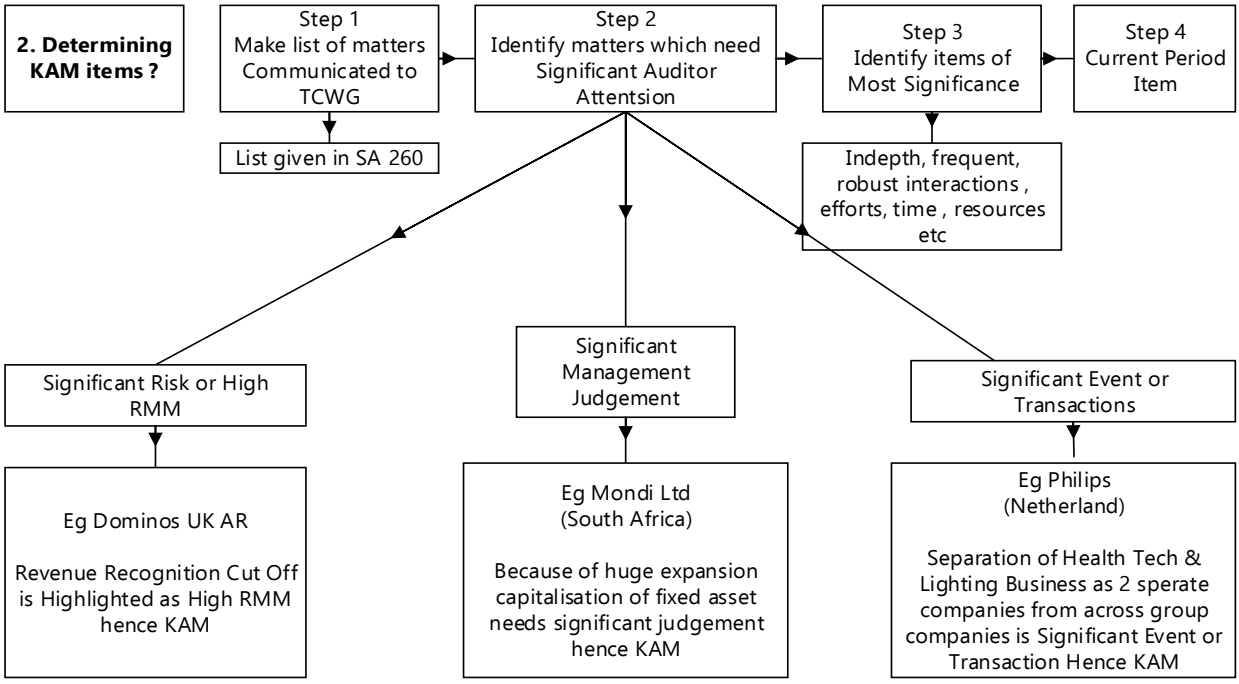
You are required to briefly discuss the factors determining the key audit matters.

Answer

Part I -- Relevant Standards & Laws

- SA 701 – Communicating Key Audit Matters In The Independent Auditor's Report

Part II -- Requirements of Relevant Standards & Laws



➢ **Determining Key Audit Matters:**

SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.

➢ **Factors determining Key Audit Matters:**

As per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
- Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

Part III – Case Discussion

➢ In the instant case, AKY Ltd., a listed company engaged in the business of software and its contracts with its various customers are also quite complicated and different. Further, the audit team spends significant time on audit of revenue and efforts towards audit of revenue also involve significant involvement of senior members of the audit team including audit partner during audit. This matter was also discussed with management at various stages. After completion of audit, the audit partner communicated the management regarding inclusion of paragraph on revenue recognition as key audit matter in his audit report.

Part IV – Conclusion

➢ In view of SA 701, the assessment of the auditor is valid as above matter qualifies to be a key audit matter in the opinion of auditor. Hence, it should be reported accordingly by the auditor in his audit report.

QNO 112.150	**Whether Key Audit Matter Required - Case Study** **BHASKAR CNO—SA701.040**	**Old Course – (N21R)** **New Course – (N21R)**

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2020-21, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit.
During F.Y. 2020-21, there was an implementation of ERP system in a phased manner**, in Kshetra Lap Ltd. due to which** some of its business processes got automated**. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him** that such a matter may be a key audit matter to be reported in the audit report.
Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter.
Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?

Answer

As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
(i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
(ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
(iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are

	intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit. In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition). In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period. Accordingly, such a matter can be considered as a key audit matter if according to Mr. Hemant, such a matter required significant attention that had affected his overall audit strategy. Thus, the contention of Mr. Vishay is not proper as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant attention of the auditor which had an impact on its audit.

QNO 112.200	Reporting of Key Audit Matters BHASKAR CNO—SA701.060	Old Course – (N18M, M19M, M20M, N20E) New Course – (M18E, M19M, M20M)
	Toddle Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March 2017. The Financial Statements for the year ended 31/03/2017 ' had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets-shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above. **OR** **TBR Limited has plan of its business being closed due to huge loss incurred due to the recent outbreak of global pandemic, within a short period from the close of the accounting year ended on 31st March 2020. The Financial Statements for the said year have been prepared on the same basis as in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above**	
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 701 – Communicating Key Audit Matters in the Independent Auditor's Report ▪ SA 570– "Going Concern", **Part II -- Requirements of Relevant Standards & Laws** ➢ ***SA 570 "Going Concern"*** As per SA 570 "Going Concern", management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern.	

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

- **SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report"**
  Further, as per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report", when matters relating to going concern may be determined to be key audit matters and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasizes on auditor's responsibility to communicate key audit matters in the auditor's report.

Part III -- Facts

- As per the facts given in the case, intention of the Toddle Limited had definite plan of its business being closed down within short period from 31 March 2017. However, financial statements for the year ended 31.03.2017 had been prepared on the same basis as it had been in earlier periods with an additional note.

Part IV -- Conclusion

- Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern is a key audit matter. Therefore, the auditor is required to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, be made at the time of cessation only by the auditor in his report is not sufficient.

Author's Note:

I am personally not happy with the answer.

Scenario 1
If going concern is invalid and company doesn't shift to liquidation basis then adverse opinion **should be given.**

Scenario 2
If there is material uncertainty over going concern then separate section "Material Uncertainty Over Going Concern" should be introduced and KAM section should simply have reference to MUGC section.

This case fits in Scenario 1 but ICAI has taken it to scenario 2 and further treatment given to include it in KAM matter is also not appropriate.

QNO 112.300	Description of Key Audit Matters in Auditing BHASKAR CNO—SA701.060	Old Course – (N18E)

CA. Amar has come across certain key matters while auditing the accounts of PR Ltd. for the financial year 2017-18. He, being the associate of your firm, seeks your advice on "Communicating Key Audit Matters" in the Auditor's Report. Guide him.

Answer

- **Communicating Key Audit Matters in the Auditor's Report:**
  - **Separate Section & Separate Sub heading for each point**
    The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters".
  - **Introductory Language**
    The introductory language in this section of the auditor's report shall state that

- Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and
- These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

- **Description of Key Audit Matter**

  The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:
  - Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and
  - How the matter was addressed in the audit.
- **Exemption from Disclosure**

  The auditor shall describe each key audit matter in the auditor's report unless:
  - Law or regulation precludes public disclosure about the matter; or
  - In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.
- **Don't include matters of modification**

  The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter.

QNO 112.350	**Adverse Opinion & KAM** **BHASKAR CNO-SA701.080**	**New Course- (N22M)**
	While auditing the complete set of consolidated financial statements of Moksh Ltd., a listed company, using a fair presentation framework, XYZ & Co., a Chartered Accountant firm, discovered that the consolidated financial statements are materially misstated due to the non-consolidation of one of the subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements could not be determined because it was not practicable to do so. Thus, XYZ & Co. decided to provide an adverse opinion for the same and further determined that, there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section. Comment whether XYZ & Co. needs to report under SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report'?"	
Answer	SA 700 establishes requirements and provides guidance on forming an opinion on the financial statements. Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. SA 705, "Modifications to the Opinion in the Independent Auditor's Report", addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements. When the auditor expresses a qualified or adverse opinion in accordance with SA 705, presenting the description of a matter giving rise to a modified opinion in the Basis for Qualified (Adverse) Opinion section helps to promote intended users' understanding and to identify such circumstances when they occur. Separating the communication of this matter from other key audit matters described in the Key Audit Matters section, therefore, gives it the appropriate prominence in the auditor's report. Further, when the auditor expresses a qualified or adverse opinion, communicating other key audit matters would still be relevant to enhancing intended users' understanding of the audit, and therefore the	

	requirements to determine key audit matters apply. **However, as an adverse opinion is expressed in circumstances when the auditor has concluded that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements depending on the significance of the matter(s) giving rise to an adverse opinion, the auditor may determine that no other matters are key audit matters.** In the given situation Moksh Ltd., a listed company, has not consolidated one of its subsidiary. Further, Consolidated Financial Statements of Moksh Ltd. Are materially misstated due to such non-consolidation. The material misstatement is also deemed to be material and pervasive and effect of the failure to consolidate have not been determined. In the given situation it is appropriate to give Adverse Opinion by XYZ & Co., a Chartered Accountant Firm. Since, in the given case, Adverse Opinion is being expressed thus XYZ & Co. can communicate Key Audit Matter in given below manner: **Key Audit Matters:** Except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communicate in our report.

QNO 112.400	**Key Audit Matter, But No Relevant Disclosure in FST** **BHASKAR CNO—SA701.060**	**New Course -- (M22R)**
	What is the auditor's responsibility to report a key audit matter for which there are no relevant disclosures in the financial statements?	
Answer	When communicating key audit matters, the fact that there are no disclosures in the financial statements related to a matter determined to be a key audit matter does not relieve the auditor from the requirement to communicate it. An auditor may determine a key audit matter related to the audit for which relevant disclosure requirements do not exist in the applicable financial reporting framework. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular, if such a change had a significant effect on the auditor's overall audit strategy or related t significant risk (e.g., changes to a system affecting revenue recognition Also, if an auditor determines that it is necessary to include information about the entity in order to effectively describe a key audit matter that has not been disclosed by management and management does not agree to disclose that information, the auditor should reconsider the adequacy of the disclosures in accordance with applicable financial reporting framework. The auditor should communicate the matter as a key audit matter unless law or regulation precludes public disclosure about the matter or in extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.	

QNO 112.500	**Placement of KAM** **BHASKAR CNO—SA701.080**	**New Course -- (M22R)**
	Where should the placement of the key audit matters section be in the auditor's report?	
Answer	Generally, the Key Audit Matters section is required to be placed after the Basis for Opinion paragraph and before the Management's Responsibility paragraph. In case, 'Material uncertainty relating to going concern' section is required as per SA 570(Revised), then KAM section is placed after that section. Further, regarding placement of KAM section, SA 706 (Revised), "Emphasis of Matte Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" provides as under: When a Key Audit Matters section is presented in the auditor's report, an Emphasis of Matter (EOM) paragraph may be presented either directly before or after the Key Audit Matters section, based on the auditor's judgment as to the relative significance of the information included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter – Subsequent Event", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.	

Part 3 - [SA 705] MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S

QNO 113.000	Types of Modification BHASKAR CNO—SA705.020	Old Course – (N12E, P17M, N17R, N17E, M19M) New Course – (S17M, M19M, S21M)

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705 Under SA 705, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

OR

Explain the circumstances which require a modification to the Auditor's Opinion

OR

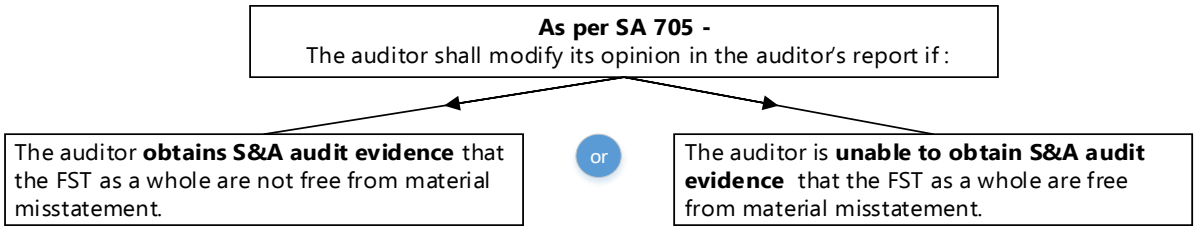
ADKS & Co LLP are the newly appointed statutory auditors of PKK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of financial statements. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise.

Answer

Part I -- Relevant Standards & Laws

- SA 705 – Modifications To The Opinion In The Independent Auditor's Report

Part II -- Requirements of Relevant Standards & Laws



➢ **Modifications in Audit Report:** As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", the auditor may modify the opinion in the auditor's report in the following circumstances:

- If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that, the financial statements as a whole are free from material misstatement.

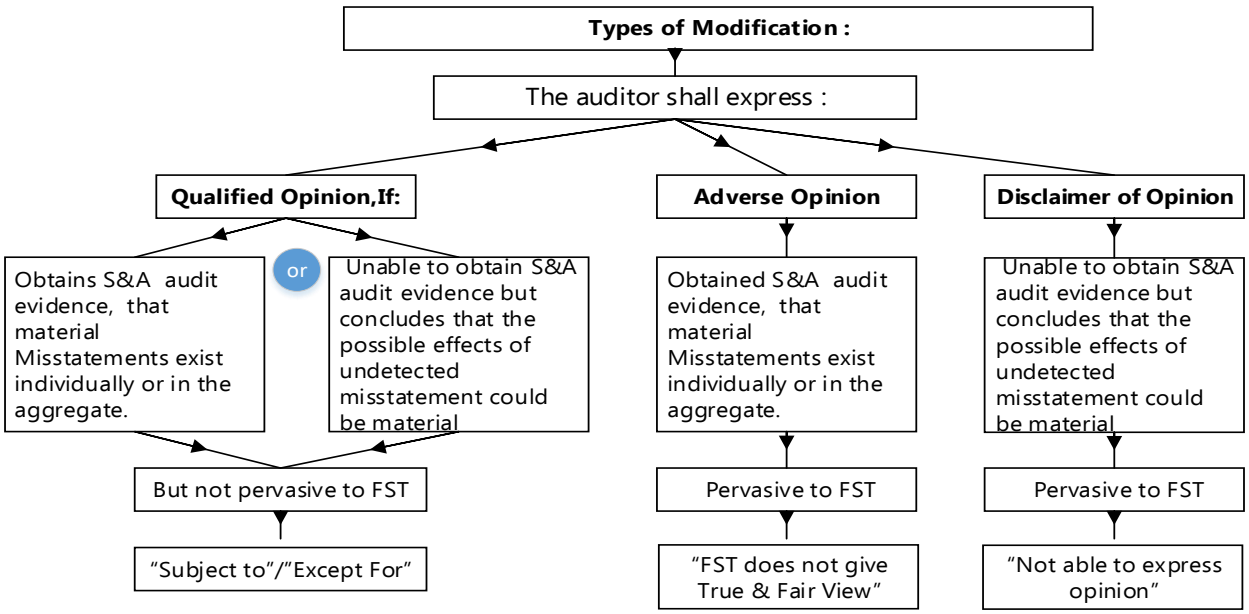
If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved,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

➢ **Types of Modification to the Auditor's Opinion:**

As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", modified opinion may be defined as a qualified opinion, an adverse opinion or a disclaimer of opinion.

Types of modifications possible to the said report are below mentioned:

- **Qualified Opinion:**
  - The auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or



- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

- **Adverse Opinion:**
  The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

- **Disclaimer of Opinion:**
  The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Author's Notes:

In Case 3:
Give Conditional Answer
If Pervasive — Adverse Opinion
If Not Pervasive — Qualified Opinion

QNO 113.010	Special Consideration for Various Opinion BHASKAR CNO—SA705.060	Old Course – (M20R) New Course – (N18R, S21M, M20R)

"When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." As an expert you are required to brief the special considerations required for expressing:
(a) Qualified Opinion.
(b) Adverse Opinion and
(c) Disclaimer of Opinion.

Answer

(a) **Special consideration required for expressing Qualified Opinion:** When the auditor expresses a qualified opinion due to a **material misstatement in the financial statements,** the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for **Qualified Opinion section:**

- When reporting in accordance with a **fair presentation framework,** the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

- When reporting in accordance with a **compliance framework,** the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].
- When the modification arises from **an inability to obtain sufficient appropriate audit evidence,** the auditor shall use the corresponding phrase **"except for the possible effects of the matter(s) ..." for the modified opinion.**

(b) **Special consideration needed for expressing Adverse Opinion:** When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, **because of the significance of the matter(s) described in the Basis for Adverse.**
Opinion section:

- When reporting in accordance with a **fair presentation framework,** the accompanying financial statements do not present fairly (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or
- When reporting in accordance with a **compliance framework**, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

(c) **Special consideration is required for expressing Disclaimer of Opinion:** When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

- State that the auditor **does not express an opinion on the accompanying financial statements.**
- State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements. Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

QNO 113.020	Reasons for No S&A Evidence BHASKAR CNO—SA705.050	Old Course – (N18R, M20R) New Course – (M20R)
	The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from: **(i) Circumstances beyond the control of the entity.** **(ii) Circumstances relating to the nature or timing of the auditor's work; or** **(iii) Limitations imposed by management.** **Explain with the help of examples.**	

Answer

➢ **Reasons (R)**

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:
R 1 - Circumstances beyond the control of the entity;
R 2 - Circumstances relating to the nature or timing of the auditor's work; or
R 3 - Limitations imposed by management.

- **R1 – Fault of External Factors**
  Examples of circumstances **beyond the control of the entity include when:**
  - The entity's accounting records have been **destroyed.**
  - The accounting records of a significant component have been **seized indefinitely by governmental authorities.**
- **R2 – Fault of Management**
  Examples of an inability to obtain sufficient appropriate audit evidence arising from a **limitation on the scope of the audit imposed by management** include when:
  - Management prevents the auditor from observing the counting of the physical inventory.

- Management **prevents the auditor from requesting external confirmation** of specific account balances.

- **R3 – No one's Fault**
  Examples of circumstances **relating to the nature or timing of the auditor's work include** when:
  The entity is required to use the **equity method of accounting** for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
  - The **timing of the auditor's appointment** is such that the auditor is unable to observe the counting of the physical inventories.
  - The auditor determines that **performing substantive procedures alone is not sufficient, but the entity's controls are not effective.**

➢ **Solution**
An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

113.030	**Audit evidence not consistent with the affirmation in the FST** **BHASKAR CNO—SA705.020**	**New Course – (S21M,N22E)**

CA Omkar is the statutory auditor of Sabhyata Ltd. for the FY 2020-21. The company is engaged in the business of manufacture of floor tiles. During the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Discuss as to how CA Omkar should deal with the situation in the auditor's report

Part I -- Relevant Standards & Laws

- SA 705 - "Modifications To The Opinion In The Independent Auditor's Report.

Part II -- Requirements of Relevant Standards & Laws

➢ SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.
➢ The decision regarding which type of modified opinion is appropriate depends upon:
  - The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
  - The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.
➢ Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

Part III – Case Discussion

➢ In the present case, during the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements.

Part IV -- Conclusion

➢ Therefore, CA Omkar should modify his report in accordance with SA 705- "Modifications to The Opinion in The Independent Auditor's Report.
➢ CA Omkar should issue either a qualified opinion or an adverse opinion depending upon the circumstances of the case:
  - CA Omkar shall express a qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements.
  - CA Omkar shall express an adverse opinion, when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

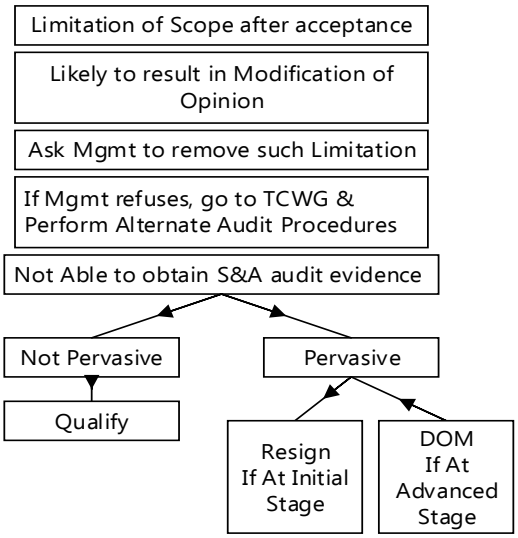
	➢ Thus, since CA Omkar has obtained audit evidence which are inconsistent with the affirmations made in the financial statement, CA Omkar should modify his opinion as per the circumstances of the case.

QNO 118.000	Q Vs E UNIQUE	Old Course – (N14E, M17R, P17M) New Course – (S17M, M18R, S21M)
	Audit Qualification vs Emphasis of Matter	
Answer	**Audit Qualification**	**Emphasis of Matter**
	➢ SA-705 "Modifications to the Opinion in the Independent Auditor's Report", Deals with the provisions relating to Audit Qualification.	➢ SA-706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" Deals with the provisions relating to Emphasis of Matter.
	➢ Audit Qualifications are also known as "subject to report" or "except that report".	➢ EOM para is included in auditor's report to draw attention of the users' towards important matter(s) which are already disclosed in FST and are fundamental to users' for understanding of Financial Statements.
	➢ Audit Qualifications are given when auditor : • Obtains S&A audit evidence, that material Misstatements exist individually or in the aggregate. Or • Is Unable to obtain S&A audit evidence but concludes that the possible effects of undetected misstatement could be material and both the above are not pervasive to FST	➢ EOM para is issued when there is uncertainty relating to : • future outcome of exceptional litigation, regulatory action, etc.; or • there is early application of a new accounting standard that has a pervasive effect on FST in advance of its effective date.

QNO 119.000	Limitation on Scope. BHASKAR CNO—SA705.040	Old Course – (N20E) New Course – (M19E)
	After accepting the statutory audit of M/s All in One Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may adversely affect and result in your inability to obtain sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences and your response to the limitations imposed by the management on your scope. **OR** **While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation?**	
Answer	**Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement** ➢ If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.	

➢ If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
  - Withdraw from the audit, where practicable and possible under applicable law or regulation; or
  - If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.



➢ If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion

119.030	**No Co-operation & Obligation After Resignation** **BHASKAR CNO—SA705.040**	**Old Course - (N14E, P17M, N20E)**
	What are the professional obligations of the statutory auditor who has resigned before completion of his term due to non-co-operation of the Management in completing certain audit procedures?	
	Resignation Due to Management Imposing Limitation on the Scope of Audit : SA 705 "Modifications to the Opinion in the Independent Auditor's Report" provides the consequence of an inability to obtain sufficient appropriate audit evidence due to a management - imposed limitation after the auditor has accepted the engagement. The practicability of resigning from the audit may **depend upon the stage of completion of the engagement** at the time that management Imposes the scope limitation. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a **professional, regulatory or legal requirement** for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity's owners. In the case of resignation from the company, provisions of the Companies Act, 2013 apply. Section 140(2) **of the Companies Act, 2013**, requires the auditor, who has resigned from the company **to file within a period of 30 days**. from the date of resignation, **a statement with the company and the registrar**, and in case of government companies, the auditor shall file such statement with the **Comptroller and Auditor-General of India**, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor will be **liable for penal provisions.**	

QNO 119.100	**Drafting Disclaimer of opinion.** **UNIQUE**	**New Course – (N18M, M18M)**
	As an auditor of ABC Limited, in view of given circumstances, you are required to draft disclaimer of opinion and basis for disclaimer of opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about Multiple Elements of the Financial Statement. **Audit of a complete set of financial statements of an entity other than a company incorporated under the Companies Act, 2013, using a fair presentation framework. The audit is not a group audit (i.e., SA 600, does not apply).**	

	• **The financial statements are prepared by management of the entity in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India (a general-purpose framework).** • **The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.** • **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements, that is, the auditor was also unable to obtain audit evidence about the entity's inventories and accounts receivable.** • **The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.** • **The relevant ethical requirements that apply to the audit are ICAI's Code of Ethics and applicable law/regulation.** **Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.** **A more limited description of the auditor's responsibilities section is required.** **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under relevant law/ regulation.**
Answer	➢ **Disclaimer of Opinion:** We were engaged to audit the financial statements of ABC & Associates ("the entity"), which comprise the balance sheet as at March 31, 20XX, the statement of Profit and Loss, (the statement of changes in equity)(where applicable) and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. ➢ **Basis for Disclaimer of Opinion** We were not appointed as auditors of the Company until after March 31, 20X1 and thus, did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and 20X1, which are stated in the Balance Sheets at Rs xxx and Rs xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of Rs xxx as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of Profit and Loss (and statement of cash flows) (Where applicable).

QNO 119.120	**Drafting Disclaimer of Opinion** **BHASKAR CNO—SA705.020**	**New Course – (N22R)**
	CA Bahubali is the statutory auditor of Bharat Ltd. for the FY 2021-22. During the course of audit CA Bahubali noticed the following: **(i) With respect to the debtors amounting to ` 240 crore, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit.The Company has created a provision for doubtful debts to the tune of `40 crore during the year under audit. The Company has stated that the provision is based on receivables which are older than 39 months, which according to the audit team is inadequate and as such the audit team is unable to ascertain the carrying value of trade receivables.** **(ii) In respect of Inventories (which constitutes 38% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic**	

	intervals. Also, the Company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified. **Under the above circumstances what kind of opinion should CA Bahubali give? Write the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's Report.**
Answer	In the present case, CA Bahubali is unable to obtain sufficient and appropriate audit evidence with respect to the following: (i) The balance confirmation with respect to debtors amounting to ` 240 crore is not available. Further there has been default in payment by the debtors and the provision so made is not adequate. The audit team is also unable ascertain the carrying value of trade receivables. (ii) With respect to 38% of the company's inventory, neither the physical verification has been done by the management nor are adequate inventory records maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified. In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. Thus, CA Bahubali should give a Disclaimer of Opinion. **The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:** **Disclaimer of Opinion** We do not express an opinion on the accompanying financial statements of Bharat Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. **Basis for Disclaimer of Opinion** We are unable to obtain balance confirmation with respect to the debtors amounting to ` 240 crore. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of ` 40 crore during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained. Further, in respect of Inventories (which constitutes 38% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count and as such the value of inventory could not be verified.

QNO 119.200	**Drafting Adverse opinion.** **UNIQUE**	**New Course – (M19E)**
	ALM Associates has been appointed as auditor of M/s Hary Ltd. which acquired 55% shares- in M/s Sam Ltd. on 15th October 2018. During audit of Harry Ltd., the auditors found that the company have not prepared consolidated financial statements because on the date of acquisition the fair value of certain assets & liabilities has not been ascertained which is significant and are accounted for on estimated basis only. Help ALM Associates in framing opinion paragraph of audit report.	
Answer	**Opinion Paragraph of Audit Report:** In the instant case, M/s Hary Ltd. acquired 55% shares in M/s Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not	

	correct as the financial statements are materially misstated due to non-consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, ` **Adverse Opinion** In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2019, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended. **Basis for Adverse Opinion is given below:** As explained in Note X, the M/s Hary Ltd. has not consolidated subsidiary M/s Sam Ltd. that the M/s Hary Ltd acquired during 2018 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had M/s Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

QNO 119.300	**Draft Opinion (Not Given Agreement)** **UNIQUE**	**(N21E, M23M)**
	CA Madhu is the statutory auditor of Lakshmi Ltd. for the Financial year 2020-21. In respect of loans and advances of ` 75 Lakh given to Srinian Pvt. Ltd., the Company has not furnished any agreement to CA Madhu and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms. Justify the type of opinion which CA Madhu should give in such situation. Also, Draft an appropriate Opinion paragraph and Basis of opinion paragraph.	
Answer	In the present case, with respect to loans and advances of ` 75 Lacs given to Sriman Pvt. Limited, the Company has not furnished any agreement to CA Madhu. In the absence of such an agreement, CA Madhu is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Madhu to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion. Thus, in the present case, CA Madhu should give a qualified opinion The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under: **Qualified Opinion** In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshmi Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 and profit/ loss for the year ended on that date. **Basis for Qualified Opinion** The Company is unable to furnish the loan agreement with respect to loans and advances of ` 75 Lacs given to Sriman Pvt Limited. Consequently, in the absence of such a agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.	

QNO 119.500	Draft Opinion (Disclaimer) BHASKAR CNO-SA705.020	New Course- (N22M)
	BREW Ltd., FMCG Company having its tea gardens in northeastern states of the country is exclusively dealing in blending, processing, packing and selling of various brands of Tea. During the year under audit, the company entered into joint venture for purchasing Tea Gardens in Sri Lanka and Kenya. M/s PM & Associates are the statutory auditors of the company for the financial year 2021-22. During the course of audit, the audit team was unable to obtain sufficient appropriate evidence about a single element of the consolidated financial statement being Joint venture investment in Dharma Ltd. representing over 91% of the group's net assets having both material and pervasive possible effect to the consolidated financial statements. The group's investment in Dharma Ltd. is carried at ` 115 crore in the group's consolidated balance sheet. **Draft the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's report.**	
Answer	M/s PM & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 91% of the group's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements. Therefore, the statutory auditor should issue a disclaimer of opinion. The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under: **Disclaimer of Opinion** We were engaged to audit the accompanying consolidated financial statements of BREW Ltd., (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group), which comprise the consolidated balance sheet as at March 31, 2022, the consolidated statement of Profit and Loss, (consolidated statement of changes in equity) and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the "Consolidated Financial Statements"). We do not express an opinion on the accompanying consolidated financial statements of the Group. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements. **Basis for Disclaimer of Opinion** The Group's investment in its joint venture Dharma Ltd. Company is carried at ` 115 crore on the Group's consolidated balance sheet, which represents over 91% of the Group's net assets as at March 31, 2022. We were not allowed access to the management and the auditors of Dharma Ltd. Company, including Dharma Ltd.'s auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of Dharma Ltd.'s assets that it controls jointly, its proportional share of Dharma Ltd.'s liabilities for which it is jointly responsible, its proportional share of Dharma Ltd.'s income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.	

Part 4 - [SA 706] EMPHASIS OF MATTER PARAGRAPHS & OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

QNO 120.000	EMP BHASKAR CNO—SA706.020	Old Course – (M08E, P17M, N19E) New Course – (S17M, S21M)
	Write a short note on Emphasis of matter paragraph in Audit Reports. **OR** **Enumerate certain** important matters which can be included in 'Emphasis of Matter paragraph' in an auditor's report.	

Answer

➢ **Emphasis of Matter Paragraph in Audit Reports:**

- **Standard on Auditing 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"**
  "Deals with the provisions relating to Emphasis of Matter."
- **EOM is a paragraph which is included in auditor's report to draw attention of the users towards important matter(s) which are already disclosed in FST and are fundamental to users' for understanding of FST. The auditor must obtain sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.**
- **EOM para is issued when there is uncertainty relating to:**
  - **Future outcome of exceptional litigation, regulatory action, etc.; or**
  - **There is early application of a new accounting standard that has a pervasive effect on FST in advance of its effective date.**
  - **A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.**

In Detail

➢ SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", deals with additional communication in the auditor's report when the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

➢ **Specific requirements given in various Standards of Auditing for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:**

- SA 210 - When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- SA 560 - When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).
- SA 800 - To alert users that the financial statements are prepared in accordance with a special purpose framework.

➢ **Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:**

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- Major prior period items.
- Major amalgamation during the year.

	• A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position. • A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report

QNO 121.000	EMP Case Study with Drafting (Income Tax) UNIQUE	New Course – (M18R)
	Relevant Notes given by the management in the financial statements of India Branch Office of ABC Limited are: **•Income tax authorities have raised demands (including interest upto the date of demand) aggregating to Rs 100 crores and Rs 40 crores respectively for assessment year 2013-14 based on report by auditors consequent to conduct of special audit as directed under section 142(2A) of the Income tax Act, 1961 and in addition, have also initiated penalty proceedings against the Company. The Company has contested these demands before the Commissioner of Income tax (Appeals) and has also filed applications for stay of penalty proceedings and the same are currently pending disposal.** **Based on review of underlying documents and legal inputs, the management has assessed that there is probability of likely outflow to the extent of Rs 50 crores (including interest liability till date of stay of payment of Rs 15 crores) in relation to the above demands and has accounted for the same in these financial statements.** **With respect to further liability of Rs 50 crores, the management believes that it has the necessary documents to furnish to the tax authorities and basis the expert's inputs believes that Company has good chances of success of receiving the judgments in its favour. Further, the management believes that the likelihood of penalties being imposed against the Company is not probable and accordingly, no adjustments are considered necessary in these financial statements.** **• As at March 31, 2017, the Company has accumulated losses of Rs 150 crores against equity of Rs 100 crores and also net current liabilities of Rs 35 crores. The management is of the view that the current year losses are primarily attributable to income tax liabilities devolving on the Company, as discussed under paragraph XX. As per the management assessment, it is likely to generate Rs ___ and Rs ___ from the operations during the financial years ending March 31, 2018 and March 31, 2019 respectively. Further, the Company's key shareholders have confirmed that they shall provide continuing financial support to the Company's day to day operations so as to enable the Company to pay off its debts, as and when they fall due. Accordingly, these financial statements have been prepared on a going concern basis.** **As an auditor of ABC Limited, you are required to draft emphasis of matter para in the given situation on the basis of analysis of above notes (when there is material tax litigation that casts significant doubt on the entity being regarded as going concern).**	
Answer	➢ **Emphasis of Matters Para:** • **IT Demand** We draw attention to Note XX, regarding certain income-tax demands of Rs 100 crores pending in various stages of assessments/ appeals. The management based upon expert's advice believes that no demand or liability including interest and penalty on account of settlement of assessment/ appeals of the pending matters by the Income tax authorities is likely to devolve on the Company, in addition to those already provided for in these financial statements. Pending the final outcome of the aforesaid matters, no further adjustments have been made in these financial statements in this regard. • ***Going Concern (Earlier, this issue was covered in EMP now same matter is covered under heading material uncertainty over going concern)*** Note XX of the financial statements that as at March 31, 2017, the Company has accumulated losses of Rs 150 crores against equity of Rs 100 crores and also net current liabilities of Rs 35 crores. These conditions indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern, which is dependent on establishing profitable operations and obtaining continuing financial support from its key shareholders.	

- These mitigating factors have been more fully discussed in Note XX of the accompanying financial statements, in view of which the accompanying financial statements have been prepared under the going concern assumption, and consequently, no further adjustments have been made in these financial statements.
- Our opinion is not modified in respect of the above matters.

122.050	**Case Study (EMP & Modification)** **BHASKAR CNO—SA706.020**	**Old Course – (N20R)** **New Course – (N20R)**

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

Observation 1:
The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. **As a result of the same**, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2:
Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise, whether AKB Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

Observation 1 –

Part I -- Relevant Standards & Laws

- SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report"

Part II -- Requirements of Relevant Standards & Laws

- As per SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgement is of such importance that it is fundamental to users' understanding of the financials.

Part III – Case Discussion

- The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Part IV – Conclusion

- Hence, in this case, the auditor shall report about the consequences of the flood which affected the Company's warehouse under Emphasis of Matter Paragraph.

Observation 2 –

Part I -- Relevant Standards & Laws

- SA 705, "Modification to Opinion in the Independent Auditor's Report",

Part II -- Requirements of Relevant Standards & Laws

- As per SA 705, "Modification to Opinion in the Independent Auditor's Report", where the auditor is unable to obtain sufficient and appropriate audit evidence and where such mater is material but not pervasive, the auditor shall issue a qualified opinion.

Part III – Case Discussion

- Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

Part IV – Conclusion

- Thus, in the given situation, on account of flood few records pertaining to particular transactions was completely destroyed and in the absence of duplicate records, the auditor was unable to obtain sufficient and appropriate audit evidence and those details were material but not

	pervasive. Therefore, in accordance with SA 705, the auditor is required to issue qualified opinion.

QNO 123.000	OMP (Report) UNIQUE	Old Course – (N13E, P17M)
	Beta Limited, is a company registered with SEBI, having five subsidiaries. **MIs XYZ, Chartered Accountants, have been appointed as Statutory Auditors for the audit of the Consolidated Financial Statements for the year ending March 31, 2015.** Out of five subsidiaries, the audit of one subsidiary was conducted by another auditor, M/s Badnam and Company, Chartered Accountants. The "Opinion" para of audit report furnished by M/s XYZ Chartered Accountants is given below: **Opinion** **In our opinion and to the best of our information and according to the explanations given to us the consolidated financial statements give a true and fair view, except the financial statement of** one subsidiary whose accounts were audited by M/s Badnam and Company, Chartered Accountants and about the same we are not in a position to express our opinion as the audit has not been performed by us: **(i) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 2015.** **(ii) in the case of the consolidated Statement of Profit and Loss, of the profit/loss for the year ended on that date.** **Do you find** any deficiencies in the opinion para**? If yes, you are required to give your suggestions and redraft the opinion para.**	
Answer	➢ **Opinion Para and Other Matter Para**: Yes, the opinion para contains the following deficiencies- • Out of five subsidiaries, the audit of one subsidiary was conducted by another auditor, M/s Badnam and Company which would be reported in other matter para. • After point no. (ii) in the opinion para, point no. (iii) would appear as under- "in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date." The redrafted opinion para and other matter para are given hereunder as per SA 706 on Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report – • **Opinion Para** In our opinion and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the other auditors on the financial statements of the subsidiaries as noted below, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India: (i) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 2015; (ii) in the case of the consolidated Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (iii) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date. • **Other Matter Para** We did not audit the financial statements of one subsidiary, whose financial statements reflect total assets (net) of Rs XXXX as at March 31, 2015, total revenues of Rs XXXX and net cash outflows amounting to Rs XXXX for the year then ended. These financial statements have been audited by other auditor's M/s Badnam and Company, Chartered Accountants whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.	

QNO 123.500	EMP-Case study on impact of Change in LAW on Financial position BHASKAR CNO—SA706.020	New Course – (N22M)
	Difficult Books Limited is engaged in manufacturing of active pharmaceutical ingredients. Due to change in laws and regulations, every company engaged in manufacturing in active pharmaceutical ingredients would now require production capacity license which will restrict the production of companies. Management of the company assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statement. Audit Team of the company evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same in Other Matter Paragraph. You as an Engagement Partner are required to guide the Audit Team with respect to reporting of the said matter in Audit Report.	
	As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided: (i)The auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter; and (ii) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. In the instant case, since Difficult Books Limited is engaged in manufacturing of active pharmaceutical ingredients, would now require production capacity license which will restrict the production of companies, due to change in laws and regulations. Management of the Difficult Books Limited assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statement. Audit team of the Difficult Books Limited evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same. The said matter is already disclosed and presented appropriately in financial statement and is of such importance that is fundamental to the users understanding of the financial statement and hence, it required to be disclosed under Emphasis of Matter paragraph. Therefore, decision of audit team to disclose the same in Other Matter Paragraph is not in order, it should be disclosed in Emphasis of Matter Paragraph.	

Part 5 - [SA 710] COMPARATIVE INFORMATION CORRESPONDING FIGURES & COMPARATIVE FINANCIAL STATEMENTS

QNO 125.000	Comparatives (Audit Procedures) BHASKAR CNO—SA710.020	Old Course – (M10E, M12R, M13E, P17M) New Course – (N18R)
	Auditor's responsibilities regarding comparatives.	

Answer

Part I -- Relevant Standards & Laws

- SA 710 – "Comparative Information – Corresponding Figures and Comparative Financial Statements"
- "Applicable when the FST consist of amounts and disclosures of one or more prior period

Part II -- Requirements of Relevant Standards & Laws

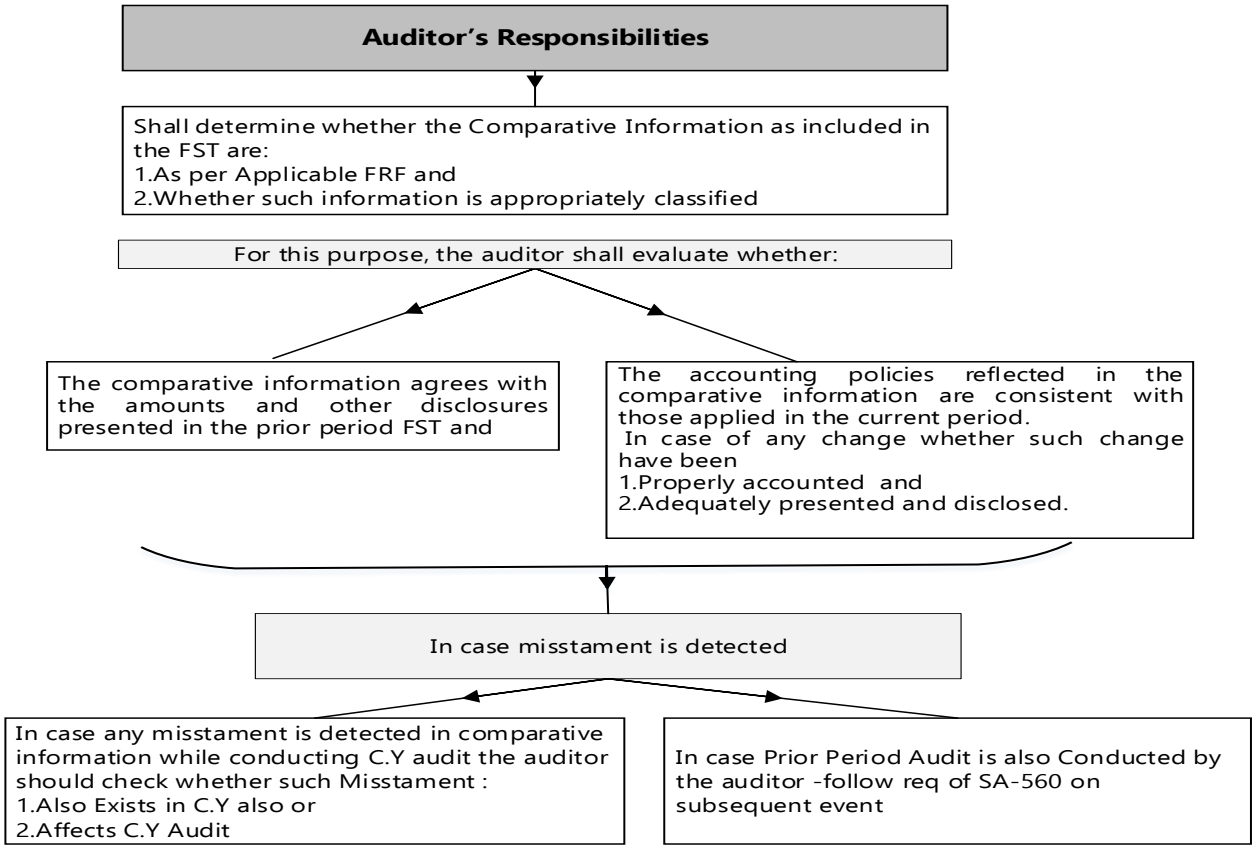
Audit procedures: -

➢ **Basic Evaluation of comparative information:**

- The Auditor shall determine whether the Financial Statements include the Comparative Information **required by the Applicable Financial Reporting Framework** and whether such information is appropriately classified.
- For this Purpose, the Auditor shall evaluate whether.
  - The comparative Information **agrees with the amounts & other disclosures presented in the prior period**, and
  - The **Accounting Policies reflected in the Comparative Information** are consistent with those applied in the current period or, if there have been changes in Accounting Policies, whether those **changes have been properly accounted for and adequately presented and disclosed.**

➢ **Additional procedures in case of Material Misstatement:**

- If the Auditor of becomes aware of a **possible material misstatement** in the Comparative Information while performing the current period audit, he shall perform such additional audit procedures as are necessary in the Circumstances, to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.

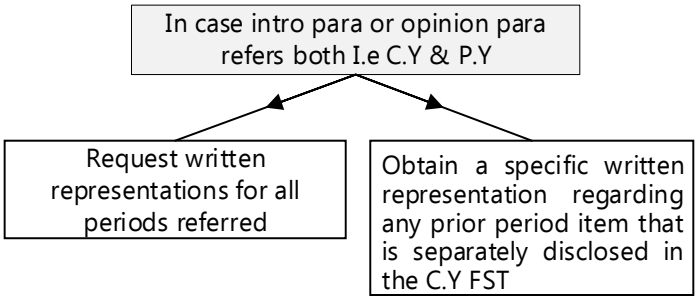


- If the Auditor **had audited the Prior Period's Financial Statements, he shall also follow the relevant requirements of SA 560** on the effect of Subsequent Events

➢ **Written Representations:**

The Auditor shall

- Request Written Representations for **all periods referred** to in the opinion.
- Obtain a specific Written Representation regarding **any Prior Period Item** that is separately disclosed in the current year's Statement of Profit and Loss.
  - **In case of comparative financial statements**
    Written Representations are requested for **all periods** referred to in the Auditor's Opinion because Management needs to reaffirm that the Written Representations it previously made with respect to the prior period remain appropriate.



  - **In case of corresponding figures**
    Written Representations are requested for the Financial Statements of the **current period only,** because the Auditors Opinion IS on those Financial Statements, which include the Corresponding Figures.

QNO 126.000	Comparatives (Previous Year Misstatements) BHASKAR CNO—SA710.080	Old Course – (M09E, M11R, M12R, N12M, N14R, N14E, P17M, M18E, N18E,N20M) New Course – (M18M, N20M, M23M)

The audit report of P Ltd. for the year 2016-17 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2017-18, decide how would you report, if :

(i) The company does not make provision for doubtful debts in 2017-18?

(ii) The company makes adequate provision for doubtful debts in 2017-18?

OR

For the year ended 31st March, 2016, the audit report of Avinash Ltd. contained a qualification regarding non-provision for diminution in the value of investments to the extent of ? 50 lacs. As an Auditor of the Company for the year 2016-17, how would you report, if :

(i) The Company does not makes provision for diminution in the value of investments in the year 2016-2017.

(ii) The Company makes adequate provision for diminution in the year 2016-2017.

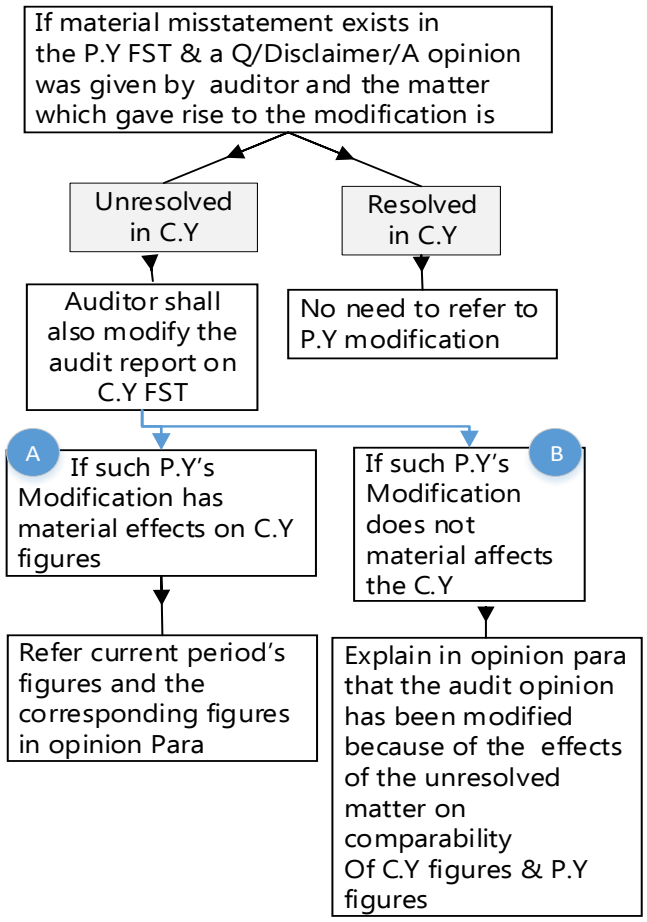
OR

It was observed from the modified audit report of the financial statements of AS Ltd. for the year ended 31st March 2017 that depreciation of Rs 2.50 crore for the year 2016-2017 had been charged off to the Statement of Profit and Loss instead of including it in "carrying value of asset under construction". State in relation to the audit for the year ended 31st March 2018, whether such modification in the previous year's audit report would have any audit implication for the current year and if yes, how would you deal with it in your audit report?

Answer

Requirement of SA 710

Auditor's responsibility in cases where audit report for an earlier year is qualified is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements".



- **Matter Resolved**

  As per SA 710, when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

- **Matter Not Resolved**

  SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

  - **Material effect on Current year**

    Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

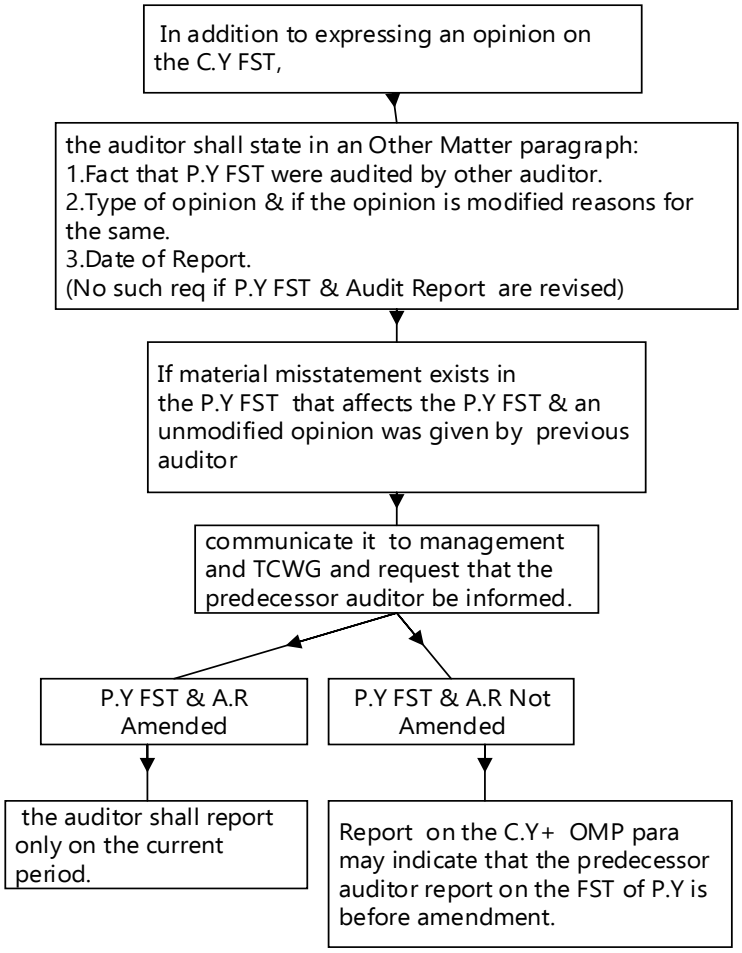
  - **No-Material effect on Current year**

	In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
	Case Discussion & Conclusion
	In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.
	Author's note • **In current year, a previous year matter is unresolved however it does not affect current year materially then why current year audit report is modified?** o In Comparative Financial Statement Approach we have to comment on both years, CY & PY so here we should always comment about PY. o In Corresponding figures approach we generally comment on CY only, but if there is misstatement in PY then comparison on CY with PY goes wrong and gives in appropriate interpretations, hence it is mandatory to modify with respect to PY and explain it is done because CY comparison and interpretation is going wrong

QNO 127.000	**Comparatives (Previous Year Misstatements Wages) BHASKAR CNO—SA710.080**	**Old Course – (M15R)**
	Mr A, a practicing Chartered Accountant, audited the financial statements of year 2012-13 and expressed an unmodified opinion C Ltd was of the view that Mr A is not conducting the audit properly and therefore, for the current year 2013-14, it appointed Ms B, a leading practicing Chartered Accountant to conduct the audit and present Comparative Financial Statements Ms B, while performing the auditing procedures, found that C Ltd has undercharged the wages of Rs 10 lakhs during the previous year resulting in overstatement of profits What are the further procedures, Ms B is required to pursue?	
Answer	**Misstatement in Prior Period Financial Statements Audited by a Predecessor Auditor:** According to SA 710 "Comparative Information—Corresponding Figures and Comparative Financial Statements", if the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph: ➢ That the financial statements of the prior period were audited by a predecessor auditor;	

- The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
- The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

However, if the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.



Case Discussion & Conclusion

- In the given case, Mr. A has issued an audit report without modification for the previous year 2012-13. While Ms. B found a material discrepancy of undercharging wages of Rs 10 lakhs during the year 2012-13. Hence, Ms. B is required to communicate the matter to the management and request them to inform the same to Mr. A. After revision or non-revision of the prior period's financial statements, Ms. B may report accordingly as stated above.

Part 6 - [SA 720] THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

QNO 127.050	Other Information Auditors Responsibility BHASKAR CNO—SA720.040/SA720.060	New Course – (N20E, N21M, M23M, M23R)
	GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y 2019-20. The audit team has completed the audit and is in the process of preparing audit report. Management of the company has also prepared draft annual report. Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report **indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction.** Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management**.** **Do you think that the partner is correct in his approach on this issue?** Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting.	
	Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists: As per SA 720, "The Auditor's Responsibility in Relation to Other Information" Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information. The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment. Auditor's duties with regard to reporting in the given case are given hereunder: **As per SA 720, "The Auditor's Responsibility in Relation to Other Information",** if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management: (i) Agrees to make the correction, the auditor shall determine that the correction has been made; or (ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made. **Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect**	

QNO 127.100	Examples of "Amounts" or "other items" included in the "other information UNIQUE	Old Course – (M21M) New Course – (N19E, S21M, M21M)
	LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report While regarding other information, Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates with examples of "Amounts" or "other items" that may be included in the "other information" with reference to SA 720.	
Answer	**Part I -- Relevant Standards & Laws** ▪ **SA 720 - The Auditor's Responsibilities Relating to Other Information** **Part II -- Requirements of Relevant Standards & Laws** ➢ Definition of Other information –	

- Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.
- Appendix 1 of SA 720 contains examples of amounts or other items that may be included in the other information.
- **Examples of Amounts or Other Items that May Be Included in the Other Information**

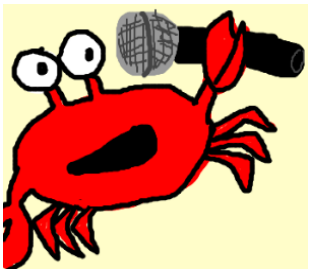
  The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.
  - **Amounts**
    - Items in a summary of **key financial results,** such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
    - Selected **operating data,** such as income from continuing operations by major operating area, or sales by geographical segment or product line.
    - Special items, such as **asset** dispositions, **litigation** provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
    - **Liquidity and capital resource information**, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
    - **Capital expenditures** by segment or division.
    - Amounts involved in, and related financial effects of, off-balance sheet arrangements.
    - Amounts involved in **guarantees**, contractual obligations, legal or environmental claims, and other contingencies.
    - **Financial measures or ratios**, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.
  - **Other Items**
    - **Explanations** of critical accounting estimates and related assumptions.
    - Identification of related parties and descriptions of transactions with them.
    - Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
    - Descriptions of the nature of off-balance sheet arrangements.
    - Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
    - **Descriptions of** changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position or will have a material impact on the entity's future financial prospects.
    - **Management's** qualitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
    - General descriptions of the business environment and outlook.
    - Overview of strategy.

	○ Descriptions of trends in market prices of key commodities or raw materials. ○ Contrasts of supply, demand and regulatory **circumstances** between geographic regions. ○ Explanations of specific factors influencing the entity's profitability in specific segments.
	Author's Note • **Above is the list of Examples of "Amounts" or "other items" included in the "other information. Students are advised to write the number of points on the basis of marks for which question is asked .**

QNO 127.200	**Material Misstatement in other information** **BHASKAR CNO—SA710.100**	**Old Course – (N20M)** **New Course – (N20M)**
	ING Associates, Chartered Accountants, conducting the audit of XYZ Ltd., a listed Company for the year ended 31st March 2020 is concerned with the auditor's responsibilities relating to misstatements in other information, both financial and non-financial, included in the Company's annual report. While reading other information, ING Associates considers whether there is any material misstatement of the other information in the Company. After performing their procedures, the auditor concludes that a material misstatement of the other information exists**.** **ING Associates discussed with the Management about the other information that appeared to be materially misstated to the auditor and also requested management to provide evidence for the basis of management's statements in the other information along with supporting documents.** **Guide ING Associates as to how to respond to that material misstatement of other information obtained prior to the date of auditor's report.** Will your answer be different in case ING Associates conclude the same after the date of auditor's report?	
	➢ **Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:** • As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management: • Agrees to make the correction, the auditor shall determine that the correction has been made; or • Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made. • If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance, the auditor shall take appropriate action, including: • Considering the implications for the auditor's report and communicating with those charged with governance about how the auditor plans to address the material misstatement in the auditor's report. • Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation. • If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor shall: • If the other information is corrected, perform the procedures necessary in the circumstances; or • If the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations, to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared.	

07 Audit Committee and Corporate Governance

QNO 421.000	LODR BHASKAR CNO—ACCG.040	Old Course – (N15E, M17R, N18R)
	Enumerate the issues addressed in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 regarding Corporate Governance	
Answer	**Part I -- Relevant Standards & Laws** • **LODR, 2015** **Part II Requirements of Relevant Standards & Laws** **Explanation** • Issues of Corporate Governance: Issues addressed in the LODR, 2015 regarding corporate governance are- • S-**Securities** Transfer • S- **Stakeholder** Committee • S- **Subsidiary** company management procedures • S- **Statement** of Deviation or Variation • C- **Compliance Certificate** by the CEO and CFO • C-**Compliance Certificate** from either the auditors or practising company secretaries regarding compliance of conditions on corporate governance • R-**Risk management** procedures • R- **Report** on Corporate Governance • R- **Related party transactions** disclosures, • A-**Audit Committee** --> Composition / Meetings / Powers / Role and Responsibilities • B-**Board** composition / key function & responsibilities / compensation / disclosures; • O- **Obligations** of Director and Senior Management • M-**Management** Discussion & Analysis Content • I- **Information** to shareholders; ***(About Directors)*** • C- **Code of Conduct** and vigil mechanism • D-**Disclosure** Principles • S-**Sexual** Harassment • L-**Limited** Review of Audit • R-Nomination &**Remuneration** Committee • V- Vigil Mechanism	
	Author's Note $C^2R^3ABS^4O$n **MIC** 4 get **DSLR-V**.	



QNO 421.500	CEO-CFO Compliance Certificate BHASKAR CNO—ACCG.040	Old Course – (N20E)
	A certificate of compliance of conditions of corporate governance has been issued by CEO of VAM Ltd. In the context of internal control, which points you as an auditor would like to ensure and examine in the said compliance certificate?	
Answer	**Compliance Certificate as per Part B of Schedule II:** The Chief Executive Officer and the Chief Financial Officer shall certify to the Board that they accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of the internal control systems of the listed entity pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.	

In the context of internal controls, the auditor should ensure that:

- The management has instituted an internal control framework with respect to financial reporting controls. The framework should be examined in the context of the documentation created for each significant process in terms of the related risk and mitigating control;
- He has further examined whether the assessment process followed for evaluation of controls is reasonable and there is a process by which significant deficiencies as well as steps taken to correct them is communicated to the Audit Committee and to the auditors; and
- He should also examine whether a process exists in the listed entity whereby all significant changes in the accounting policies and in the system of internal controls are communicated to the Audit Committee and the auditors.
- The auditor should examine the adequacy of the process followed for issuing the Compliance Certificate and should review the same in regard to matters stated above and the consideration of the same by the Audit Committee. For this purpose he should refer to the minutes of the Audit Committee meetings.
- In situations where negative or adverse comments or exclusions/disclaimers are contained in the Compliance Certificate, the auditor should take cognizance of the same in the Audit Report and/or the certificate of compliance of conditions of corporate governance.

QNO 422.000	**Audit Committee -Features** BHASKAR CNO— ACCG.160/ACCG.180	**Old Course – (N08E, M14R, N14R, N15R, M16M, M16R, N16R, N16M, P17M, N17M, N17E, M18M, M19R)** **New Course – (S17M, M18R, N18M, M18M, M19R, S21M)**

State the main features of the Qualified and Independent Audit Committee set up under LODR,2015

OR

Key features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

OR

"Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference." State the main features of the Qualified and Independent Audit Committee set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

OR

Classes of Companies Required to Constitute Audit Committee

OR

Explain the Constitution of Audit Committee under Section 177 of the Companies Act, 2013

OR

Audit Committee under LODR Vs Company Act 2013

Answer

Main features of the Qualified and Independent Audit Committee Applicability of LODR –

Particulars	LODR	Companies Act
Applicability	Same as applicability of LODR (below, after chart)	As per Section 177 all listed companies, Public companies having paid up capital 10 crores or more, turnover 100 crores or more, Loan/Borrowing/ Debenture/ Deposit 50 crores or more are supposed to have AUDIT COMMITTEE. The following classes of unlisted public company shall not be covered under sub-rule (1), namely :— (a) a joint venture; (b)a wholly owned subsidiary; and

		(c)a dormant company as defined under section 455 of the Act. *Figures as on last audited balance sheet
Composition	Minimum 3 Directors (2/3rd IDs) However, in case of a **listed entity having outstanding SR (Superior Rights) equity shares,** the audit committee shall **only comprise of independent directors**	Minimum 3 Directors (Majority IDs)
Qualifications	All members should be "Financially Literate" At least one Expert	Majority including Chairman should be able to "able to understand FST"
Chairman	Should be ID	Silent
Secretary	Company Secretary of Company.	Silent
Number of meetings	Audit Committee shall meet at least 4 times in a year, Gap between 2 meetings should not be more than 4 months.	Silent
Quorum	2 Members or 1/3rd of members whichever is higher. (At least 2 IDs)	Silent
Invitees to committee Meetings	Finance Head / Head of Internal Audit / Representative of Statutory Auditor /	Auditor / Key Managerial Person can attend and have right to be heard with respect to audit report but cannot vote
Presence at AGM	Chairman of Audit Committee should be present at AGM	Silent

➢ **Companies which are required to constitute Audit committee under LODR,2015:**

Unless otherwise provided, these regulations shall apply to the listed entity who has listed any of the following designated securities on recognized stock exchange(s):

(That means Approved by Central Government under SCRA)

Designated Securities

➢ **Popular Securities**

- Specified securities listed on
  - Main board (*Simply means having Nationwide Trading Terminal)* or SME Exchange or
  - Innovators Growth Platform (*Also Known as Institutional Trading Platform)*

  ('Specified securities' means 'equity shares' and 'convertible securities)

➢ **Other Securities (NISSU)**

- **N**on-convertible securities;
- **I**ndian depository receipts;
- **S**ecurity Receipts (*Securities issued by Asset Reconstruction Company giving ownership of Bad Loans as discussed under SARFESI Act)*
- **S**ecuritised debt instruments; (*Generally gives ownership of good quality Loan Assets)*
- **U**nits issued by mutual funds;

➢ Any other securities as may be specified by the Board.

➢ **Explanations**

- The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.
- A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight

responsibility.

- The paid-up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the said purpose.

Author's Note

⚠ **# Mistake point**

For the purpose of better understanding of students, comparison of features Audit Committee under Companies Act and LODR is provided. Students are only required to write about different aspects of audit committee as per LODR or Company Act depending on question.

QNO 422.050	**Audit Committee -Functions** BHASKAR CNO—ACCG.180	**Old Course – (M04E, M11R, N13R, M15R)**

You are required to elucidate the functions of the Audit Committee as per section 177 of the Companies Act, 2013

Answer

Part I -- Relevant Standards &Laws

- **Section 177 of the Companies Act, 2013**

Part II Requirements of Relevant Standards & Laws

➢ **Functions of The Audit Committee:**

The Audit Committee performs various important functions like investigating the matters referred by board, discuss about internal control system etc.

These sub-sections of Section 177 are reproduced hereunder which specify the terms of reference as well as functions of the Audit Committee:

Sub Section 4:

"Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include, —

(Start of the year)

- evaluation of internal financial controls and risk management systems;
- the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(During the year)

- review and monitor the auditor's independence and performance, and effectiveness of audit process;
- approval or any subsequent modification of transactions of the company with related parties;

(Amendment)

- *(However, the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.*
- *In case of transactions other than transactions referred to in section 188 of the Companies Act 2013, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.*
- *These provisions shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.*
- *Also, in case any transaction involving an amount not exceeding Rupees 1 crore is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorized by any other director, the director concerned shall indemnify the company against any loss incurred by it.*

(End of the year)

- examination of the financial statement and the auditors' report thereon;

	• valuation of undertakings or assets of the company, wherever it is necessary; • scrutiny of inter-corporate loans and investments; • monitoring the end use of funds raised through public offers and related matters."
	Author's Note • **Text in italics are the amendment in RTP** • **Instead of above students can also use points mentioned in QNO 429.010**

QNO 422.100	**Risk Management Committee (Applicability)** **BHASKAR CNO—ACCG.100**	**Old Course – (N18M)** **New Course – (M18E, S21M)**
	M/s All -in-One Limited is a large-sized listed Indian Company with focus on design and delivery of custom-made Information Technology applications for various business entities in India and abroad. The Management wants to know whether they are required to constitute Risk Management Committee as per LODR, 2015 and if so, required, what should be its composition. Advice.	
Answer	**Part I -- Relevant Standards & Laws** **Regulation 21 of LODR, 2015** **Part II Requirements of Relevant Standards & Laws** • **Regulation 21 of LODR 2015,** Provision relating to constitution of risk management committee is applicable to top 1000 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year. In the instant case, All-in-One Limited, is a large sized listed Indian Company with focus on design and delivery of custom-made IT applications for various business entities in India and abroad. As per fact of the case it is a large sized listed Indian company, assuming that it is included in top 1000 listed entities, all – in – One Limited is required to constitute risk management committee. • **Composition of Risk Management Committee:** • The Board of Directors shall **constitute** a Risk Management Committee. • The Risk Management Committee shall have **minimum three members** with majority of them being members of the board of directors, including **at least one independent director** and in case of a listed entity having outstanding SR equity shares, **at least two third** of the Risk Management Committee shall comprise independent directors. • The **Chairperson** of the Risk Management Committee shall be a member of the Board of Directors and senior executives of the listed entity may be members of the committee. • The Board of Directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit and ***such function shall*** specifically cover cyber security. ***It may be noted that the role and responsibilities of the Risk Management Committee*** shall mandatorily include the performance of functions specified in Part D of Schedule II. ***(****Part D specifies roles of various committees , which include roles of risk management committees****)*** These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. A majority of this Committee will be the members of the Board of Directors. Senior executives of the company may be also being members of the Committee, but the Chairperson of the Committee shall be a member of the Board of Directors.	

QNO 422.150	**Risk Management Committee (Roles & responsibilities)** **BHASKAR CNO—ACCG.100**	**New Course – (M23R)**
	Role of the Risk Management Committee.	
Answer	**Role of the Risk Management Committee:** The role of the Risk Management Committee shall, inter alia, include the following: i. To formulate a detailed risk management policy which shall include: (a) A framework for identification of internal and external risks specifically faced by the listed entity, in particular	

	including financial, operational, sectoral, sustainability (particularly, ESG related risks), information, cyber security risks or any other risk as may be determined by the Committee. (b) Measures for risk mitigation including systems and processes for internal control of identified risks. (c) Business continuity plan. ii. To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company. iii. To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems. iv. To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity. v. To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken.

QNO 422.200	**Related Party Disclosure Requirement BHASKAR CNO—ACCG.140**	**New Course – (N20E, M22M, M22R)**
	LDH Ltd., a company incorporated in India and Listed on a recognized Stock Exchange in India has entered into various related parties transactions during the financial year. You are required to answer the following keeping in mind the Listing Obligations and Disclosure Requirements (LODR) on corporate Governance. Who should sign the report of material transactions with related parties? What type of transactions and policy are required to be disclosed in relation to related party transactions? Whether disclosures of related party transactions on consolidated financial statements are required to be made? If yes, what are the guidelines?	
Answer	➢ The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within twenty one (21) days from end of the quarter. ➢ Details of all material transactions with related parties shall be disclosed therein. The report shall be signed either by the compliance officer or the chief executive officer of the listed entity. ➢ The company shall disclose the policy on dealing with related party transactions on its website and a web link thereto shall be provided in the Annual Report. ➢ The listed entity shall disclose the transactions with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results. ➢ The listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website. Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year ➢ Related party transactions and siphoning of funds from the business were the emergent issues in corporate governance of India Inc in 2019, moving beyond board governance and executive compensation that dominated the discussions earlier. From Sun Pharma to Indigo Airlines to Apollo Hospitals, these companies faced scrutiny for their related-party transactions.	

QNO 425.000	Audit Committee (Mandatory Review) – BHASKAR CNO—ACCG.190	Old Course – (M12E, M16M, P17M, M18M) New Course – (N18E,M20R)
	State the "Mandatory Review" areas of the audit committee. **OR** **List few documents that require mandatory review by Audit Committee.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ **LODR, 2015** **Part II Requirements of Relevant Standards & Laws** **(Start of the year)** ➢ The appointment, removal and terms of remuneration of the chief internal auditor or shall be subject to review by the audit committee. **(During the year)** ➢ Management letters/letters of internal control weaknesses issued by the statutory auditors. ➢ **Internal audit** reports relating to internal control weaknesses; and **(Quarter/Yearend)** ➢ Statement of deviations: - • Quarterly statement of deviation(s) including report of monitoring agency, inapplicable submitted to stock exchange(s) in terms of regulation 32(1). • Annual statement of funds utilised for purposes other than those stated in the offer document /prospectus/notice in terms of regulation 32(7) **(Year-end)** ➢ Management discussion and analysis of financial condition and results of operations.	

QNO 425.500	Mandatory Review--Case Study BHASKAR CNO—ACCG.190	Old Course – (N20E) New Course – (N21M)
	Mr. BK, Partner in M/s. BK and Associates, as part of their audit presentation to the Audit Committee of M/s. XYZ Limited, a listed company, highlighted the following: **• Difficulties faced during the audit** **• Disagreements with the management** **• Management Letter Points** **• Draft Management Representation letter to be provided by the Company in connection with the audit.** **Some of the Audit Committee members were not happy with the above presentation and asked Mr. BK to take it back and submit directly to the Board.** They believe that Audit Committee is not the forum for discussing such problems and this has to be sorted out between auditors and the management. Please comment on the above.	
Answer	**Mandatory Review Areas of Audit Committee:** As per the Auditing Standards, the statutory auditor of the Company is having an obligation to bring certain matters to the attention of those in charge of governance, which inter alia includes aspects such as – • Difficulties faced by them during the audit • Disagreements with the management • Management Letter Points • Draft Management Representation letter to be provided by the Company in connection with the audit. Further, the Audit Committee is also having an obligation to mandatorily review certain areas before providing their recommendations/inputs to the board. Given below are the areas required to be mandatorily reviewed by the ACM in the case of listed companies.	

	The Audit Committee shall mandatorily review among other points the following information as per LODR Regulations: (i) Management discussion and analysis of financial condition and results of operations; (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management; (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors; (iv) Internal audit reports relating to internal control weaknesses; The auditor should further ascertain whether the Management Discussion and Analysis report includes discussion on the matters stipulated. Where certain deficiencies or adverse findings are noted by the Audit Committee, the auditor will be required to see that these have been suitably dealt with by the management in the report on corporate governance. In the instant case, Mr. BK, Partner in M/s BK and Associates highlighted the facts such as difficulties faced during the audit, disagreements with the management, managements letters points and draft management letters to be provided by the Company in connection with the audit. However, some of the audit committee members were not happy and as according to them audit committee is not the forum for discussing such problems. Contention of those audit committee members regarding problems to be sorted out between auditors and the management is not in order as Audit Committee is required to mandatorily review the same in accordance with Schedule II of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

QNO 426.000	Audit Committee (Meeting) BHASKAR CNO—ACCG.160	Old Course – (N13E, M15R, N16R, P17M, N17R) New Course – (S17M, N18R, N19E, S21M)

D Ltd., a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India, the revenue of the company is going down and there is slowdown in other activities of the company. Therefore, it is expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet only once at the year end. They reviewed monthly information system of the Company and found no errors As an auditor of D Limited, would you consider the decision taken by the Audit Committee to hold the meeting once in a year, in complying with Listing Obligation and Disclosure Requirements (LODR)? Also state the quorum requirements for such meetings.

OR

PSU Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slow down in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet once in a year only on March 31, 2018. They reviewed monthly information system of the Company and found no errors. As an auditor of PSU Limited would you consider the decision taken by the Audit Committee is in line with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

Answer

Part I -- Relevant Standards & Laws

- **LODR, 2015**

Part II Requirements of Relevant Standards & Laws

➢ **Audit Committee Meetings:**

One of the following additional requirements as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015("LODR Regulations") on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – **The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two**

independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- Management discussion and analysis of financial condition and results of operations;
- Management letters / letters of internal control weaknesses issued by the statutory auditors;
- Internal audit reports relating to internal control weaknesses;
- The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee; and
- Statement of deviations:
  - quarterly statement of deviations including report of monitoring agency if applicable and
  - Annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations.

Part III – Case Discussion

- In the instant case, due to recessionary conditions, slowdown in activities of the company and not expecting the significant work for the members of the audit committee, D Ltd. decided unanimously to meet only once at the year end. They also reviewed monthly information system of the company and found no errors.

Part IV – Conclusion

- In view of above, decision taken by the audit committee to hold the meeting only once at the year end is not correct as the Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings

QNO 426.500	Conducting Meeting BHASKAR CNO—ACCG.160	New Course – (S21M)

XYZ Limited has conducted 4 meetings in 2019-20. i.e., June 15, 2019, October 18, 2019, February 10, 2020 and June 10, 2020. Does it comply with provisions of conducting meeting?

Part I -- Relevant Standards & Laws

- **LODR, 2015**

Part II Requirements of Relevant Standards & Laws

- **As per Listing Obligation and Disclosure Requirements Regulations 2015,depending upon the facts and circumstances,**
  - Some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance.
  - The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings.

Part III – Case Discussion

- **In the given case,** XYZ Limited has conducted 4 meetings in 2019-20. i.e., June 15, 2019, October 18, 2019, February 10, 2020 and June 10, 2020.

Part IV – Conclusion

- It does not comply with provisions because time gap between June 15 and October 18 is more than 120 days i.e., 125 days.

QNO 427.000	Audit Committee (Power) BHASKAR CNO—ACCG.180	Old Course – (M17M)
	Power of Audit Committee as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations.	
Answer	**Part I -- Relevant Standards & Laws** ▪ LODR, 2015 **Part II Requirements of Relevant Standards & Laws** ➢ **Power of Audit Committee**: As per SEBI (Listing Obligations and Disclosure Requirements) Regulations, the Audit Committee shall have powers, which should include the following- • To investigate any activity within its terms of reference. • To seek information from any employee. • To obtain outside legal **or other** professional advice. • To secure attendance of **outsiders with relevant expertise**, if it considers necessary. It may be noted that the powers mentioned above are only illustrative and not exhaustive.	
	Author's Note **Audit committee power: - OOII powers** **I-Investigate/I-seek Information from employee/O-Obtain professional advice/O-secure attendance of Outsiders with relevant expertise.**	

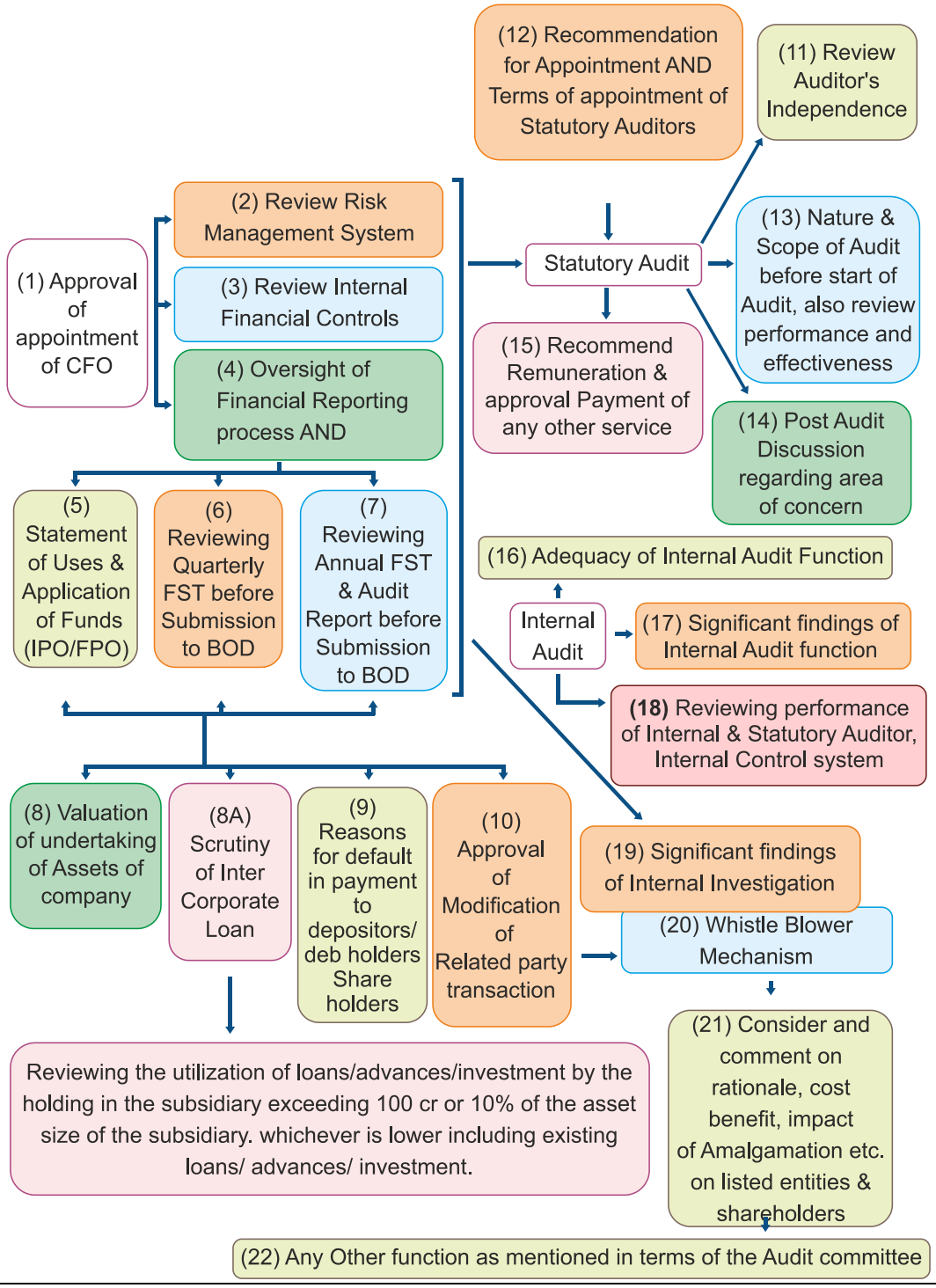
QNO 429.000	Audit Committee (Role of Auditor) BHASKAR CNO—ACCG.380	Old Course – (M17R)
	Briefly explain the role of auditor in audit committee and certification of compliance of conditions of Corporate Governance.	
Answer	**Part I -- Relevant Standards & Laws** ▪ LODR, 2015 **Part II Requirements of Relevant Standards & Laws** ***(Importance of Audit Process)*** ➢ The LODR Regulations as well as the Companies Act, 2013 in respect of the constitution of Audit Committee underline the importance of audit process and its contribution to the corporate governance process. ***(Attending AC Meetings)*** ➢ Regulation 18 (1) (f) stipulates that a representative of the statutory auditor, when required, shall be invited to the meetings of the Audit Committee. Similarly, Section 177 of the Companies Act, 2013 provides the auditors of a company and the key managerial personnel the right to be heard in the meetings of the Audit Committee when it considers the auditor's report, but they shall not have the right to vote. ***(Communication with AC)*** ➢ The auditor must ensure that he communicates frequently and openly with the Audit Committee on key accounting or auditing issues that, in the auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, and ensure that he addresses any questions or concerns voiced by the Audit Committee. He can contribute significantly in assisting and advising the Audit Committee on improving corporate governance, oversight of financial reporting process, implementation of accounting policies and practices, compliance with accounting standards, strengthening of the internal control systems about financial reporting and reporting processes. ***(Assisting Management & AC)*** ➢ The auditor must devote substantial professional time in assisting the management and the Audit Committee to enable them to discharge their functions effectively and in certification of the requirements of corporate governance. The auditor has to keep in mind that his role is not to drive corporate governance directly. Rather, it is the management's responsibility to do so and, in the process, he should play a significant role in assisting management to ensure better standards of corporate governance.	

	➢ **Auditor's Responsibility** The auditor's responsibility in certifying compliance with the requirements of corporate governance relates to the verification and certification of factual implementation of requirements of corporate governance as stipulated in the LODR Regulations. **Such verification and certification is neither an audit nor an expression of opinion on the financial statements of the company.** The certificate from the auditor as regards compliance with the requirements of corporate governance is **neither an assurance as to the future viability of the company, nor the efficiency or effectiveness with which the management has conducted the affairs of the company.**
	Author's Note **Role of auditor in audit committee – C^2ARVE** 1. **R-Right to be heard in meetings** 2. **C-Communicate frequently with audit committee on key issues** 3. **C-address Concern voiced by audit committee** 4. **A-Advice to improve corporate governance, oversight of financial reporting process, implementation of accounting policies and practices, compliance with accounting standards, strengthening of the internal control systems** 5. **V-The auditor's responsibility in certifying compliance with the requirements of corporate governance relates to the Verification and certification of factual implementation of requirements of corporate governance** 6. **E-Such verification and certification is neither an audit nor an Expression of opinion on the financial statements of the company.**

QNO 429.010	**Audit Committee (Role of Audit committee)** **BHASKAR CNO—ACCG.180**	**Old Course – (M09R, M16R)**
	The audit committee has been granted several roles under Clause 49 of the Listing Agreement Oversight of the company's financial reporting process; recommendation for appointment of auditors; approval of payment to statutory auditors etc are some of the roles that an audit committee perform State the role of Audit Committee as provided under Clause 49 of the Listing Agreement	
Answer	➢ **The role of the audit committee shall include the following:** • oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible; • recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity; • approval of payment to statutory auditors for any other services rendered by the statutory auditors; ➢ **reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:** • matters required to be included in the director's responsibility statement to be included in the board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013; • changes, if any, in accounting policies and practices and reasons for the same; • major accounting entries involving estimates based on the exercise of judgment by management; • significant adjustments made in the financial statements arising out of audit findings; • compliance with listing and other legal requirements relating to financial statements; • disclosure of any related party transactions; • modified opinion(s) in the draft audit report; ➢ reviewing, with the management, the quarterly financial statements before submission to the board for approval; ➢ reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;	

	➢ reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process; ➢ approval or any subsequent modification of transactions of the listed entity with related parties; ➢ scrutiny of inter-corporate loans and investments; ➢ valuation of undertakings or assets of the listed entity, wherever it is necessary; ➢ evaluation of internal financial controls and risk management systems; ➢ reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems; ➢ reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit; ➢ discussion with internal auditors of any significant findings and follow up there on; ➢ reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board; ➢ discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern; ➢ to look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors; ➢ to review the functioning of the whistle blower mechanism; ➢ approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate; ➢ Carrying out any other function as is mentioned in the terms of reference of the audit committee. ➢ Reviewing the utilization of loans/advances/investment by the holding in the subsidiary exceeding 100 Cr or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments. ➢ Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders. ➢ Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders.
	Author's Note **Below is the chart of the** points **above, students can refer it for quick overview.**

ROLE OF AUDIT COMMITTEE (LODR)



QNO 430.500	BOD Composition & Chairmanship BHASKAR CNO—ACCG.200	Old Course – (N21R) New Course – (N21R)
	Kayask Ltd. is a public company which got listed on BSE and NSE in the F.Y. 2015-16 and is amongst the top 500 listed entities on the basis of market capitalization. JP Bhuj & Co., a CA firm, has been appointed as its statutory auditor for the F.Y. 2020-21. **Mr. Pankaj Bhuj was assigned its audit as an engagement partner and he was verifying the composition of the Board of Director because of some changes in the same. The present composition of the Board of Kayask Ltd. is as follows: -** **(1) There are 9 directors out of which there are 4 non-executive directors and 3 independent directors. The board has only one woman director and she is an executive director.** **(2) Mr. Madhusudan Mehra has been appointed as the non-executive chairperson of the Board. He is brother in law of the Managing Director of Kayask Ltd.** **Whether present composition of the board of Kayask Ltd. complies with the requirement of the provisions of SEBI LODR Regulations?**	
Answer	As per Regulation 17 and 17A of the SEBI LODR Regulations, - ✓ The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. It may be noted that the Board of directors of the top 1000 listed entities shall have at least one independent woman director. ✓ The auditor should also verify that where the Chairperson of the Board is a nonexecutive director, at least one-third of the Board should comprise of independent directors. ✓ The auditor shall ensure that the Chairperson of the board of the top 500 listed entities is - (a) a non-executive director; (b) not related to the Managing Director or the Chief Executive Officer as per the definition of the term "relative" defined under the Companies Act, 2013. As per the term "relative" defined under the Companies Act, 2013 – Brother-in-law i.e. sister's husband is not included. In the given case, Kayask Ltd. is a public company which got listed on BSE and NSE in the F.Y. 2015-16 and is amongst the top 500 listed entities on the basis of market capitalization. The present composition of the board of Kayask Ltd includes 9 directors out of which there are 4 non-executive directors and 3 independent directors. The board has only one woman director and she is an executive director. In addition, Chairperson of the Board Mr. Madhusudan Mehra is brother in law of the Managing Director of Kayask Ltd. and has been appointed as the non-executive Chairperson. In view of Regulation 17 and 17A of the SEBI LODR Regulations, there should at least 5 non-executive directors and 3 Independent directors as its Chairperson is a non-executive director. Further as the company is amongst the top 500 listed entities, at least one independent woman director should be there in its board. Thus, it can be concluded that the present composition of the board of Kayask Ltd. does not comply with the requirement of the provisions of SEBI LODR Regulations as the woman director should be an independent director and there should be 5 non-executive directors.	

QNO 430.600	Independent Director - Case Study on Share Holding UNIQUE	New Course – (N21E)
	CA Pradeep is appointed auditor of Delicious Foods Ltd. (DFL) a listed company to audit the financial statements for the year ended 31st March 2021. Paid-up share capital of DFL is ` 5.97 Cr. While auditing director's remuneration CA Pradeep observed that Mr. Shrinivas Gupta has been appointed as an independent director. Mr. Srinivas Gupta is holding shares of ` 8,95,500 in DFL and his wife is holding shares of ` 2,98,500 in the same company. CA Pradeep raised an objection on the appointment of independent director, but other directors explained that holding of shares by Mr. Srinivas is less than the prescribed limit hence, he is eligible to be appointed as independent director. How will CA Pradeep deal with this situation and how will he report this issue?	
Answer	**LODR Regulation 17 regarding Verification regarding Composition of Board of Directors of Listed Entity:** An independent non-executive director should not be a substantial shareholder of the listed entity and in determining 'not a substantial shareholder'; he (together with his relatives) should not own 2% or more of total voting power of the listed entity. In the given case of Delicious Foods Ltd. (DFL), Mr. Shrinivas Gupta along with his wife is substantial shareholder of the DFL, Listed Company, because their holding in DFL is 2 % of the total voting power of the DFL calculated as under: Mr. Shrinivas Gupta's holding in DFL = 8,95,500 His wife's holding in DFL = 2,98,500 Combined holding of Mr. Shrinivas Gupta and his wife = 11,94,000 Total Voting Power of DFL = 597,00,000 Percent calculation = 11,94,000 x100/59700000 = 2% Hence objection raised by CA Pradeep on the appointment of independent director is valid and Mr. Shrinivas is not eligible to be appointed as independent director of the company. In this case CA Pradeep should specifically mention in his report about the disqualification of appointment as independent director of Mr. Shrinivas. He should mention name of the disqualified director, date of disqualification and reasons of disqualifications in his audit report.	

QNO 431.000	Auditor's Certificate BHASKAR CNO—ACCG.080	New Course – (N16E, M18E, N19E) Old Course – (N18M)
	The auditor of Mould Limited made an adverse statement in his certificate as the Audit Committee of the company did not meet four times a year. Discuss few circumstances **which** require an adverse or qualified statement **in the auditor's certificate in respect of compliance of the requirements of Corporate Government.** **OR** **Some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate,** in respect of compliance of requirements of corporate governance. Give four examples of such situations**.** **OR** **A listed entity has to obtain a compliance certificate from either the statutory auditors or practicing company secretaries regarding compliance of conditions of corporate governance and annex it to the Directors' Report.** Discuss some situations which may require an adverse or qualified statement in respect of the above	
Answer	**Part I -- Relevant Standards & Laws** ▪ LODR, 2015 **Part II Requirements of Relevant Standards & Laws** ➢ **Adverse or Qualified Statement & Examples** Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the	

Auditors' Certificate, in respect of compliance of requirements of corporate governance for e.g., Examples of such circumstances:

- *Shareholder Related*
  - ***(Transfer of Shares)*** **-** The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.
- *Director Related*
  - ***(Number of Non-Executive Directors)*** **-** The number of non-executive directors is less than 50% of the strength of Board of directors.
  - ***(Directorships)*** **-** A director is a member of more than 10 committees or acts as Chairman of more than 5 committees across all companies in which he is a director.
  - ***(Time gap between 2 BOD Meetings)*** **-** The time gap between two Board meetings is more than one hundred and twenty days.
- *Audit Committed Related*
  - ***(Setting up Audit Committee)*** **-** A qualified and independent audit committee is not set up.
  - ***(Chairman of Audit Committee)*** **-** The Chairman of the audit committee is not an independent director.
  - ***(Meetings of AC)*** **-** The Audit Committee does not meet four times a year.
  - ***(Powers of Audit Committee)*** **-** The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.
- *Financial Reporting Related*
  - ***(Quarterly Results)*** - The information of quarterly results **is neither put on the listed entity's website nor sent in a form so as to enable the stock exchange** on which the entity's securities are listed to enable such stock exchange to put it on its own website.

QNO 432.000	**LODR (Code of Conduct)** **BHASKAR CNO—ACCG.360**	**Old Course – (M17R, N17M)**

Pataka Limited is a listed Company in which no code of conduct is laid down for its board members and senior members. As an auditor of Pataka Limited:

(i) Briefly explain the compliance requirements with respect to Code of Conduct as per Listing Order Disclosure Requirement (LODR) Regulations.

(ii) What will be your role in compliance of above-mentioned Code of Conduct as per LODR Regulations?

Answer

Part I -- Relevant Standards & Laws

- LODR, 2015

Part II Requirements of Relevant Standards & Laws

Explanation

➢ *Compliance requirements for code of conduct as per LODR-*

- *(Responsibility of BOD & SM)*
  - **The Board shall lay down a code of conduct for all Board members and senior management of the listed entity.**
- *(Incorporate Companies Act)*
  - **The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013. ***
- *(Posting on Website)*
  - **The code of conduct shall be posted on the website of the company.**
- *(Compliance)*
  - **All Board members and senior management personnel shall affirm compliance with the code on an annual basis.**

- *(Declaration by CEO)*
  - **The Annual Report of the company shall contain a declaration to this effect signed by the CEO.**
- *(Senior Management)*
  - **For this purpose, the term "senior management" shall mean personnel of the listed entity who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.**
- *(Responsibility of Auditor)*
  - **The auditor should ascertain whether the Board of Directors of the company has laid down a Code of Conduct for all Board members and senior personnel of the company and obtain a copy of the same. He should also verify whether all Board members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on company's website.**

QNO 433.000	Management Discussion and Analysis. BHASKAR CNO—ACCG.320	Old Course – (N13E, P17M, N17R) New Course – (S17M, S21M)
	Briefly explain the Content of Management Discussion and Analysis	

Answer

Part I -- Relevant Standards & Laws

- LODR, 2015

Part II Requirements of Relevant Standards & Laws

➢ **Management Discussion and Analysis**

- **Addition to BOD Report**

  As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion &Analysis should include discussion on the following matters within the limits set by the company's competitive position:

- **Matters to be Covered**

  SO²FT Discussion with **RISHI²** in Management Discussion & Analysis

  - **Segment–wise or product-wise** performance
  - **Outlook*(Future of economy & industry)***
  - Discussion on **Financial performance with respect to operational performance**
  - Opportunities and **Threats*(At Macro Level)***
  - **Risks** and concerns***(At Micro Level)***
  - **Industry** structure and developments***(Past Year)***
  - details of **Significant changes** (i.e. change of 25% or more as compared to the immediately previous financial year) in key financial ratios, along with detailed explanations therefore, including:
    - Details of any change in Return on Net Worth as compared to the immediately previous financial year along with a detailed explanation thereof
    - Current Ratio
    - Debtors Turnover
    - Inventory Turnover
    - Debt Equity Ratio
    - Operating Profit Margin (%)
    - Net Profit Margin (%) or sector-specific equivalent ratios, as applicable.
  - Material developments in **Human Resources / Industrial Relations** front, including number of people employed. ***(HR Function in company)***
  - **Internal control systems** and their adequacy***(ICS in Company)***
  - **Interest** Coverage Ratio

- **Disclosure of Accounting Treatment:**
  Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the **fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.**

- **Don't verify just check compliance, Useful for understanding Entity**
  The above information presented by the management is likely to include non-financial information, which may be outside the auditor's area of expertise. In such situations, the auditor may keep in mind SA 315 relating to "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment" and the **fact that he is only required to review the compliance with disclosure requirements and not verify the particular facts as disclosed by the management.**

- **Consistent with reporting in Financial Statements**
  The auditor should ascertain that the segment-wise or product-wise performance (sub-clause (c)as stated above) is **consistent with what is reported in financial statements** complying with AS 17(Segment Reporting)/ Indian Accounting Standard 108 (Operating Segments) and also as per provisions of Section 133, 134 and 143 of the Companies Act, 2013.

QNO 433.010	LODR (Regulation 36) BHASKAR CNO—ACCG.340	New Course – (M18M)
	Mr. Suzain has been appointed as a director of CAC Ltd. As an auditor, you are required to state the information to be provided to the shareholders of the company in accordance with Regulation 36 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.	
Answer	**Part I -- Relevant Standards & Laws** ▪ **LODR, 2015** **Part II Requirements of Relevant Standards & Laws** ➢ **Disclosure of Information to the Shareholders relating to Director's Appointment –** Disclosure of Information to the Shareholders relating to Director's Appointment: As per Regulation 36 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, in case of the appointment of a new director or re-appointment of a director, the shareholders must be provided with the following information- • **B**- A **B**rief resume of the director; • **E**- Nature of his **E**xpertise in specific functional areas; • **N**-**N**ames of listed entities in which the person also holds the directorship and the membership of Committees of the Board; and • **D**- **D**isclosure of relationships between directors inter-se; • **S**- **S**hareholding of non-executive directors. The auditor should ascertain from the communications sent, whether in the case of appointment of a new director or re-appointment of a director, the shareholders have been provided with the information stipulated above.	
	Author's Note **B**-**B**rief/ **E**-**E**xpertise/ **N**-**N**ames/**D**-**D**isclosure / **S** -**S**hareholding	

433.020	Affirmation of compliance with the code on an annual basis. BHASKAR CNO—ACCG.360	New Course – (S21M)
	The Board of Directors of PQR Ltd. have laid down the code of conduct for all Board members and senior management. The auditor is provided with the annual compliance affirmations received from the Board members and explained that since there has been no change in the composition of the senior management, the previous year's affirmations may be considered valid. Is the contention of	

	the Company valid?
	Part I -- Relevant Standards & Laws ▪ **LODR, 2015** **Part II Requirements of Relevant Standards & Laws** ➢ Under Regulation 26(3) of LODR, all Board members and senior management personnel have to affirm compliance with the code on an annual basis. **Part III – Case Discussion** ➢ **In the given case,** the auditor is provided with the annual compliance affirmations received from the Board members and explained that since there has been no change in the composition of the senior management, the previous year's affirmations may be considered valid. **Part IV – Conclusion** ➢ The decision to consider the previous year's affirmations from the senior management personnel as valid is not in line with the LODR Regulations.

433.030	**POSH Act – Harassment** **BHASKAR CNO—ACCG.460**	**New Course – (S21M)**
	Genuine Ltd. has established the Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ('POSH Act'). The details (names, email addresses and contact numbers) of the Committee members are available on the company intranet which is accessible by all employees. However, no disclosure regarding number of complaints pertaining to sexual harassment of women at workplace is being made. Are the measures taken by the Company adequate?	
	Part I -- Relevant Standards & Laws ▪ **LODR, 2015** **Part II Requirements of Relevant Standards & Laws** ➢ As per Schedule V Disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, amongst other matters, following should be disclosed in the section on Corporate Governance of the Annual Report: • number of complaints filed during the financial year. • number of complaints disposed of during the financial year • number of complaints pending as on end of the financial year. ➢ The POSH Act offers protection to all women, be it employees or contract staff or any other women who are associated with the Company in any other capacity (including service providers, vendors, professionals, etc.) By only providing the details in the intranet, the Company has failed to meet the requirements under LODR **Part III – Case Discussion** ➢ In the given case, no disclosure regarding number of complaints pertaining to sexual harassment of women at workplace is being made by the company. **Part IV – Conclusion** ➢ In view of above, Genuine Ltd. is required to make necessary disclosures in accordance with Schedule V of SEBI (LODR) Regulation 2015.	

QNO 434.010	**Independent Director-** **Unique**	**Old Course – (N18E, M19M, N19R)** **New Course – (M19M, N19R, S21M)**
	Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued for a listed company **where the Board** consists of 10 directors **including a non -executive director as its chairman and further:** **(i) There were** 5 meetings **held during the year as follows: 01/04/2017, 01/06/2017, 01/09/2017, 03/01/2018, 25/03/2018.** **(ii) There are** 4 independent directors**. One of them resigned on 25/05/2017. A new independent director was appointed on 01/09/2017.** **(iii) The** Chairman of Audit Committee did not attend the Annual General Meeting **held on 14/09/2017.** (iv) **The internal audit reports were obtained by Audit Committee on quarterly basis. Quarter 1 internal audit report commented on certain serious irregularities as regards electronic online**	

	auction of scrap. The agenda of Audit Committee did not deliberate or take note of the issue. **(v)** There is no women director.
Answer	➢ **Compliance Certificate as per LODR** As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for example. (i) The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The numbers of days between the meetings held on 1.9.2017 and 3.01.2018 is more than 120 days. Hence it is a non-compliance and would require qualification in certificate of corporate governance (ii) Since the Chairman is the non-executive director, there should be 1/3rd of directors (rounded to next integer) to be independent. In this case, 4 directors need to be independent. Any vacancy during shortfall of independent directorship should be filled within next 3 months. In the instant case, since the independent director was appointed after lapse of 3 months (i.e. on 1.9.2017) and after next first meeting 1/6/2017, there is default which would require qualification in certificate on corporate governance. (iii) Chairman shall be present at Annual General Meeting to answer shareholder queries. In the given scenario, Chairman of Audit Committee did not attend the Annual General Meeting held on 14/09/2017, which is not in order/compliance. (iv) The Audit Committee shall mandatorily review the Internal audit reports relating to internal control weaknesses as per Part C (B) of Schedule II and the auditor should ascertain from the minutes book of the Audit Committee and other sources like agenda papers, etc. whether the Audit Committee has reviewed the above-mentioned information. In the given situation, the agenda of Audit Committee did not deliberate or take note of serious irregularity mention in Internal Audit Report which is again not in compliance of conditions of Corporate Governance and warrant audit qualification in certificate on corporate governance (v) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one-woman director. Therefore, there should be at least one-woman director. In the given situation there is no woman director which is again not in compliance

QNO 434.020	**Director Case Study --Top 1000 Company** **BHASKAR CNO—ACCG.200**	**New Course – (M22E, M23M)**
	Comment on the following in the light of certificate of compliance of conditions of Corporate Governance to be issued under SEBI (LODR) Regulations 2015, for a Listed Company (one among the top 1000 listed companies) where the Board consists of 20 directors with a Non-executive director as its Chairman and further- **(i) One Non-executive Director has attained the age of 70 years;** **(ii) One of the Directors is a Director in eight other listed entities;** **(iii) The Managing Director is serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a Stock exchange;** **(iv) The Non-executive Chairman is the promoter of the Listed Entity which has nine Independent Directors;** **(v) One Independent Director has been serving as Independent Director in eight listed entities of which equity shares are listed on a Stock Exchange.**	
Answer	**(i)** **One non-executive director has attained the age of 70 years:** The auditor should ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years. In the given situation, there	

is no violation of LODR 2015 for Non-executive director who has attained the age of 70 years.

(ii) **One of the Directors is a Director in eight other Listed Entities:** As per LODR 2015, a person shall not be a director in more than seven listed entities. In the given situation, there is non-compliance as one of the Directors is a Director in eight other listed entities which is exceeding the prescribed limit of seven entities.

(iii) **The Managing Director is serving as Independent Director in Four listed entities of which one entity's equity shares are not listed on a Stock Exchange:** Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of above mentioned provision, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, Managing Director has been serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a stock exchange. So it is not exceeding the prescribed limit of three entities, hence there is no violation of LODR 2015.

(iv) **The Non-executive Chairman is the Promoter of the Listed Entity which has nine Independent Directors:** The auditor should also verify that if the regular nonexecutive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors. In the given situation, Board consist of 20 directors with a Nonexecutive Director as its Chairman has 9 independent directors i.e., less than half of Board is not in compliance with the requirement of LODR, 2015.

(v) **One Independent Director has been serving as Independent Director in Eight Listed Entities of which Equity Shares are listed on a Stock Exchange:** A person shall not serve as an independent director in more than seven listed entities in case its equity shares are listed on a Stock Exchange. It may be noted that the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

In the given situation, there is non-compliance as one of the Independent Director has been serving as Independent Director in eight listed entities which is exceeding the prescribed limit of seven entities.

QNO 434.100	**Obligations of Directors & Senior Management** **BHASKAR CNO—ACCG.300**	**Old Course – (M19E)**
	The Directors and senior management of a listed company of which you are the statutory auditor, want to know their obligations under the SEBI Regulations in regard to Board or Non-Executive Directors. (Mention any five)	

Answer

(Senior Manager Disclosure)

- Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

(Max Directorships)

- A director shall not be a member in more than 10 committees or act as Chairperson of more than 5 Committees across all listed entities in which he is a director. Furthermore, every director shall inform the listed entity about the committee positions he occupies in other listed entities and notify changes as and when they take place. It may be noted that for the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies, **high value debt listed entities** and companies under Section 8 of the Companies Act, 2013 shall be excluded and for the purpose of reckoning the limit under this sub clause, Chairpersonship/membership of the Audit Committee and the Stakeholders' Relationship Committee alone shall be considered.

(BOD Meetings)

- The Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

(Review Compliance Reports)

- The Board shall periodically review compliance reports of all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.

(Liability of Independent Director)

- An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the LODR Regulations.

(Notice Period of Independent Director)

- An independent director who resigns or is removed from the Board of Directors of the listed entity shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.

  Provided that where the listed entity fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

(Succession of BOD / Senior Management)

- The Board of Directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

434.150	**Nomination and Remuneration committee** **BHASKAR CNO—ACCG.480**	**New Course – (N20E)**

BG Limited is a large-sized listed company. The Board of directors have constituted Nomination and Remuneration committee comprising of non-executive and independent directors. The management seeks your advice on the composition and role of the committee. Elucidate the composition and role of Nomination and Remuneration committee as per SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

- **Composition of Nomination and Remuneration committee:**
  It shall comprise of at **least three directors**, **all** of whom **shall be non-executive directors** and **at least 2/3rd shall be independent directors**.

  Chairperson of the committee shall be an independent director.

  Chairperson of the committee **shall be an independent director** and it may be noted that the **Chairperson of the company (whether executive or nonexecutive)** may be appointed as a **member** of the Nomination and Remuneration Committee **but shall not chair such committee**.

  The **Chairperson of the Nomination and Remuneration Committee may be present** at the **Annual General Meeting**, to **answer the shareholders' queries**. However, it would be up to the **Chairperson to decide who shall answer the queries**.

- **Role of Nomination and Remuneration committee**
  - **Nomination Related**
    - Devising a policy on **Board diversity**.
    - Formulation of the **criteria** for determining qualifications, positive attributes and independence of a director and
    - **Identifying persons** who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down and recommend to the Board their appointment and removal.
    - Formulation of criteria for **evaluation of performance** of independent directors and the Board of Directors.
    - whether to **extend or continue** the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.

	• **Remuneration Related**
	  • recommend to the Board of Directors a policy, relating to the remuneration of the **directors, key managerial personnel and other employees.**
	  • **recommend** to the board, all remuneration, in whatever form, payable to **senior management.**

QNO 434.160	**Regulation 17(6)--Remuneration Recommendation & Approval** **BHASKAR CNO—ACCG.490**	**Old Course – (M21E)**
	You have been appointed as a statutory auditor of ABC Ltd; a listed company. As an auditor, state the points to be considered by you in verification of approval of remuneration to directors of ABC Ltd. Under Regulation 17(6) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.	
Answer	**Approval of Remuneration of Directors [Regulation 17(6)]:** As an auditor of ABC Ltd., a listed company, following points to be considered regarding verification of approval of remuneration to directors of ABC Ltd., under Regulation 17(6) of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015: 1. The auditor should ascertain from the minutes of the Board of Directors' meetings, shareholders' meetings, relevant agenda papers, notices, explanatory statements etc., whether the remuneration of non-executive directors has been decided by the Board of Directors after receiving prior approval of the shareholders in the general meeting; 2. The approval of shareholders by special resolution shall be obtained every year, in case the annual remuneration payable to a single non-executive director exceeds fifty percent of the total annual remuneration payable to all non-executive directors, giving details of the remuneration thereof. 3. The auditor should refer to the Articles of Association of the company, wherever applicable; 4. The auditor is required to examine the Report of the Board of Directors on corporate governance to be included in the annual report of the company and ascertain whether the same contains the disclosures with respect to remuneration of directors and compensation to non-executive directors. The auditor should correlate this data with that contained in the financial statements. Where application of this clause requires the value of ESOP to be determined, the services of expert may have to be utilized. In this regard, reference may be made to SA 620 dealing with "Using the Work of an Auditor's Expert".	

QNO 434.200	**Verification of composition of Board under Regulation 17** **BHASKAR CNO—ACCG.200**	**New Course – (M19E)**
	You have been appointed as an auditor of M/s Real Ltd. in which total number of directors in the board is 9. As an auditor, state the points to be considered in verification of composition of Board under Regulation 17 of The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.	
Answer	➢ **Verification regarding Composition of Board [Regulation 17]** • The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one-woman director and not less than 50% of the Board of Directors comprising non-executive directors. The minutes of the Board of Directors' meetings should be verified to ascertain whether a director is an executive director or a non-executive director. • The auditor should also verify that where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case the listed entity does not have a regular non-executive Chairperson, at least half	

	of the Board of Directors should comprise independent directors. Further, if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors. In determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, in the number of one-half or one-third as the case may be, should be rounded off. Since the terms in this clause refer to 'not less than' and 'at least', it would be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e., seven directors), the independent directors should be three or more. • Annual disclosure submitted by the directors to the Board of Directors may be examined for this purpose. If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same. Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined. • An independent non-executive director, apart from receiving remuneration, should not have had/ should not have any material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. Also, such independent director, either by himself or with any of his relatives should not be a material supplier, service provider or customer or a lessor or lessee of the listed entity and should not also be a substantial shareholder of the listed entity. In determining 'not a substantial shareholder', he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

QNO 434.250	**Material Unlisted Subsidiary--Appointment of Independent Director** **BHASKAR CNO—ACCG.220**	**Old Course – (M21M)** **New Course – (M21M)**
	BN Limited is a listed entity having two subsidiaries namely BUS Limited and ROBUS Limited. Both the subsidiaries are unlisted and are incorporated in Australia. The consolidated net worth of BN Limited and its subsidiaries is Rs. 350 crore (including net worth of BUS Limited and ROBUS Limited Rs. 36 crore & Rs. 80 crore respectively) in the immediately preceding year 2019-20. On observing this fact, your senior manager advises you to inform the management of BN limited to make certain changes in the board of directors of both the subsidiaries, in accordance with the LODR regulation 24(1). Comment.	
Answer	As per SEBI - LODR Regulation 24(1), at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of the unlisted material subsidiary, whether incorporated in India or not. For the purpose of Regulation 24(1), notwithstanding anything to the contrary contained in Regulation 16, the term 'material subsidiary' means a subsidiary, whose income or net worth exceeds 20% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. In the given case, the fact that both the subsidiaries are unlisted and incorporated outside India is irrelevant. From the above case we have the following details: ○ 20% of consolidated net worth of BN Limited = 350*20% = Rs. 70 crore. ○ Net worth of BUS Limited = Rs. 36 crore. ○ Net worth of ROBUS Limited = Rs. 80 crore. Accordingly, it is clear that out of the two subsidiaries, the net worth of only one subsidiary (ie. ROBUS Limited) exceeds 20% of the consolidated net worth of BN Limited and all its subsidiaries. Therefore, the change in the composition of board of directors needs to be made only for ROBUS Limited and not both the subsidiaries.	

	Thus, contention of senior manager regarding change in composition of board of directors in BUS Limited is not in order as per Regulation 24(1). However, change in composition of board of director is required for ROBUS Limited. Further, as per Regulation 24 (1) of LODR Regulation, 2015 one of the independent directors present in the board of director of BN Limited should also be made as a director in the board of directors of ROBUS Limited.

QNO 434.260	**Material Unlisted Subsidiary--Appointment of Independent Director** **BHASKAR CNO—ACCG.220**	**Old Course – (M21M)** **New Course – (M21M)**

RAO & Co., a Chartered Accountant Firm, is appointed as the principal auditor of a listed company, Triumph Ltd.
Figures of income and net-worth of five out of seven components of Triumph Ltd., which are its unlisted subsidiaries, is tabulated below for the immediate preceding financial year along with the consolidated amount :

(Rs. in crores)

Particulars	Consolidated	Component 'A'	Component 'B'	Component 'C'	Component 'D'	Component 'E'
Income	300	35	10	70	65	20
Net Worth	800	40	20	140	180	50

The remaining two components i.e., Component 'F' & Component 'G' of Triumph Ltd. were unaudited. According to Mr. RAO, the engagement partner, Component 'F' is material to the consolidated financial statements whereas Component 'G' is not material to consolidated financial statements and this fact has also been discussed in writing with those charged with governance of Triumph Ltd. and it will also form part of report as a 'Key audit matter' in accordance with SA 701.
(i) Which of the components of Triumph Ltd. can be termed as "material subsidiary" and in the board of which of the unlisted subsidiaries at least one independent director of Triumph Ltd. needs to be appointed or would be appointed?

(ii)What shall be the audit consideration in relation to reporting in case of unaudited components of Triumph Ltd. by RAO & Co. and how RAO & Co. as a principal auditor shall report in case of Component 'F' & Component 'G', respectively?

Answer

(i) As per Regulation 16(c) of the SEBI (LODR) Regulations, 2015, "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. [Explanation- The listed entity shall formulate a policy for determining 'material' subsidiary.]

Regulation 24(1) of the SEBI (LODR) Regulations, 2015, provides that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

[Explanation- For the purposes of Regulation 24(1), notwithstanding anything to the contrary contained in regulation 16, the term "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year]

On the basis of above provisions, following information is tabulated as below:

Particulars	Share in Consolidated Income	Share in Consolidated Net Worth
Component 'A'	11.67%	5%
Component 'B'	3.33%	2.5%
Component 'C'	23.33%	17.5%
Component 'D'	21.67%	22.5%
Component 'E'	6.67%	6.25%

It can be observed that Component 'A', Component 'C' and Component 'D', respectively, can be termed as "material subsidiary" as their shares in either consolidated Income or net worth exceeds 10%.

Further, at least one independent director from the board of directors of Triumph Ltd. shall be appointed or would have been appointed on the board of Component 'C' and Component 'D', respectively, as their shares in either consolidated income or net worth exceeds 20%.

(ii) Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi - location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

In the given situation, two out of seven components of Triumph Ltd. have remained unaudited where Component 'F' is material and Component 'G' is not material to the consolidated financial statements. Since Component 'F' is material, therefore, it may be assumed that reporting of Key Audit Matter in accordance with SA 701 is being done for Component 'F' and not for Component 'G'.

Thus, in case of Component 'F', the Principal Auditor needs to consider its impact on the auditor's opinion on the consolidated financial statements of the group, in terms of the principles laid down in SA 705, Modifications to the Opinion in the Independent Auditor's Report. Whereas in case of Component 'G', the principal auditor should make appropriate reporting under the "Other Matters" paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs, in the Independent Auditor's Report.

QNO 434.300	Vigil Mechanism BHASKAR CNO—ACCG.500	New Course – (S21M)

RST Ltd. has established a vigil mechanism to enable its directors and employees to report genuine concerns and seek protection against victimization. The details of the mechanism are available on the company intranet **which is accessible by the directors and employees. Are the measures taken by the Company in line with the LODR Regulations?**

Part I -- Relevant Standards & Laws

- **LODR, 2015**

Part II Requirements of Relevant Standards & Laws

- **Under Regulation 22 of the LODR,**
  The vigil mechanism can be used by directors, employees and any other person.
- **Regulation 46 of the LODR** requires the details of establishment of such mechanism to be disclosed by the Company on its website and in the Board Report.

Part III – Case Discussion

- RST Ltd. has established a vigil mechanism to enable its directors and employees to report genuine concerns and seek protection against victimization. The details of the mechanism are available on the company intranet which is accessible by the directors and employees.

Part IV – Conclusion

- By only providing the details in the intranet, the Company has failed to meet the LODR Regulations.

QNO 434.400	Compliance with LODR (Multiple Case) BHASKAR CNO—ACCG.280/ ACCG.480/ ACCG.100	New Course – (N20R)

M/s FCA & Associates, Chartered Accountants is one of the leading auditing firms in Guwahati. The firm received an assignment to examine the compliance conditions [as stated in SEBI (LODR) Regulations] of corporate governance by ABC Ltd., a listed entity with no outstanding SR equity shares. The firm had made the following observations:

Observation No. 1:
Mr. Fine, one of the Director of the Company, also the Chairman of the Stakeholder Relationship Committee, was acting as the audit committee Chairman in 4 other listed companies as well & 1 private company, simultaneously.

Observation No. 2:
The Nomination & Remuneration Committee consisted of 6 members, which regularly met biannually.

Observation No. 3:
The Risk Management Committee consisted of 9 directors, out of which, the number of independent directors is the majority, but it was less than two thirds of the total strength.

Which among the above three observations made by the auditor of ABC Ltd. should be reported by M/s. FCA & Associates?

- **Observation No. 1 –**
  - **Mr. Fine, one of the Director of the Company, also the Chairman of the Stakeholder Relationship Committee, was acting as the Audit committee Chairman as well in 4 other listed companies & 1 private Company, simultaneously:**
    As per Regulation 26 of SEBI (LODR) Regulations, a Director cannot be a Chairman in more than 5 committees across all listed entities. However, for the purpose of reckoning the limit under this Regulation, chairmanship of committees in a private company shall be excluded. In this case, since Mr. Fine is the Chairman of audit committee in ABC Ltd. And Chairman in 4 other listed companies, there is no violation of the limit specified under the Regulation 26. Accordingly, this observation need not be reported by the auditor.
- **Observation No. 2:**
  - **The Nomination & Remuneration Committee consisted of 6 members, who regularly met biannually:**
    As per Regulation 19, Part D of Schedule II of SEBI (LODR) Regulations, every listed company should have a Nomination &Remuneration Committee, which shall meet at least once in a year. Since, in the given case the committee met biannually (i.e. once in 2 years), the said observation needs to be reported by the auditor.
- **Observation No. 3:**
  - **The Risk Management committee consisted of 9 directors, out of which the number of independent directors is the majority, but it was less than two thirds of the total strength:**
    As per Regulation 21 of SEBI (LODR) Regulations, only in case of a listed entity having outstanding SR equity shares, at least two thirds of Risk Management Committee shall comprise of independent directors. In the given case, ABC Ltd. does not have outstanding SR equity shares. Accordingly, this observation need not be reported by the auditor.

Conclusion

- Thus, in the given scenario, only observation 2 will be reported.

QNO 434.500	SEBI circular on auditor resignation (resignation within 45 days) BHASKAR CNO—ACCG.540	New Course – (S21M)

Statutory auditor of ABC Limited has resigned on July 10, 2020. Whether he shall be liable for issuing limited review report for quarter ended June 30, 2020.

Part I -- Relevant Standards & Laws

- **LODR, 2015**

Part II Requirements of Relevant Standards & Laws

- All listed entities/material subsidiaries while appointing/re-appointing an auditor shall ensure compliance with SEBI circular on auditor resignation, which specifies, if the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter.

Part III – Case Discussion

- In the given situation, statutory auditor of ABC Limited has resigned on July 10, 2020.

Part IV – Conclusion

- He would be liable for issuing limited review report for quarter ended June 30, 2020 because time gap between July 13, 2020 and June 30, 2020 is less than 45 days.

QNO 434.600	SEBI circular on auditor resignation (limited review report of last quarter) BHASKAR CNO—ACCG.540	New Course – (S21M)

PQR, auditor of XYZ Limited has signed limited review report of 2nd and 3rd quarter. Whether auditor is liable to issue limited review report of 4th quarter before resignation?

Part I -- Relevant Standards & Laws

- **LODR, 2015**

Part II Requirements of Relevant Standards & Laws

- All listed entities/material subsidiaries while appointing/re-appointing an auditor shall ensure compliance with SEBI circular on auditor resignation, which specifies, in case the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year

Part III – Case Discussion

- PQR, auditor of XYZ Limited has signed limited review report of 2nd and 3rd quarter

Part IV – Conclusion

- In the instant case, PQR, auditor of XYZ Limited has signed limited review report of 2nd and 3rd quarter. Auditor is not liable to issue limited review report of 4th quarter because he has not signed limited review report of first 3 quarters.

QNO 434.700	SEBI circular on auditor resignation (Applicability of Circular if there is Disqualification) BHASKAR CNO—ACCG.540	Old Course – (N21M) New Course – (N21M,N22M)

" Mr. Bharat was appointed as statutory auditor of N Limited and O Limited. Both the Companies were having their base in Mumbai they had recently listed their shares on the Stock Exchange.For the financial year 2020-21, Mr. Bharat had signed limited review reports for each quarter, till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he tendered his resignation to N Limited on 30th January2021 and asked the Company to appoint another auditor to issue audit report for the remaining quarter and the FY 2020-21 as a whole. But the management of the Company did not accept the same.

Mr. Bharat continued to as act as auditor for O limited. During the 1st week of March 2021, Mrs. D (wife of Mr. Bharat) had borrowed a sum of Rs. 5.85 lakh from the Company for her personal use. Having come to know about this, Mr. Bharat immediately informed the management that he had been disqualified to act as auditor and told them that he won 't issue audit report for last quarter. But management of the Company argued that it's the legal responsibility of Mr. Bharat to do the same.

Whether contention of management of N Limited and O Limited is justified in asking Mr. Bharat to issue audit report for the last quarter and the FY 2020-21 as a whole, despite his resignation?

	Please comment on the above"
Answer	In the given scenario, Mr. Bharat was appointed as statutory auditor of two listed entities i.e., N Limited and O Limited. For the financial year 2020-21, Mr. Bharat had signed limited review reports for first three quarter i.e., till the quarter ended 31st December 2020 for both the companies. Owing to his personal commitments and increased workload, he resigned from N Limited and asked the Company to appoint another auditor to issue audit report for the remaining quarter and audit report for the FY 2020-21. Further, Mr. Bharat immediately informed the management of O Limited that he had been disqualified to act as auditor and told them that he won 't issue audit report for last quarter as Mrs. D (wife of Mr. Bharat) had borrowed a sum of ` 5.85 lakh from the Company for her personal use. As per SEBI LODR Regulations, if the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year. This provision will not apply if the auditor is disqualified due to Section 141 of the Companies Act, 2013. Thus, in the given situation, in view of above conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary with respect to limited review / audit report as per SEBI LODR Regulations, Mr. Bharat is required to issue the audit report for the last quarter and audit report for the year 2020-21 for N Limited as he has issued audit report for the first three quarters whereas Mr. Bharat is not required to issue the audit report for remaining quarter and audit report for the year 2020-21 as a whole for O Limited as he is disqualified under section 141 of Companies Act. Accordingly, contention of Management of N Limited is correct and tenable for issuing the audit report for remaining quarter and audit report for financial year 2020-21 however, contention of management of O Limited is not correct regarding the legal responsibility of Mr. Bharat to issue audit report for remaining quarter and for the whole year.

08 Audit of Consolidated Financial Statements

QNO 435.000	Applicability of Consolidated Financial Statement BHASKAR CNO—CFS.020	Old Course – (M17M, N18R) New Course – (S21M)

Xcess Ltd., having two subsidiaries but did not have any holding company, is a company whose securities are not listed on any stock exchange, whether in India or outside India.
The CEO of the Xcess Ltd says that since it is an unlisted company therefore consolidation of financial statement is not applicable. Comment on the contention of the CEO.

OR

Where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Explain clearly with reference of relevant Sections of the Companies Act, 2013 and The Companies (Accounts) Rules, 2014.

OR

Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.

OR

Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.

Answer

Part I -- Relevant Standards & Laws

- Section 129(3) of the Companies Act, 2013
- Section 129(3) of the Companies Act, 2013
- Companies (Accounts) Rules, 2014,

Part II -- Requirements of Relevant Standards & Laws

➢ **Section 129(3) of the Companies Act, 2013, :**
- Where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.
- The consolidated financial statements shall also be approved by the Board of Directors before they are signed on behalf of the Board, along with its standalone financial statements and shall also be laid before the annual general meeting of the company along with the laying of its standalone financial statement.
- The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary(ies) in Form AOC-1.

➢ **Section 129(4) of the Companies Act, 2013,provides that:**
- The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to it's the consolidated financial statements.

➢ **According to the Companies (Accounts) Rules, 2014,**
- The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards.
- However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act [refer Appendix given at the end of Chapter 5 for Schedule III].

➢ **Exemption:**
However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:
- it is a wholly owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company,

do not object to the company not presenting consolidated financial statements;

- it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- Its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which is in compliance with the applicable Accounting Standards. Thus, all the three above-mentioned conditions need to be complied for getting exemption from preparation of consolidated financial statements.

Part III – Case Discussion

- In the given case, Xcess Ltd. is itself a holding company of two subsidiaries i.e. not satisfying the condition of being wholly/partially owned subsidiary.

Part IV – Conclusion

- Therefore, contention of the CEO of the company is not tenable and the company needs to prepare consolidated financial statements.

QNO 436.000	**Temporary Holding (AS & IND AS - Combined)** BHASKAR CNO—CFS.020	**Old Course – (M19E, N19E) New Course – (S21M)**

R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its financial statements since 'the shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As the Statutory Auditor of R Ltd, how would you deal when the consolidated financial statements are to be drawn up in compliance with Ind AS?

Answer

Part I -- Relevant Standards & Laws

- **Section 129(3) of the Companies Act, 2013**
- **Companies (Accounts) Rules, 2014,**
- **Accounting Standard 21**
- **Accounting Standard 13**
- **IND-AS 110**

Part II -- Requirements of Relevant Standards & Laws

- **Companies Act, 2013**
  - **Section 129(3) of the Companies Act ,2013**

    Where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

  - **Companies (Accounts) Rules, 2014,**

    The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act

- **Accounting Standard**
  - **Accounting Standard 21 "Consolidated Financial Statements", states that**

    Accounting Standard 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

  - **Control to be considered Temporary& AS 13**

    Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

Certain things that auditor should verify

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that

- the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary.
- The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

As per Ind AS 110 "Consolidated Financial Statements", states

There is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

Part III – Case Discussion

- In the given case, Parent Ltd. has acquired 51% shares of Child Ltd. during the year ending 31.03.2016 and sold 20% shares during the year 2016-17. Parent Ltd. did not consolidate the financial statements of Child Ltd. for the year ending 31.03.2016 and 31.03.2017.

Part IV – Conclusion

- The intention of Parent Ltd. is quite clear that the control in Child Ltd. is temporary as the former company disposed off the acquired shares in the next year of its purchase.

AS 21 "Consolidated Financial Statements"

- Therefore, Parent Ltd. Is not required to prepare consolidated financial statement **as per AS 21**
- However, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, Parent Ltd. is required to made disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act' 2013.

Ind AS 110 "Consolidated Financial Statements"

- However, if the Parent Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements **in accordance with Ind AS 110** as exemption for 'temporary control', or "for operation under severe long -term funds transfer restrictions" is not available under Ind AS 110.
- Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

Author's Note

- **Refer author's note of QNO 436.300.**

QNO 436.100	Temporary Holding (AS) BHASKAR CNO—CFS.020	Old Course – (M6E, M8E, M15E, M15E, P17M,) New Course – (S17M, N18R, M18M, S21M)

R Ltd owns 51% voting power in S Ltd It however, holds and discloses all the shares as Stock-in-trade in its accounts The shares are held exclusively with a view to their subsequent disposal in the near future R Ltd represents that while preparing Consolidated Financial Statements, S Ltd can be excluded from the consolidation As a Statutory Auditor, how would you deal?

OR

Moon Ltd. acquired 51% shares of Star Ltd. during the year ending 31-3-2017. During the financial year 2017-18 the 20% shares of Star Ltd. were sold by Moon Ltd. Moon Ltd. while preparing the financial statements for the year ending 31-3-2017 and 31-3-2018 did not consider the financial statements of Star Ltd. for consolidation. As a statutory auditor how would you deal with it?

OR

Ajanta Ltd. owns 51% voting power in Alora Ltd. It discloses all the shares as "Stock-in-trade" in its accounts with a view to their subsequent disposal in the near future. Ajanta Ltd. represents that while preparing Consolidated Financial Statements, Alora Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Answer

Part I -- Relevant Standards & Laws

- **Section 129(3) of the Companies Act, 2013**
- **Companies (Accounts) Rules, 2014,**
- **Accounting Standard 21**
- **Accounting Standard 13**

Part II -- Requirements of Relevant Standards & Laws

➢ **Companies Act, 2013**

⩔ **Section 129(3) of the Companies Act ,2013**

Where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

⩔ **Companies (Accounts) Rules, 2014,**

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act

➢ **Accounting Standard**

⩔ **Accounting Standard 21 "Consolidated Financial Statements", states that**

Accounting Standard 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

⩔ **Control to be considered Temporary & AS 13**

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

⩔ **Certain things that auditor should verify**

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that

- the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary.
- The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

Part IV – Conclusion

➢ The intention of R Ltd. is quite clear that the control in S ltd is temporary as shares are held exclusively with a view of subsequent disposal in the near future

➢ Therefore, R Ltd. Is not required to prepare consolidated financial statement **as per AS 21.**

➢ However, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, R Ltd. is required to made disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act' 2013.

Author's Note

- **Refer author's note of QNO 436.300.**

QNO 436.200	Temporary Holding (IND AS) BHASKAR CNO—CFS.020	Old Course – (M17E)

Moon Ltd acquired 65% shares of Sun Ltd on 28th October 2016 On 25th April 2017they sold 25% shares of Sun Ltd While preparing consolidated financial statements for the year ended 31st March, 2017, accountant of Moon Ltd did not consider financial statements of Sun Ltd for consolidation. Comment

Answer

Part I -- Relevant Standards & Laws

- **Section 129(3) of the Companies Act, 2013**
- **Companies (Accounts) Rules, 2014,**
- **IND-AS 110**

Part II -- Requirements of Relevant Standards & Laws

- **Companies Act, 2013**
  - **Section 129(3) of the Companies Act ,2013**

    Where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

  - **Companies (Accounts) Rules, 2014,**

    The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act

- **Accounting Standard**
  - **As per Ind AS 110 "Consolidated Financial Statements", states**

    There is no such exemption for 'temporary control' or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

Part III – Case Discussion

- In the given case, **Moon Ltd acquired 65% shares of Sun Ltd on 28th October 2016 on 25th April 2017they sold 25% shares of Sun Ltd. On 31st of March control existed.**

Part IV – Conclusion

- Here as per In **AS 110 "Consolidated Financial Statements** "if MOON Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements **in accordance with Ind AS 110** as exemption for 'temporary control', or "for operation under severe long -term funds transfer restrictions" is not available under Ind AS 110.
- Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

Author's Note

- **Answer of this question has been redrafted as per IND-AS**
- **Refer author's note of QNO 436.300.**

QNO 436.300	Temporary Holding (Investment Company) BHASKAR CNO—CFS.020	New Course – (N18E, S21M, N21E,N22R)

H its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25 % in SI Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need X to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your opinion.

OR

"Jambu & Sudharma Investments Ltd. is a company having paid up share capital of ` 1 crore, it has a subsidiary, Investors Fund Management Ltd. Major business of Jambu & Sudharma Investments Ltd. is to

pool money from investors on a collective basis and invest this money in various funds. This company pooled ` 12 crore from a number of clients, which represent the Company's shareholders. While auditing books of accounts of Jambu & Sudharma Investments Ltd. CA Vardhman observed that whole amount of ` 12 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company. Performance of all of its investments is measured on fair value basis. Now, CA Vardhman raised an issue while auditing financial statements of Jambu & Sudharma Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013? Analyse the above issue and give your opinion."

Answer

Part I -- Relevant Standards & Laws

- Ind AS 110'Consolidated Financial Statements'
- Section 129(3) of the Companies Act, 2013
- Companies (Accounts) Rules, 2014

Part II -- Requirements of Relevant Standards & Laws

➢ **Section 129(3) of the Companies Act, 2013**

Where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

➢ **Companies (Accounts) Rules, 2014,**

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

➢ **Ind AS 110'Consolidated Financial Statements'**

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

An investment entity is an entity that

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

Part III – Case Discussion

➢ In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in SI Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies.

Part IV – Conclusion

➢ In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.

Author's Note

1.



#controversy

This answer originally when provided by ICAI in suggested of NOV 18 (New) was not correct but later on Board of Studies changed the answer after discussion with the author.

2. AS-21 , gives two exemption from consolidation.

(a) Temporary Holding

(b) Restriction on repartrition of funds

	But IND-AS 110, does not gives above two exemptions.So consolidation will be required as per IND-AS 110, even in above two points (a) & (b) are applicable. IND-AS 110 gives exemptions in folowing cases (i) Investment entities (ii) Intermediary Subsidiaries(provided all conditions are satisfied) (iii) Employee benefit plans covered under IND-AS 19 If the question is silent about whether the answer should be as per AS or IND AS ,it is advisable that answer should be provided per both .
	3. The answer provided above is with reference to Investment company, for which exempotion given under Ind AS.

QNO 436.400	**Exemption from Consolidation for Intermediate Subsidiary & Give 2 Reasons of Exclusion (Exemption)** **BHASKAR CNO—CFS.020**	**New Course – (N20E)**
	JRS Limited holds the majority ownership of R Ltd. & K Ltd. S Ltd. is an intermediate subsidiary of JRS Limited in Surat. The JRS Limited presents the consolidated financial statements for audit purposes to MMT & Co. As a statutory auditor MMT & Co. obtain a listing of all the components and verify that all the components included in financial statements unless any component meet criterion for exclusion. Explain any two reasons which are considered by MMT & Co. for exclusion of components from the consolidated financial statements and reporting of reasons of exclusion thereof.	
Answer	**Where a component is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion and whether such exclusion is in conformity with the applicable financial reporting framework.** (i) Under Companies (Accounting Standards) Rules, 2006, there could be two reasons for exclusion of subsidiary, associate or jointly controlled entity- one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be **temporary** or the subsidiary, associate or joint venture operates under severe **long-term restrictions** which significantly impair its ability to transfer funds to the parent. (ii) Similarly, under the Companies Act, 2013, **intermediate subsidiary** in India is not required to present consolidated financial statements. **Ind AS 110** also prescribes certain criteria where consolidated financial statements are not required. In such cases, the auditor should satisfy himself that the exclusion made by the management falls within these categories, example in the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is **temporary**, the auditor should verify that the intention of the parent, to dispose off the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity. (iii) The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the applicable financial reporting framework, the auditor should consider its effect on the auditor's report to be issued.	

QNO 437.000	**Control Over Composition of Board** **UNIQUE**	**Old Course – (M15E, P17M, N17R, M21M)** **New Course – (S17M, S21M, M21M)**
	ALFA Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of GAMA Ltd. While planning the statutory audit of ALFA Ltd., what factors would be considered by you for audit of financial statements?	
Answer	➢ **Facts of the Case** In this case, A Ltd. holds only 10 percent of the voting power and control over the composition of the Board of Directors of B Ltd. In such a case, A Ltd. would be considered as a parent of B Ltd. and, therefore, it would consolidate B Ltd. in the consolidated financial statements as subsidiary	

➢ **Audit Procedure**

- **(Obtain Understanding)**- The auditor should make plans, among other things, for the understanding of accounting policies of the parent, subsidiaries, associates and joint ventures and determining and programming the nature, timing, and extent of the audit procedures to be performed etc.
- **(Control overboard)**- The auditor should verify whether the parent controls the composition of the Board of Directors or corresponding governing body of any entity. There would be various means by which such kind of control can be obtained.

  In this regard, the auditor may verify the Board's minutes, shareholder agreements entered into by the parent, agreements with the entities to which the parent might have provided any technology or know how, enforcement of statute, as the case may be, etc.
- **(Adjustments)**-The auditor should verify that the adjustments warranted by the relevant accounting standards have been made wherever required and have been properly authorized by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments.
- **AS 18**–Further, the duties of an auditor with regard to reporting of transactions with related parties as required by Accounting Standard 18 are given in SA 550 on Related Parties.
- **SA 550**-As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party.
- **Framing Opinion**- In forming an opinion on the financial statements the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks); or cause the financial statements to be misleading (for compliance frameworks).

Author's Note

- **Is 10% shareholding minimum for control over the composition of Board?**
  - **No, there is no 10% rule or criteria. Point is we can control BOD if we are able to appoint or nominate majority of directors either because of law or contracts, even if shareholding is below 50% and thereby control whole company. This question specifies 10% holding but it is silent on how ALFA ltd controls BOD of GAMMA.**

QNO 437.500	**Planning Audit of Consolidated Financial Statements** UNIQUE	**Old Course – (N20E)**
	Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. What are the important aspects that an auditor should consider in audit plan?	
Answer	**Auditing the Consolidation:** Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. The auditor should make plans, among other things, for the following: (i) Understanding of the group structure and group-wide controls including assessment of Information Technology (IT) system and related general and applications IT related controls (manual and automated) for consolidation process; (ii) Understanding of accounting policies of the parent and its components as well as of the	

	consolidation process including the process of translation of financial statements of foreign components; (iii) Determining and programming the nature, timing, and extent of the audit procedures to be performed based on the assessment of the risk of material misstatement in the consolidation process; (iv) Determining the extent of use of other auditor's work in the audit; and (v) Coordinating the work to be performed. A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework. The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

QNO 438.000	**Permanent Consolidation Adjustment** **BHASKAR CNO—CFS.080**	**Old Course – (M11R,M13E,M14R,N15E,M16R,N16M, P17M)** **New Course – (S17M, S21M)**
	Write a short note on - Permanent Consolidated Adjustments	
Answer	➢ **Definition** Permanent consolidation adjustments are those adjustments that are made **only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity** which is consolidated. Permanent consolidation adjustments are: ⩔ Determination of **goodwill or capital reserve** as per applicable accounting standards. ⩔ Determination of amount of **equity attributable to minority/ no controlling interests** ➢ **Pre-acquisition Reserves** The auditor should verify that the above calculations have been made appropriately. The auditor should pay particular attention to the determination **of pre-acquisition reserves of the components. Date(s) of investment** in components assumes importance in this regard. The auditor should also examine whether the pre-acquisition reserves have been **allocated appropriately between the parent and the minority interests/ non-controlling interests** of the subsidiary. The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of **subsequent acquisition of shares in the components, disposal of the components in the subsequent years.** ➢ **Netting off of Goodwill & Capital Reserves** It may happen that while working out the permanent consolidation adjustments, **in the case of one subsidiary, goodwill arises and in the case of another subsidiary a capital reserve arises.** The parent may **choose to net off these amounts to disclose a single amount** in the consolidated balance sheet where permitted by the applicable financial reporting framework. In such cases, the auditor should verify that the **gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements** to reflect the excess/shortage over the parents' portion of the subsidiary's equity	

QNO 439.000	**Current Consolidation Adjustment** **BHASKAR CNO—CFS.100**	**Old Course – (M09E, M11R, M14R, M14E, M16R, P17M, M21E)** **New Course – (S17M, S21M)**
	While doing the audit of consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?	

Answer

➢ **Current Period Consolidation Adjustments**

Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done. Current period consolidation adjustments primarily relate to elimination of intra-group transactions and account balances. While doing the audit of consolidated Financial Statements, current period consolidation adjustments should be taken into account. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements. This would also help the auditor in ascertaining whether there is any difference in the elimination. Following are the current period consolidation adjustments while making consolidation of financial statements:

- **(Intra group income / expense)**-intra-group interest paid and received, or management fees, etc.;
- ***(Stock Reserve)****- unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;*
- **(Intra group balances)**- intra-group indebtedness;
- **(Harmonising accounting policy)**-adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- **(Subsequent Events)**-*adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.*

➢ ***There are two types of subsequent events:***

- *The first type of subsequent events consists of events or transactions that provide additional evidence about conditions that existed at the date of the financial statements, including the estimates inherent in the process of preparing financial statements (i.e. adjusting events).*
- *The second type of subsequent events consist of events that provide evidence about conditions that did not exist at the date of the financial statements but arose subsequent to that date (i.e. non-adjusting events).*

➢ *Events occurring after balance sheet date which do not require adjustments would not normally require disclosure, although they may be of such significance that they may require a disclosure in the report of approving authority in the case of accounting standards and in the financial statements in case of Ind AS. For such events, the following shall be disclosed*

- *The nature of the event; and*
- *An estimate of its financial effect or a statement that such an estimate cannot be made*
- *adjustments for the effects of significant transactions or other events that occur between the date of the components balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when the financial statements of the component to be used for consolidation are not drawn up to the same balance sheet date as that of the parent;*
- ***(Foreign Component)****-In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared.*
- ***(Minority Interest)*** *- determination of movement in equity attributable to the minorities interest/no controlling interest since the date of acquisition of the subsidiary.*
- ***(Deferred Tax)****-adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intra group transactions and undistributed profits of the component in case of consolidated financial statements prepared under In AS.*

QNO 439.010	Harmonising Accounting Policies BHASKAR CNO—CFS.120	New Course – (M18E)
	H Co. Ltd. is a holding company with two subsidiaries R Co. Ltd., and S Co. Ltd., The H Co. Ltd., adopts straight line method of depreciation for its assets whereas S Co. Ltd., follows written down value or diminishing value method. Though R Co. Ltd. follows straight line method of depreciation, it does not give effect to component accounting of depreciation in respect of high value assets. While consolidating the financials of the R Co. Ltd., and S Co. Ltd., with those of H Co. Ltd., determine the possible issues that you have to ensure for compliance in the light of above facts	
Answer	➢ **When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent:** ⩔ A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual. ⩔ Group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies". ⩔ When applying this approach of, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. ➢ **Ind-AS 8** ⩔ It may be noted that change in the selection of the method of depreciation is an accounting estimate and not an accounting policy as per Ind-AS 8. ⩔ Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. ⩔ That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements. Therefore, there can be different methods for calculation of depreciation for its assets, if their expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements. **Case Discussion** ➢ In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment. **Conclusion** ➢ Thus, R Co. Ltd., though adopting straight line method but does not giving effect to component accounting of depreciation in respect of high value assets, is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plan and Equipment.	

QNO 440.000	Responsibility of Parent BHASKAR CNO—CFS.040	Old Course – (N12E, M16M, P17M, N17M, N18M, N21R) New Course – (S17M, S21M, N21R)
	Briefly explain the responsibility of holding company for preparation of Consolidated Financial Statements.	
Answer	➢ The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent. This includes: ⩔ **identifying components**, and ⩔ obtaining accurate and **complete financial information from components**; and ⩔ ***GAAP conversion,*** *where applicable.*	

- ***harmonization of accounting policies and accounting framework; and.***
- **including the financial information** of the components to be included in the consolidated financial statements;
- making appropriate **consolidation adjustments.**
- where appropriate, identifying **reportable segments** for segmental reporting;
- identifying **related parties and related party transactions** for reporting;

➢ **Instructions to Component**

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

QNO 440.050	**Objective, as an Auditor, in the audit of Consolidated Financial Statement** **BHASKAR CNO—CFS.060**	**Old Course – (M18E, N19R)** **New Course – (N19R)**
	Deluxe Ltd. holds the ownership of 51% of voting power and control over Executive Ltd. Holding company have prepared the consolidated financial statement as required by Sec. 129 of the Companies Act, 2013. What will be your objective, as an Auditor, in the audit of such Consolidated Financial Statement?	
Answer	**Part I -- Relevant Standards & Laws** ▪ **Section 129 (4) of the Companies Act, 2013** **Part II -- Requirements of Relevant Standards & Laws** ➢ **Objective of the Auditor in the audit of Consolidated Financial Statements** As per section 129 (4) of the Companies Act, 2013 the auditor's objectives in an audit of consolidated financial statements are: - to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of applicable financial reporting framework; - to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements. - to enquire into the matters as specified in section 143(1) of the Companies Act, 2013;and. - to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013; for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a),(b) and (c), on the basis of auditors' report of the respective component to the extent applicable. - The auditor should also validate the requirement of preparation of CFS for the company as per applicable financial reporting framework.	

QNO 442.000	**Relevance of SA 600-** **BHASKAR CNO—CFS.160**	**Old Course – (N15E, N17R, N18E,M22E)**
	CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. Auditors are duly appointed for the subsidiaries and branches as well. With regard to the determination of materiality during the audit of consolidated financial statements, what should be the considerations of CA H? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter in accordance with SA 705/706) made by component auditors? **OR** **Describe the relevance of SA 600 while auditing consolidation of Financial Statements** **OR** **What is meant by "Group financial statements"? Give reference of relevant Auditing Standard and issues addressed concerning the audit of Group financial statements.** **OR** **What is meant by "Group financial statements"? Give reference of relevant Auditing Standard and issues**	

	addressed concerning the audit of Group financial statements.
Answer	**Part I -- Relevant Standards & Laws** ▪ SA 600 "Using the work of Another Auditor" **Part II -- Requirements of Relevant Standards & Laws** ➢ **SA 600 and its relevance –** Standard on Auditing (**SA) 600, 'Using the Work of Another Auditor' establishes standards when an auditor, reporting on the financial statements of an entity** (the group—in the case of consolidated financial statements), **uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity.** **The principal auditor, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements, should comply with the requirements of SA 600.** ➢ **Determination of materiality during the audit of consolidated financial statements** In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following: ⩔ The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS ⩔ The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components and consider using the work of other auditors as applicable. However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the QNO of materiality would be considered. Thus, the component auditor's observation, if any, on the components financial statement, irrespective of whether the auditor of the component are also the auditor of CFS or not, are required to be included in the parent **audit report of Consolidated financial statement only if material for the group**.
	Author's Note ⚠ **# Mistake point** **IMPORTANT – Recent Change in answer.** **Last para of the answer has changed recently. Earlier in the answer provided by the institute, it was mentioned that while considering the observations of the component auditor in his report on the standalone financial statements, the concept of materiality would "not "be considered.** **However, this was inconsistent with SA 600** which **requires to consider the concept of materiality while giving observations in audit report of Consolidated financial statement.** **The impact of including the word "not" was that, the component auditor's observation was mandatory to be included in audit report of Consolidated financial statement irrespective of whether the component was material or not.** **Such inconsistency has been removed after removal of the word "not".**

QNO 442.500	**Dealing with Modifications in Audit Report of Subsidiary** **BHASKAR CNO—CFS.160**	**New Course- (N22M)**
	T Ltd. is holding 68% share of B Ltd, 51% share of C Ltd. RS & Co. Chartered Accountants are the statutory auditors of T Ltd. MN & Co. Chartered Accountants are the statutory auditors of B Ltd. and C Ltd. MN & Co have qualified the report of B Ltd. due to material discrepancies in standalone financial statement. While framing the opinion on Consolidated Financial Statement of T Ltd., RS & Co. (Principal Auditor) have ignored the qualification of B Ltd. considering it not material at Group Level. Comment.	

Answer	In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following: • The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) • The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable. • The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS. • The principal auditor also obtains certain confirmations from component auditor like independence, code of ethics, certain information required for consolidation and disclosure requirements etc. However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered., The parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor". Therefore, the concept of materiality would be considered while considering the observations of the component auditor. Hence RS & Co. cannot ignore the qualification of B Ltd. while framing the opinion on consolidated financial statements of T Ltd.

QNO 443.000	**Reporting** **BHASKAR CNO—CFS.120**	**Old Course – (M17R, M17E, M18R, M20M)** **New Course – (M18R, N18M, M18M, M20M, S21M, N21M, M22R)**
	You are appointed as an auditor of Nawab Limited, a listed company which is a main supplier to the UK building and construction market. With a turnover of 2.9 billion, the company operates through 11 business units and has nearly 180 branches across the countries. As an auditor, how will you draft the report in case: **(a) When the Parent's Auditor is also the Auditor of all its Components?** **(b) When the Parent's Auditor is not the Auditor of all its Components?** **(c) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?** **(d) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?** **(e) Where the financial statements of one or more components is not audited** **OR** **C Ltd is holding 55% shares of D Ltd M/s AB & Associates are statutory auditors of C Ltd whereas for D Ltd there is another firm appointed as statutory auditors What are the reporting responsibilities of M/s AB & Associates for audit of consolidated financial statements?**	
Answer	**(a) Parents Auditor = Auditor of all Components**	While drafting the audit report, the auditor should report whether Principles / procedures for preparation / presentation is as per accounting standard. In case of any departure or deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation. Auditor should issue an audit report expressing opinion whether the -consolidated financial statements, (at b/s date) -consolidated profit and loss statement (during the year) -cash flow (if prepared) give a true and fair view of the state of affairs of the Group.
	(b) Parents Auditor not Same as	**The auditor of the CFS should consider the requirement of SA 600.** **As per SA 706-**

component auditor	if the auditor considers it necessary to make reference to the audit of the other auditors i.e. considers it material, the auditor's report on the CFS should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). **This may be done by stating in aggregate:** Rs or % of total assets, revenues and cash flows of components included in the CFS not audited by the parent's auditor. Above should be presented before giving effect to permanent and current period consolidation adjustments. Reference in audit report of CFS that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its components.
(c) FRF of component is different from FRF of Parent	The parent may have components located outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its FST. When a component's FST are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's CFS , the parent's management perform a conversion of the components' audited FST from the framework used by the component to the framework under which the CFS are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation. A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual. Group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies". When applying this approach of, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information will be directly usable and relevant for the preparation of CFS by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.
(d) Auditing Framework used by component auditor is different from parent's auditor	Audits of FST, including CFS, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the CFS, the components' FST should also be audited under a framework that corresponds to Indian GAAS.
(e) Financial Statements of component not audited.	Where the FST of one or more components continue to remain unaudited, the auditor reporting on the CFS should consider unaudited components in evaluating a possible modification to his report on the CFS.

		The auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

QNO 443.050	**Checking Completeness of the components in consolidation** **BHASKAR CNO—CFS.140**	**New Course – (N20E, N21M, M23R)**
	CA. Vimal is the auditor of Excellent Ltd., a parent company which presents Consolidated Financial Statements. The management of Excellent Ltd. has provided the list of the components included in the Consolidated Financial Statements. As an auditor of Consolidated Financial Statements, CA Vimal has to verify that all the components have been included in the Consolidated Financial Statements and review the information provided by the management in identifying the components. State the procedures to be followed by CA. Vimal in respect of completeness of this information.	
Answer	A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework. The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion. In the given case, Excellent Ltd has provided the list of components included in the consolidated financial statements (CFSs). CA Vimal shall verify that all the components have been included in the CFSs. Further, in respect of completeness of this information, CA Vimal should perform the following procedures: i. review his working papers for the prior years for the known components; ii. review the parent's procedures for identification of various components; iii. make inquiries of the management to identify any new components or any component which goes out of consolidated financial statements; iv. review the investments of parent as well as its components to determine the shareholding in other entities; v. review the joint ventures and joint arrangements as applicable; vi. review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group; vii. review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013; viii. Identify the changes in the shareholding that might have taken place during the reporting period.	

QNO 443.060	**Including only Relevant Notes to accounts of Standalone FST in Consolidated FST** **BHASKAR CNO— Unique**	**New Course – (N22E)**
	ABC Limited holds 51% equity of BBB Limited, 63% equity of TTT Limited. There are different information and explanations which are disclosed by the respective companies in the notes to their financial statements. At the time of consolidation, management of ABC Limited has consolidated all the information and explanations disclosed in the notes as well. The principal auditor is of the view that only those information and explanations should form part of the notes to the consolidated financial statements which are relevant at group level. Please mention any five aspects which are given in the notes to the separate financial statements of the parent and the subsidiaries, need not be included in the consolidated financial statements.	

The Ind AS 110 does not give a list of information which is part of the separate financial statement of the components but that need not be reported in the notes and other explanatory material of the consolidated financial statements, however, based on section 129(4) and circular issued by MCA, it can be construed that, even in consolidated financial statements under Ind AS, only those disclosures should be given which are relevant to consolidated financial statements.

Based on the above discussion, in case of companies, the information such as the following given in the notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

i Source from which bonus shares are issued, e.g., capitalization of profits or reserves or from securities premium account.

ii Disclosure of all unutilized monies out of the issue indicating the form in which such unutilized funds have been invested.

iii Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006.

iv A statement of investments (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.

v Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:
   a) raw materials;
   b) components and spare parts;
   c) capital goods.

vi Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.

vii Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.

viii The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.

ix Earnings in foreign exchange classified under the following heads, namely:
   a. export of goods calculated on F.O.B. basis;
   b. royalty, know-how, professional and consultation fees;
   c. interest and dividend;
   d. other income, indicating the nature thereof.

QNO 444.000	**(Losses in Subsidiary) AS 21-** **Unique**	**Old Course – (M09R, M13E, M16M, P17M)** **New Course – (S17M, S21M, M23M)**

K Ltd. had 5 subsidiaries as at 31st March 2015 and the investments in-subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 15 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline' as the other three subsidiaries are doing exceptionally well. Comment.

Answer

Part I -- Relevant Standards & Laws

AS-13 - Accounting for Investments

Part II -- Requirements of Relevant Standards & law Consolidated

➢ As per AS-13 "Accounting for Investments" issued by the Institute of Chartered Accountants of India, long-term investments are usually of individual importance to the investing enterprise. The

carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long-term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

Part III – Case Discussion

- K Ltd. had 5 subsidiaries as at 31st March 2015 and the investments in-subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 15 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline' as the other three subsidiaries are doing exceptionally well. Comment

Part IV – Conclusion

- Keeping in view the above, K Ltd should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

OUR UNIQUE BOOK FEATURES

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Source of each Question

Heading for quick revision

Reference to concept no from Bhaskar

QNO 0.500	Potential Effect of Inherent Limitations of Audit Bhaskar CNO - SA200.050	New Course-(M21E)
	M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal control for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent of limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatement due to potential effects of inherent limitations.	



CA Ravi Taori

About CA Ravi Taori

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28,000+ hours, 30,000+ students

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