V'Smart Academy

CA FINAL AUDIT

PARAM

QUESTIONNAIRE



THE
ULTIMATE
ALL IN ONE
QUESTION BANK

VOLUME - 2

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

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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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INDEX

CHAPTER 09 — AUDIT OF BANKS

		NO. OF QUESTION
PART 1 - AOB	09.01-09.27	38

CHAPTER 10 — AUDIT OF INSURANCE COMPANY

PART 1 - INSURANCE COMPANIES	10.01-10.02	2
PART 2 - GENERAL INSURANCE	10.03-10.20	18
PART 3 - LIFE INSURANCE	10.21-10.28	8

CHAPTER 11 — AUDIT OF NON-BANKING FINANCIAL COMPANIES

PART 1 - NBFC	11.01-11.16	18

CHAPTER 12 — AUDIT UNDER FISCAL LAWS

PART 1 -TAX AUDIT	12.01-12.40	51

CHAPTER 13 — AUDIT OF PUBLIC SECTOR UNDERTAKING

PART 1 - PSU	13.01-13.10	13

CHAPTER 14 — LIABILITIES OF AUDITORS

PART 1 - LOA	14.01-14.11	9

CHAPTER 15 INTERNAL AUDIT MANAGEMENT & OPERATIONAL AUDIT

		NO. OF QUESTION
PART 1 - INTERNAL AUDIT	15.01-15.02	2
PART 2 - MANAGEMENT & OPERATIONAL AUDIT	15.03-15.17	20

CHAPTER 16 DUE DILIGENCE, INVESTIGATION FORENSIC AUDIT

PART 1 - DD	16.01-16.07	5
PART 2 - INVESTIGATION	16.08-16.19	14
PART 3 - FORENSIC AUDIT	16.20-16.27	8

CHAPTER 17 PEER REVIEW & QUALITY REVIEW

PART 1 - PEER REVIEW	17.01-17.10	17
PART 2 - QUALITY REVIEW	17.11-17.17	12

CHAPTER 18 PROFESSIONAL ETHICS

PART 1 - INTRODUCTION & CA ACT	18.01-18.11	14
PART 2 - FIRST SCHEDULE	18.12-18.68	85
PART 3 - SECOND SCHEDULE	18.69-18.96	42
PART 4 - COUNCIL GUIDELINES & OTHERS	18.97-18.105	13

CHAPTER 19 MISCELLANEOUS

MISC.	19.01-19.16	23

09 Audit of Banks

QNO 447.000	Principal Enactments BHASKAR CNO—AOB.040	Old Course – (N04E, N09R, N12M, M14R, P17M) New Course – Concept Covered in ICAI New Course Module

Write a short note on - Principal Enactments Governing Bank Audit.

Answer

There is an elaborate legal framework governing the functioning of banks in India. The principal enactments which govern the functioning of various types of banks are:

(Below acts are arranged in ascending sequence of years for memorisation)

• Reserve Bank of India Act, 1934	• Information Technology Act, 2000
• Banking Regulation Act, 1949	• Prevention of Money Laundering Act, 2002
• State Bank of India Act, 1955	• Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
• State Bank of India (Subsidiary Banks) Act, 1959	• Credit Information Companies (Regulation) Act, 2005
• Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 *(16 Banks were Nationalised)*	• Payment and Settlement Systems Act, 2007 *(RTGS, NEFT, ECS etc)*
• Regional Rural Banks Act, 1976	• Companies Act, 2013
• Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 *(6 Banks were Nationalised)*	

RBI Act may not affect banks directly. But the Act gives wide powers to the RBI to give directions to banks which also have considerable effect on the functioning of banks.

Authors Note –

Acts are rearranged in ascending order of years so that it is easy to remember

QNO 447.001	Peculiarities which may necessitate special audit consideration- BHASKAR CNO—AOB.020	New Course – (M19E, S21M)

Banks, because of certain characteristics, are distinguished from other commercial enterprises and hence it needs special audit consideration. As an auditor of a bank, specify the various peculiarities which may necessitate special audit consideration to be taken care by you.

Answer

➢ **Reasons**

Shortcut: - Special Audit Considerations because of **NewDONS** in banking sector.

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

	➢ **Dependence on IT** Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk. In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application;*(E.g., Customer went on vacation, duplicate sim was issued & bank account robbed)* ➢ **Effect of above factors** The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and SCAs to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements

QNO 447.005	**Investment (Portfolio Management Services- Separate Records)** **BHASKAR CNO—AOB.025**	**Old Course – (N20R, M21M)** **New Course – (N20R)**
	ABN Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year2019-20. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not maintained separate record for PMS transactions from the Bank's own investments. As a statutory auditor what methodology will be adopted by you for verification of PMS transactions?	
	Part I -- Relevant Standards & Laws ▪ RBI guidelines **Part II -- Requirements of Relevant Standards & Laws** ➢ **Separation of Investment Functions:** The auditor needs to examine whether the bank, as required by the RBI, is maintaining separate accounts for the investments made by it on their own Investment Account, PMS clients' account, and on behalf of other Constituents (including brokers). As per the RBI guidelines, banks are required to get their investments under PMS separately audited by external auditors. **Part III – Case Discussion** ➢ Thus, in the instant case, ABN Bank is required to prepare separate records for PMS and as per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. **Part IV – Conclusion** ➢ So, in the above case the auditor should not verify the PMS transactions and advise the bank to segregate the PMS transactions from its own investments and provide the certificate of external auditor as described above. In case ABN Bank does not provide the same the auditor may report accordingly.	

QNO 447.006	**Bank unable to check the work and records being small branch with shortage of manpower - Unique**	**New Course – (S21M, N21M, M23M)**
	You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1 ,S2 and S3. Among allocation of work for other areas, S1 who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important communications. S2 has possession of all bank forms (e.g., Cheque books, demand draft/pay order books, travellers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.	
	➢ Banks are required to implement and maintain a system of internal controls for mitigating risks, maintain good governance and to meet the regulatory requirements. ➢ Given below are examples of internal controls that are violated in the given situation: • In the instant case, S1 who is a peon opens all the mail and forwards it to the concerned person.	

- Further, he does not have a signature book so as to check the signatures on important communications are not in accordance with implementation and maintenance of general internal control. As the mail should be opened by a responsible officer. Signatures on all the letters and advices received from other branches of the bank or its correspondence should be checked by an officer with the signature book.
- All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock of such stationery.

- In the given case, S2 has possession of all bank forms (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which were also verified on test check basis.

➢ Further, contention of bank that being a small branch with shortage of manpower they are not able to check the work and records on regular basis, is not tenable as such lapses in internal control pose risk of fraud.

➢ The auditor should report the same in his report accordingly.

QNO 447.010	NPA (Classification of Assets) BHASKAR CNO—AOB.250	Old Course – (M11E, N16M, P17M) New Course – Concept Covered in ICAI New Course Module

"An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank." Define the criteria for classification of non-performing assets.

OR

In the course of audit of "Sabka Bank", your firm observed that the bank has classified some of the assets as non-performing assets (NPA), for example, bills receivables for remaining overdue more than 30 days, loans for remaining overdue for more than 60 days etc. Please guide the accountant with regard to criteria to be adopted for classifying an asset as NPA.

Answer

Non-Performing Assets

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

The following criteria are to be applied for determining the status of various types of credit facilities:

T-C²ABS

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

➢ Cash Credits and Overdrafts: A cash credit or overdraft account is treated as NPA if it remains out of order.

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

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

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

	➢ **Agricultural Advances**: A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. As per the guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. ➢ **Bills Purchased and Discounted**: Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. ➢ **Securitisation**: The asset is to be treated as NPA if the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

QNO 447.050	**NPA(Cash Credit Branch wise Sub Limits)** **BHASKAR CNO-- AOB.250**	**New Course – (M23R)**
	BOT Limited is enjoying cash credit facility sanctioned from Nariman Point, Mumbai branch of KNB Bank for 250 crore. However, for practical considerations, various sub-limits have been fixed for the borrower company for operation at Solapur, Pune and Nashik branches of the same bank. **The manager of the Solapur branch notices that there are no credit transactions in sub - limit account being operated at the Solapur branch for more than 90 days as on 31st March,2022.** **Discuss the approach of CA. Muni, statutory branch auditor of Nariman Point branch, Mumbai of KNB Bank, in the matter of asset classification of the above borrower account. Also discuss considerations for classifying said account at the Solapur branch.**	
Answer	Sometimes, a customer is sanctioned a cash credit limit at one branch but is authorised to utilise such overall limit at several other branches also, for each of which a sub-limit is fixed. In such a case, the determination of status of the account as NPA or otherwise should be determined at the limit-sanctioning branch with reference to the overall sanctioned limit/drawing power and not by each of the other branches where a sub-limit has been fixed. The auditor of the limit-sanctioning branch should examine whether it receives particulars of all transactions in the account at sub-limit branches and whether status of the account has been determined considering the total position of operation of the account at all concerned branches. The standalone matter of no credit transactions for more than 90 days as on 31st March,2022 at Solapur branch is irrelevant. Hence, keeping in view above, CA. Muni should consider asset classification considering the total position of operation of the account at all concerned branches. Regarding sub-limit at branches, the classification adopted by the limit-sanctioning branch should be followed. Hence, the Solapur branch has to follow asset classification made by the limit-sanctioning branch.	

QNO 449.000	**(Exceptions) NPA** **BHASKAR CNO—AOB.300**	**Old Course – (M05E, M16E, P17M)** **New Course – Concept Covered in ICAI New Course Module**
	Exceptions to the General Rule of treating advances as Nonperforming Assets.	

Answer

Exceptions to the General Rule of treating advances as Non-performing Assets:

- **Asset Classification to be Borrower-wise not Facility-wise:** All facilities granted to a borrower and investment made in securities issued by the borrower will have to be treated as NPA/NPI and not the particular investment/facility once any or a part of the facility/investment has become irregular.

- **Erosion in Value of Securities/ Frauds Committed by Borrowers:** In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, such accounts need not go through the stages of asset classification. In such cases, the asset should be straightaway classified as doubtful or loss asset, as appropriate.
  Further,
  - Erosion in the value of securities by more than 50% of the value assessed by the bank or accepted by RBI inspection team at the time of last inspection, as the case may be, would be considered as "significant", requiring the asset to be classified as doubtful straightaway and provided for adequately.
  - The realisable value of security as assessed by bank/approved valuers /RBI is less than 10% of the outstanding in the borrower accounts, the existence of the security should be ignored, and the asset should be classified as loss asset. In such cases the asset should either be written off or fully provided for.

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

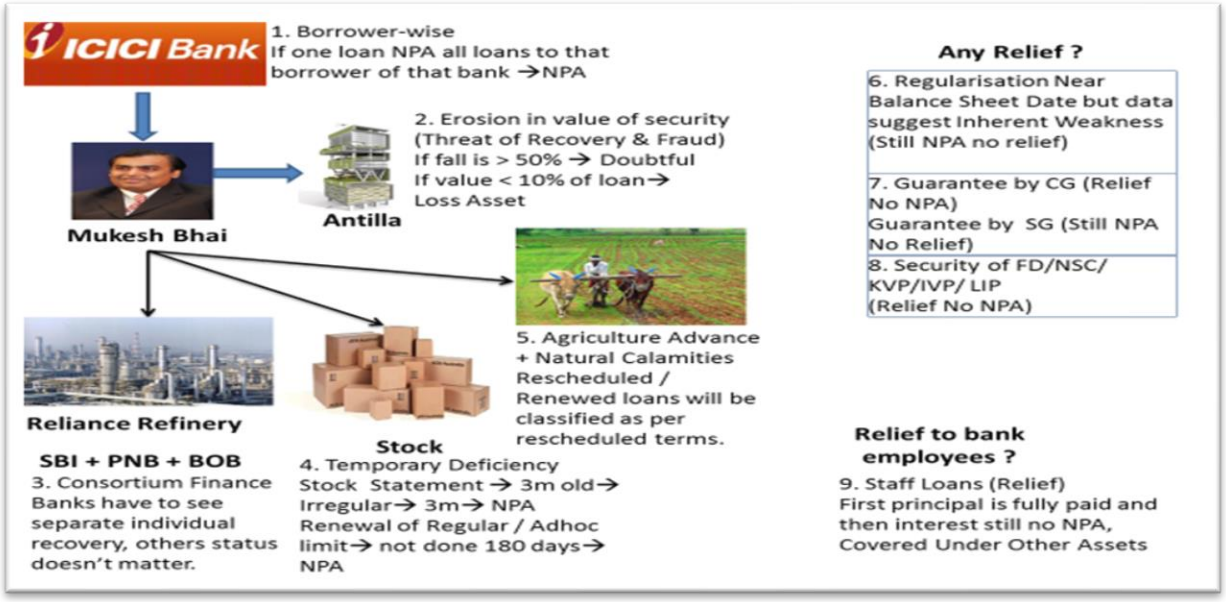
  The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

- **Temporary Deficiencies:** In the matter of classification of accounts with temporary deficiencies, banks have to follow the following guidelines:
  - Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. **However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months.**
  - The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.
  - **A working capital borrowing account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working, or the borrower's financial position is satisfactory.**
  - The accounts where regular/ad hoc credit limits have not been reviewed/renewed within 180 days from the due date/date of ad hoc sanction, the account should be treated as NPA.

- **Agricultural Advances Affected by Natural Calamities:** Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities. Banks may decide on their own relief measures, viz., conversion of the short-term production loan into a term loan or re-schedule of the repayment period and the sanctioning of fresh short-term loan, subject to the guidelines contained in RBI "s latest Master Circular on Prudential Norms on Income Recognition, Asset Classification and provisioning pertaining to Advances. In such cases, the NPA classification would be governed by such rescheduled terms.

- **Regularisation Near About Balance Sheet**: The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as an NPA.

- **Government Guaranteed Advances** The credit facilities backed by guarantees of central government though overdue may be treated as NPA only when the government repudiates its guarantee when invoked. This exemption from classification of Central Government guaranteed advances as NPA is not for the purpose of recognition of income. In case of State Government guaranteed loans, this exemption will not be available and such account will be NPA if interest / principal / other dues remain overdue for more than 90 days.
- **Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc.:** Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.
- **Advances to Staff:** Interest bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head „Others" under the schedule of Other Assets.



QNO 449.010	NPA (Classification of Assets Pressure by Bank Manager) BHASKAR CNO—AOB.300	Old Course – (N18M) New Course – (N18M)

M/s. S Ltd. is a MSME unit. The company does multiple banking. The company is availing cash credit limit from U Bank of Rs. 25 crores. The limit availed remained less than Rs. 5.00 crores during all the days of F.Y. 2017-18. The company has not done any credit in cash credit account during the year as it is operating current account in newly opened another bank branch adjoining to company premises. The company is having sufficient security of stocks and debtors and DP of Rs.25.00 crores remain all over the year. The company is availing term loans from other bank branches. Now the Bank Manager is insisting to route the sale proceeds through U Bank, otherwise cash credit limit and term loan accounts with other banks will be treated as Non-Performing Accounts. Now company seeks your opinion.

Answer

Part I -- Relevant Laws

- Classification of Account as NPA in case of Multiple Banking

Part II -- Requirements of Relevant Laws

- If the account remains overdue for more than 90 days, the account becomes Non-Performing Assets. The account will also be called as overdue, if there are not sufficient credits in the cash credit account which even could not serve the interest charged.

	Part III – Case Discussion ➢ In this case, there are no credits in accounts, it means interest has not been served in the account. Thus, accounts become overdue after 90 days for non-credit of amounts which could even serve the interest amount. Thus, cash credits will become as NPA if no credits/sale proceeds are deposited in that account. **Part IV – Conclusion** ➢ However, in multiple banking system, each bank is independent for classification of account as NPA. If SBI declares the account as NPA due to non-serving of interest amount, other bank will be free and will not classify the term loan accounts as NPA, if they are regular.

QNO 449.050	**NPA (credit limit renewal)** **BHASKAR CNO—AOB.300**	**New Course – (S21M)**
	ABC Bank had sanctioned credit limits of Rs.100 lakh to M/s Volkart Ltd on 1st September 2018. The renewal of limits was due on 1st September 2019. While doing the statutory branch audit for the year ended 31st March 2020, you find that the renewal has not been done even though 180 days are over. The bank says that the renewal process has been initiated on time and most of the documents are received. The account is operated regularly and is in order; balance is maintained within drawing power. It also shows a letter from Volkart stating that due to a sudden death of their auditor, a new auditor had to be appointed. Procedure for appointment took some time and the new auditor was doing the audit all over again. The limit was not renewed till 31/3/2020. However, the audited financials are received on 10th April 2020 and the renewal letter was issued immediately. Your assistant is insisting that the account must be classified as NPA since the limit was not renewed as on 31/3/2020. What is your opinion?	
	➢ As per Guidelines of Reserve Bank of India the account should be classified as NPA if renewal is not done in 180 days. ➢ However, in the present case, operations in the account are excellent. ➢ The bank has shown a letter from that company that due to certain reasons the audited financial statements are delayed. Further, the limit has been renewed before signing the audit report. ➢ Thus, even if the sanction was issued after the balance sheet date, it relates to the position as on the balance sheet date. ➢ Therefore, it is an adjusting event under AS 4, Contingencies and Events Occurring After the Balance Sheet Date. It is also a matter of substance over form. ➢ The auditor would consider classifying the account as a standard asset.	

449.080	**NPA (regularization before balance sheet date)-** **BHASKAR CNO—AOB.300**	**New Course – (N20E)**
	In the course of statutory Branch audit of KS Bank Ltd, you observe that some borrower accounts have been regularized before Balance sheet date by payment of overdue amount. Narrate the audit procedures to be carried out with special focus on the Classification of advances and Provisioning for Non-Performing assets of the Branch.	
	The Audit procedures that need to be carried out with special focus on classification of advances and provisioning for NPAs of KS Bank Ltd, in which the auditor has observed that some borrower accounts have been regularized before balance sheet date by payment of overdue amount shall be carried out as under : (i) As per the Reserve Bank guidelines, if an account has been regularised before the balance sheet date by payment of overdue amount through genuine sources, the account need not be treated as NPA. (ii) Where subsequent to repayment by the borrower (which makes the account regular), the branch has provided further funds to the borrower (including by way of subscription to its debentures or in other accounts of the borrower), the auditor should carefully assess whether the repayment was out of genuine sources or not. (iii) Where the account indicates inherent weakness based in the data available, the account shall be deemed as a NPA.	

	Classification and Provision **a.** Examine whether the classification made by the branch is appropriate. Particularly, examine the classification of advances where there are threats to recovery. **b.** Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly. **c.** It is to be ensured that the classification is made as per the position as on date and hence classification of all standard accounts be reviewed as on balance sheet date. **d.** The date of NPA is significant to determine the classification and hence specific care be taken in this regard. **e.** NPA should be recognized only based on concept of Past Due/ Overdue concept, and not based on the Balance Sheet date.

QNO 450.000	**(Agriculture Advance) NPA** **BHASKAR CNO—AOB.300**	**Old Course – (M14E, P17M, M19E)** **New Course – Concept Covered in ICAI New Course Module**
	Shy & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March 2015. In the audit planning, the partner of Shy & Co. observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose. He needs your assistance in incorporating the criteria prescribed for determination of NPA norms in respect of agricultural advance, in audit plan.	
Answer	➢ **Criteria** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. • **Long V/s Short** As per the guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. • **Priority Sector V/s Others** **The above norms should be made applicable to all direct agricultural advances as listed in the Master Circular on Lending to Priority Sectors.** In respect of all other agricultural loans, identification of NPAs would be done on the same basis as non-agricultural advances, which, **At present, is the 90 days delinquency norm.** • **Natural Calamities** If natural calamities impair the repaying capacity of agricultural borrowers, **banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines issued by RBI.**	

QNO 451.000	**(Consortium)NPA** **BHASKAR CNO—AOB.300**	**Old Course – (N11R, N12M, M13R, S17M, P17M, N17R)** **New Course – (M18M, S21M)**
	Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. The bank is a consortium member of Cash Credit Facilities of Rs 50 crores to X Ltd Bank's own share is Rs 10 crores only. During the last two quarters against a debit of Rs 1.75 crores towards interest the credits in X Ltd's account are to the tune of Rs 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing. Advise your views on the issue which were brought to your notice by your Audit Manager. **OR**	

The bank is a consortium member of Cash Credit Facilities of Rs 50 crores to X Ltd. Bank's own share is Rs 10 crores only. During the last two quarters against a debit of Rs 1.75 crores towards interest the credits in X Ltd.'s account are to the tune of Rs 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.

Answer

Part I -- Relevant Laws

- As per Classification Norms Related to NPAs

Part II -- Requirements of Relevant Laws

- Sometimes, **several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors.**

Part III – Case Discussion

- The bank is a consortium member of cash credit facilities of Rs 50 crores to X Ltd. Bank's own share is Rs 10 crores only. During the last two quarters against a debit of Rs 1.75 crores towards interest, the credits in X Ltd.'s account are to the tune of Rs 1.25 crores only.

Part IV – Conclusion

- Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

Author's Note

- **The conclusion part of the answer says, "Interest Should be reversed". The reason why interest should be reversed here and the logic behind it.**
  - In case of consortium every bank has to see at its own status of recovery, so as to determine whether loan is NPA or not. Even if lead bank is getting money that is not going to affect our status. Our status depends on our recovery and not what is happening with the lead bank or other banks. Here in consortium every bank has to see their own recovery for the purpose of NPA. If bank not getting money it is a NPA and if it is NPA then interest should be reversed.

QNO 454.500	NPA (Multiple Cases) BHASKAR CNO—AOB.300	Old Course – (N21R) New Course – (N21R)

Gupta & Co. has been appointed as a statutory auditor of TCB Bank Ltd., a private sector bank, registered with RBI. Mr. Kaival Gupta, the engagement partner, while performing the audit as per the checklist, noted down the following points, which would be part of the audit queries, as tabulated below:

Sr. No.	Queries
1	**Interest on State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.**
2	**There is an account for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction and such account has been treated as a performing asset in the books.**
3	**One of the NPAs was sold for a value higher than the net book value. Profit was not recognized but the excess provision in respect of the same has been reversed.**
4	**In case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit and for 120 days tenure.**
5	**On verification of outstanding forward exchange contracts, the 'net position' in respect of one of the foreign currencies was not squared and was uncovered by a substantial amount.**

You are required to provide the reasons due to which such queries would have been raised by Mr. Kaival and describe the actions that may be taken by the person responsible on behalf of TCB Bank Ltd. for solving such queries.

Answer

Sr. No.	Reason for such Query	Action that may be taken in response to the query
1	A State Government Guaranteed advance has to be treated as NPA even if it remains overdue for more than 90 days and in case of NPA, for the purpose of income	Interest income recognized on such advance would be reversed and would be taken to income only when it is realized.

		recognition, interest on such advance should not be taken to income unless interest is realized.	
	2	Accounts for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction, should be considered as NPA.	It's treatment in the books would be changed from performing asset to a non-performing asset from the date when such change in the treatment was required
	3	In case of sale of NPA, where the sale is for a value higher than the NBV, the auditor is required to ensure that no profit is recognized, and the excess provision has not been reversed but retained to meet the shortfall/ loss that may arise because of the sale of other nonperforming financial assets.	The entry for reversal of the excess provision would be cancelled in the books and such excess provision would be retained to meet the shortfall/ loss that may arise because of the sale of other non-performing financial assets.
	4	Additional temporary limit may be sanctioned, for a maximum of 20% of the existing limit and 90 days maximum tenure.	The terms of additional temporary limit in case of such account would be revised to 20% of the existing limit and for 90 days maximum tenure.
	5	Net position in respect of each of the foreign currencies should be generally squared and should not be uncovered by a substantial amount.	The net "position" of the branch in relation to each foreign currency should be squared off and get covered by a substantial amount.

QNO 454.700	**NPA Case -- Deficiency in Documents** **BHASKAR CNO—AOB.300**	**New Course – (N22R)**
	CA Prachi was conducting statutory audit of branch of a nationalized bank for the year 2021-22. While reviewing operations and documents/papers of a borrower enjoying overdraft credit facilities of ` 50 crore (availed against security of stocks and book debts), following observations were jotted down by her: -** **(i) The balance in overdraft credit facility as on 31st March,2022 was ` 55.65 crore. The balance in account exceeded sanctioned limit during the whole month of March 2022. **(ii) As per terms of sanction letter, stock/book debt statements were required to be submitted monthly. Latest available stock/book debt statement for the month of February, 2022 showed drawing power of ` 48.50 crore only. However, stock/book debt statements of previous months showed adequate drawing power.** **(iii) Stock audit of borrower was also conducted during the year by one of empanelled stock auditors of the bank. Stock audit report dated 31st December,2021 placed on the record showed adequate drawing power in the account. However, it has commented adversely on the declining turnover of borrower in year 2021 -22(till the date of stock audit report) as compared to proportionate turnover in preceding year.** **(iv) The renewal of overdraft facilities was due on 20th October,2021. The account was short renewed by competent authority for a period of 3 months pending submission** **of complete papers.** **However, borrower has not submitted complete renewal papers till 31st March,2022. There is a request letter from borrower on record stating that valuation report of a property located at a faraway location was taking time. The branch has classified the account as 'Standard Asset'. Considering above, CA Prachi is in dilemma relating to proper classification of above advance. Guide her.**	
Answer	The borrower was enjoying overdraft credit facilities of ` 50 crore against security of stocks and debts. Further, though latest available stock statement for the month of February, 2022 showed inadequate drawing power, there was adequate drawing power available throughout the year. Stock audit report dated 31.12.2021 also reflected adequate drawing power. Hence, it shows that borrower had adequate drawing power during the year. Further, comment on declining sales is of general informative value to management for making credit decisions. The fact of over drawings in account during the month of March, 2022 and inadequate drawing power in a	

month are in nature of temporary deficiencies and do not require account to be classified as NPA in accordance with asset classification and provisioning norms of RBI.

RBI instructions lay down that ordinarily credit limits need to be reviewed not later than three months from the due date. As per Guidance note on Audit of Banks, in case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is underway and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the credit limits have not been reviewed/ renewed within 180 days from the due date will be treated as NPA.

It would be pertinent to note that the counting of 180 days would be required to be done from the date of original due date for renewal and not from the date of expiry of short reviews / technical reviews. In the instant case, the original date of renewal was 20th October, 2021 and period of 180 days has still not expired as on balance sheet date.

Keeping in view all above factors, CA Prachi should accept classification of account as 'Standard Asset' made by branch.

QNO 454.600	**Audit Procedures to check Compliance of Audit norms in different situations** **BHASKAR CNO—AOB.300**	**New Course – (N21M)**

M/s Aadi & Co., Chartered Accountants, have been allotted the branch audit of a nationalized bank for the year ended 31st March, 2021. You are part of audit team and have been instructed by your partner to verify the following areas:

(i) Fulfilment of the criteria prescribed for NPA norms for government guaranteed advance.

(ii) Fulfilment of the criteria prescribed for NPA norms for the advances given for agricultural purposes.

(iii) Drawing power calculation from stock statements in respect of working capital accounts.

(iv) Accounts where regular/ad hoc limits are not reviewed within 180 days from the due date/date of ad hoc sanction. What may be your areas of concern as regards matters specified above?

Answer

Area of Focus	Suggested Audit Procedures
Government Guaranteed Advances	• If government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked. This exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days. • In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR
Agricultural Advances	• Ensure that NPA norms have been applied in accordance with the crop season determined by the State Level Bankers' Committee in each State. Depending upon the duration of crops – short term/ long term - raised by an agriculturist, the NPA norms would also be made applicable to agricultural term loans availed of by them. Also ensure that these norms are made applicable to all direct agricultural advances listed in Master Circular on lending to priority sector. • In respect of agricultural loans, other than those Specified in the circular, ensure that identification of NPAs has been done on the same basis as non agricultural advances
Drawing Power Calculation	• Ensure that the drawing power is calculated as per the extant guidelines (i.e. the Credit Policy of the Bank) formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory

		auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power. • The stock audit should be carried out by the bank for all accounts having funded exposure of more than stipulated limit. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power. The drawing power needs to be calculated carefully in case of working capital advances to companies engaged in construction business. The valuation of work in progress should be ensured in consistent and proper manner. It also needs to be ensured that mobilization advance being received by the contractors is reduced while calculating drawing power.
	Limits not reviewed	Accounts where regular/ad hoc limits are not reviewed within 180 days from the due date/date of ad hoc sanction, should be considered as NPA. Auditors should also ensure that the ad hoc/short reviews are not done on repetitive basis. In such cases, auditor can consider the classification of account based on other parameters and functioning of the account.

QNO 455.000	**Sale of NPA** **BHASKAR CNO—AOB.360**	**Old Course – (M15E)** **New Course – (M18E, N20E, S21M,N22M,M23M)**
	CA K have been doing audit of branch of LUD Bank Ltd. The principal business of the branch is lending advances to large corporates. Since last one year, many large accounts have become Non-Performing Asset (NPA) as per guidelines. The Management of the Bank decided to sell one of the NPA account and consequently one NPA namely DEF Ltd. amounting to Rs. 10.00 Crores was sold to Asset Reconstruction Company. What audit points CA K should keep in mind while doing audit of this transaction? **OR** **During the bank audit AB & Co. a new Chartered Accountant firm, observed the sale/purchase of NPAs. Please help them by narrating the aspects, relating to sale/purchase of NPAs, to be considered.** **OR** **In the course of audit of Skip Bank Ltd., you found that the Bank had sold certain of its non-performing assets. Draft the points of audit check that are very relevant to this area of checking.**	
Answer	➢ In case of a sale/ purchase of NPAs by the bank, the auditor should examine the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers. • **Sale** In case of sale of an NPA, the auditor should also ensure that: • only such NPA has been sold which has remained NPA in the books of the bank for **at least 2 years.** • the NPA has been sold at **cash basis only.** • the assets have been sold/ purchased **"without recourse"** only. • subsequent to the sale of the NPA, the bank **does not assume any legal, operational or any other type of risk** relating to the sold NPAs. • on the sale of the NPA, the same has been **removed from the books** of the account. • the **short fall in the net book value** has been charged to the profit and loss account. • where the **sale is for a value higher than the NBV,** no profit is recognised, and the excess provision has not been reversed but retained to meet the shortfall/ loss on account of sale of other non-performing financial assets. • **Purchase** Similarly, in case of purchase of NPAs, the auditor should verify that: • the bank has not purchased an NPA which it had **originally sold.** • the NPA purchased has been subjected to the **provisioning requirements** appropriate to the classification status in the books of the purchasing bank.	

	• any **recovery** in respect of an NPA purchased from other banks is first adjusted against its acquisition cost and only the recovered amount in excess of the acquisition cost has been recognised as profit. • for the purpose of capital adequacy, banks have assigned **100% risk weights** to the NPAs purchased from other banks.

QNO 458.000	**(Income, Theory) Advances** **BHASKAR CNO—AOB.320**	**Old Course – (N10E, N13R, P17M, M19R, N19E)** **New Course – (M19R)**
	What is the income recognised in the case of 'non-performing' assets of bank?	
Answer	• **Standard rule for booking income on NPA Assets.** If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. **This will apply to Government guaranteed accounts also.** **In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.** Further, in case of **banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).** • **Special Case:-Government Guaranteed** **If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.** • **Special Case:-Secured by FD / NSC / IVP/KVP / LIP** Interest income on advances against term deposits, NSCs, IVPs, KVPs and life policies **may be taken to income account on the due date, provided adequate margin is available in the accounts.**	

QNO 458.010	**(Income, CASE) Advances** **BHASKAR CNO—AOB.300**	**Old Course – (M13E, P17M, M19M, N19R, M20R, M21M)** **New Course – (S17M, M18M, N19R, M19M, M20R, S21M, M21M, M23M)**
	In course of audit of Good Samaritan Bank as at 31st March 15 you observed the following: **In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?**	
Answer	**Part I -- Relevant Laws** ▪ Classification of Government Guaranteed Advances **Part II -- Requirements of Relevant Laws** ➢ If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked. **Part III – Case Discussion** ➢ In the above case, Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed. The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days .	

	Part IV – Conclusion ➢ In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

QNO 458.020	**Investment (Income, Mutual Fund)** **BHASKAR CNO—AOB.130**	**Old Course – (N11R, N12M, N16R, P17M,)** **New Course – (S17M, N18R, N18M, S21M)**
	Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager: **The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.**	
Answer	**Part I -- Relevant Laws** ▪ RBI Circulars **Part II -- Requirements of Relevant Laws** ➢ **Interest on bonds and debentures** Banks may book income from Government Securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are pre-determined and provided interest is serviced regularly and is not in arrears. ➢ **Interest Income Guaranteed by Government** Banks may book income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears. ➢ **Dividend income on shares** Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established. ➢ **Dividend income on mutual funds** Banks may book income from units of mutual funds on cash basis. **Part III – Case Discussion** ➢ The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year. **Part IV – Conclusion** ➢ Treatment given by bank is inappropriate, such dividend on mutual fund units	

QNO 462.000	**(Audit)Advances** **BHASKAR CNO—AOB.200**	**Old Course – (N8E, M11R, N12R, N14R, M16R, N16R, P17M, M18E, M19R)** **New Course – (M19R, S21M)**
	As the concurrent auditor of Nagpur Main Branch of XYZ Bank Ltd. state the issues which have to be considered in the audit of advances. **OR** **ABC Chartered Accountants have been appointed as concurrent auditors for the branches of Effective Bank Ltd. for the year 2019-20. You are part of the audit team for Agra branch of the bank and have been instructed by your senior to verify the advances of the audit period. You are required to guide your assistant about the areas to be taken care while doing verification during the concurrent audit.**	
Answer	➢ **Audit of Advances of a Bank:** The items to be covered in the current audit of advances of a bank are as follows- • Ensure that loans and advances are sanctioned properly. • Verify whether the sanctions are in accordance with the delegated authority. • Check whether letters of credit issued by the branch are within the delegated power and ensure that they are genuine trade transactions. • Verify the instances of exceeding delegate powers have been promptly reported.	

	• Verify the frequency and geniuses of such exercise of authority beyond to delegated powers of the concerned officials. • Ensure that securities and documents have been received and properly charged/registered. • Ensure that post disbursement supervision and follow up is proper • Verify whether there is any misuse of loans and advances and whether there are instances indicative of diversion of funds. • Verify the classifications of advances are as per RBI directions. • Ensure proper follow up of overdue bills of exchange. • Verify whether the submission of claims to DICGC and ECGC is in time. • Check bank guarantees issued are properly worked and recorded.
	Authors Note **Question w.r.t Audit of Advances, ICS over advances and LFAR report over advances have similar points** **So we have created a combined common answer and have arranged it in a logical sequence .** **However original text has also been kept. Students can also read that if they want.** **For common answer see after QNO 466.000**

QNO 465.000	**Advances (ICS)** **BHASKAR CNO—AOB.200**	**New Course – (M18R)**
	Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. **As an expert in bank audit, you are required to briefly discuss the area of focus and suggested audit procedures regarding evaluation of internal controls over advances, substantive audit procedures and recoverability of advances**	
Answer	• The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank. • All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made. • Sufficient margin should be kept against securities taken to cover any decline in the value thereof and to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or after detailed scrutiny for specific accounts. • All the securities should be received and returned by responsible officer. They should be kept in the Joint custody of two such officers. • All securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give title of the bank. • All accounts should be kept within both the drawing power and the sanctioned limit as per prescribed norms. Additional temporary limit may be sanctioned, for a maximum of 20% of existing limit and 90 days maximum tenure. • All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly. • The operation (in each advance account) should be reviewed at least once every year.	

QNO 470.000	Advances (LIP) UNIQUE	Old Course – (P17M, M21M) New Course – (M21M)
	The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.	
Answer	➢ **Verification of Advances against Life Insurance Policies is as under-** The Audit program for the verification of advance against life insurance policies need to cover the following: • The auditor should **inspect the policies** and see whether they are assigned to the bank and whether **such assignment has been registered with the insurer.** • The auditor should also **examine whether premium has been paid on the policies** and whether they are in force. • **Certificate regarding surrender value obtained** from the insurer should be examined. • The auditor should particularly see that if such **surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.**	

QNO 470.100	Drawing Power BHASKAR CNO—AOB.380	Old Course – (M19E) New Course – Concept Covered in ICAI New Course Module
	Drawing power calculation from stock statements in respect of working capital accounts. What may be your areas of concern as regards matters specified above?	
Answer	➢ **DRAWING POWER CALCULATION** • **Drawing Power & Sanctioned Limit** ◦ All accounts should be **kept within both the drawing power and the sanctioned limit** at all times. The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be **brought to the notice of the Management/Head Office regularly.** ◦ *Sanction Limit = 1/5th of Last Year Turnover or (75% of LY Stock – Creditor + 60% of LY Debtor) whichever is lower* *Drawing Limit = (75% of Actual Stock – Actual Creditor) + 60% Actual Debtor* • **Stock Statements / Annual Report / Policy** The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. **The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained. It needs to be ensured that the drawing power is calculated as per the extant *(Existing)* guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors *(Outdated it should be simply as per sanction letter)*. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.** • **Irregular Account** Banks should ensure that drawings in the working capital account are **covered by the adequacy of the current assets.** Drawing power is required to be arrived at based on current stock statement. **However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months.** The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular. If such "irregular" account continues for 90 days, account has to be classified as NPA, even though the account is otherwise operated regularly. • **Stock Audit** **The stock audit should be carried out by the bank for all accounts having funded exposure of more than Rs 5 crores.** Auditors can also advise for stock audit in other cases if	

		the situation warrants the same. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital. The report submitted by the stock auditors should be reviewed during the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power. **The drawing power needs to be calculated carefully in case of working capital advances to companies engaged in construction business.** The valuation of work in progress should be ensured in consistent and proper manner. **It also needs to be ensured that mobilization advance being received by the contractors is reduced while calculating drawing power.***(Generally, 15% of total project cost)*

QNO 470.200	**Deposits-Window dressing** **BHASKAR CNO—AOB.478**	**New Course- (N22M)**
	You are part of engagement team conducting statutory audit of a branch of nationalized bank. During the course of audit, it has come to your notice that there are large number of cash credit accounts in the branch. Many of the cash credit accounts are only partially utilized during substantial part of year. However, in the month of March, the accounts are fully utilized. On further scrutiny, it is observed that these account holders have made fixed deposits from these utilized amounts at the end of year. These deposits have been liquidated in first week of April of next financial year. Comment upon how this situation would be dealt by you as a statutory branch auditor?	
Answer	In the given case, many of the cash credit accounts in the branch of a nationalized bank are only partially utilized during substantial part of year. However, in the month of March, the accounts are fully utilized. On further scrutiny, it is observed that these account holders have made fixed deposits from these utilized amounts at the end of year. These deposits have been liquidated in first week of April of next financial year. This is an example of **window dressing**. The branch is resorting to window dressing by artificially boosting its advances and deposits. Utilization of advances and placing of fixed deposits at end of year in branch and again liquidation of deposits early next year indicate that branch is resorting to window dressing to inflate its advances as well as deposits artificially. The auditor has to verify whether the unavailed portion of the credit facilities (overdraft, cash credit) are used to boost the loans and deposits which might tantamount to window dressing. The relevant regulatory guidelines also prohibit such type of practices and these might involve penal action in terms of Banking Regulation Act, 1949. The same needs to be suitably reported in audit report and commented in LFAR also. In appropriate cases, making a suitable qualification in the main audit report has also to be considered	

QNO 473.000	**Credit Card (ICS)** **BHASKAR CNO—AOB.115**	**Old Course – (M04E, N09E, M15R, P17M, N20M)** **New Course – (N19E, N20M, S21M, M22R,N22E)**
	How will you evaluate the Internal Control system in the area of Credit Card operations of a Bank? **OR** **You have been appointed as an auditor of LCO Bank, a nationalized bank. LCO Bank also deals in providing credit card facilities to its account holders. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. As an auditor of the bank, how will you evaluate the Internal Control System with respect to Credit Card operations maintained byte LCO Bank?**	
Answer	➢ **Credit Card Operations** • **Storage** There should be strict control over storage and issue of cards. • **Screening Before Issue** There should be effective screening of applications with reasonably good credit assessments.	

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

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

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

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

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

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

Authors Note
Points are rearranged for ease of understanding and memorising

QNO 474.000	TT & DD- BHASKAR CNO—AOB.105	Old Course – (N13E, M16M, P17M, M18M, N18R) New Course – Concept Covered in ICAI New Course Module

Your firm has been appointed as an auditor of a nationalised bank. You allocated the task of verifying Telegraphic Transfers and Demand Draft to your Audit Assistant. While verifying, the Audit Assistant informed you that there are a lot of irregularities in Telegraphic Transfers and Demand Drafts. What guidance would you give him?

Answer

➢ **Telegraphic Transfers and Demand Drafts**

- **Secret Codes for TT**
  The bank should have a reliable private code known only to responsible officers of its branches, coding and decoding of telegrams should be done only by such officers.
- **Signature Matching for DD**
  The signatures on a demand draft should be checked by an officer with the Signature Book.
- **Advice after Issue** *(Intimation)*
  All the T. Ts and D.Ds. sold by a branch should be immediately confirmed by the advices to the branches concerned.
- **Discrepancy**
  If the paying branch does not receive proper confirmation of any T.T. or D.D. from the issuing branch or does not receive credit in its account with that branch, it should take immediate steps to ascertain the reasons

Authors Note
Points are rearranged for ease of understanding and memorising

QNO 475.000	SLR BHASKAR CNO—AOB.135	Old Course – (P17M, M17R, N17M, M18M) New Course – (S17M, S21M)
	You have been appointed as a statutory central auditor of APNA Bank, a Nationalized bank. What special points would be borne in mind while conducting the audit of compliance with "Statutory Liquidity Ratio" (SLR) requirements?	

Answer

➢ **Statutory Liquidity Ratio (SLR) Requirements –**

The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements **of 12 odd dates in different months of a financial year not being Fridays. The resultant report is to be sent to the top management of the bank and to the Reserve Bank. The report of the statutory auditors in relation to compliance with SLR requirements has to cover two aspects:**

- **correctness of the compilation of DTL (Demand and Time Liabilities) position; and**
- **maintenance of liquid assets.**

➢ **Audit approach and procedure:**

- Obtain an understanding of the relevant circumstances of the RBI, particularly regarding **composition of items of DTL.**
- Require the **branch auditors to send their weekly trial balance** as on Friday and these are consolidated at the head office. Based on this consolidation, the DTL position is determined for every reporting Friday. The statutory central auditor should request the branch auditors to verify the correctness of the trial balances **relevant to the dates selected by him**. The branch auditors should also be specifically requested to examine the cash balance at the branch on the selected dates.
- Review the relevant **returns received from un-audited branches** to identify any obvious errors or omissions or inconsistencies.
- Examine, **on a test basis, the consolidations regarding DTL position prepared by the bank with reference to the related returns received from branches.** The auditor should examine whether the valuation of securities done by the bank is in accordance with the guidelines prescribed by the RBI.
- While examining the computation of DTL, specifically examine that the following items have been **excluded from liabilities-**

  RIL-Mobile
  - Part amounts of **R**ecoveries from the borrowers in respect of debts considered bad and doubtful of recovery. *(Recovery of Bad Debts is not a liability)*
  - Amounts received in **I**ndian currency against import bills and held in sundry deposits pending receipts of final rates. *(Such money is not returnable hence not liability)*
  - Un-adjusted deposits/balances lying in **L**ink branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches. *(Link branch of bank deals with RBI and other Banks, if money is received by such branches but not yet used or adjusted)*
  - **M**argins held and kept in sundry deposits for funded facilities. *(Money deposited in bank before giving loan)*
  - Similarly, specifically examine that the following items have been **included in liabilities –**
    - **Net credit balance in branch adjustment accounts** including these relating to foreign branches.
    - **Interest on deposit as at the end of the half year** reversed in the beginning of the next half-year.
    - Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as

'Liabilities to other'

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

- Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches.
- It may be noted that, even though interest accrues on a daily basis, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL.
- The auditor at the central level should apply the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in his report.
- Test check the relevant records maintained by the bank in respect of **investments to verify the amount of approved securities held by the bank on the dates selected by him Examine whether the valuation of approved securities has been done by the bank is in accordance with the guidelines prescribed by the RBI.**
    - While reporting on compliance with SLR requirements, the auditor should specify the **number of unaudited branches** and state that he has relied on the returns received from the unaudited branches in forming his opinion.

QNO 477.000	**Inter Branch Adjustment** **BHASKAR CNO—AOB.110**	**Old Course – (M10E, M12R, N13R, P17M)** **New Course – Concept Covered in ICAI New Course Module**
	Describe the procedure for verification of the following balances appearing in the account books of a bank: **Branch adjustment account.**	
Answer	➢ **Branch Adjustment Account:** In the final balance sheet of the bank, this balance represents the difference between inter branch debits and credits and should normally comprise items which are in transit as on the closing date. This account is the one which is most commonly used by unscrupulous persons in committing a fraud. The verification of this account is, therefore, of great importance. The procedure for verification is as follows: • See that all branch accounts are periodically reconciled. • Check all adjustments in the account and ensure that the adjustments are done properly and supported by adequate documentary evidence as to its validity. • Verify that reversal entries are made under proper authority and after due explanation and evidence.	

QNO 478.000	**Concurrent Audit-** **BHASKAR CNO—AOB.580**	**Old Course – (P17M)** **New Course – Concept Covered in ICAI New Course Module**
	Discuss the concurrent audit system in commercial banks.	
Answer	➢ Concurrent audit is an examination which is contemporaneous with the occurrence of transactions or is carried out as near thereto as possible. It attempts to shorten the interval between a transaction and its examination by an independent person not involved in its documentation. There is an emphasis in favour of substantive checking in key areas rather than test checking. This audit is essentially a management process integral to the establishment of sound internal accounting functions and effective controls and setting the tone for a vigilance internal audit to preclude the incidence of serious errors and fraudulent manipulations. A concurrent auditor may not sit in judgement of the decisions taken by a branch manager or an authorised official. This is beyond the scope of concurrent audit. However, the audit will necessarily have to see whether the transactions or decisions are within the policy parameters laid down by the Head Office, they do not violate the instructions or policy prescriptions of the RBI, and that they are within the delegated authority.	

In very large branches, which have different divisions dealing with specific activities, concurrent audit is a means to the in charge of the branch to ensure on an ongoing basis that the different divisions function within laid-down parameters and procedures.

➢ **Coverage**

- The Departments/Divisions at the Head Office dealing with Treasury functions viz investments, funds management including inter-bank borrowings bill rediscount and foreign exchange business are to be subjected to concurrent audit. In addition, all branch offices, undertaking such business and dealing rooms have to be subjected to continuous audit.
- The coverage of branches should ensure that concurrent audit covers:
  - Branches whose total credit and other risk exposures aggregate to not less than 50% of the total credit and other risk exposures of the bank; and
  - Branches whose aggregate deposits cover not less than 50% of the aggregate deposits of the Bank.
- To achieve these twin criteria, it is suggested that branches may be listed according to credit and other risk exposures and selected in the descending order of exposures to achieve a 50% coverage. If the deposits of these branches do not aggregate to 50% of the Bank's deposits, additional branches in descending order of deposits may be added to achieve a 50% coverage of the branches.
- While complying with the above parameters, it is necessary to ensure that the coverage encompasses:
  - exceptionally large branches
  - very large and large branches
  - special branches handling foreign exchange business, merchant banking business, large corporate wholesale banking business and forex dealing room operations.
  - large problem branches rated as poor/very poor.
  - Head Office department dealing with treasury/funds management and handling investment portfolio.
  - any other branches or departments where in the opinion of the Bank concurrent audit is desirable.
  - Branches subjected to concurrent audit should not normally be included for revenue/income audit.

➢ **Types of activities to be covered**

- The main role of concurrent audit is to supplement the efforts of the bank in carrying out simultaneous internal check of the transactions and other verifications and compliance with the procedures laid down.
- The scope of concurrent audit should be wide enough to cover certain fraud-prone areas like handling of cash, deposits, safe custody of securities, investments, overdue bills, exercise of discretionary powers, sundry and suspense accounts, inter-branch reconciliation, clearing differences, foreign exchange business including Nostro accounts, off-balance sheet items like letters of credit and guarantee, treasury functions and credit-card business.
- The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Bank's Inspector and Audit Department in consultation with the Bank's Audit Committee of the Board of Directors (ACB).
- In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving small amounts.
- While the detailed scope of the concurrent audit may be determined and approved by the ACB

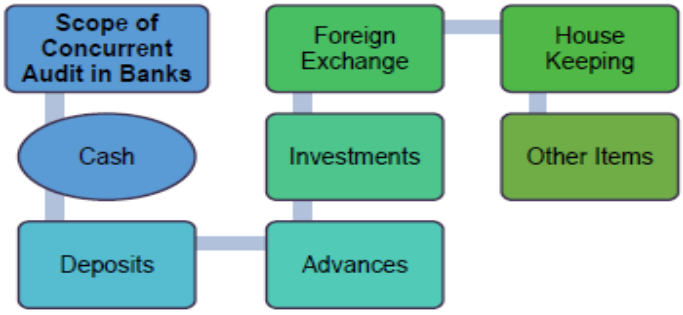
QNO 478.010	Concurrent Audit(Scope)- BHASKAR CNO—AOB.540	Old Course – (N06E, M09R, P17M) New Course – (S17M, S21M)
	Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India guidelines	

Answer

➢ **Scope of Concurrent Audit**

- The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Banks Inspector and Audit Department in consultation with the Banks Audit Committee of the Board of Directors (ACB).
- In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving small amounts.
- While the detailed scope of the concurrent audit may be determined and approved by the ACB.

Further**, the guidelines issued by the RBI cover**all the key areas of activities of the branch which is under concurrent audit. Most banks have prepared an Audit Manual for this purpose. Broadly stated, the following areas are covered by these guidelines:



QNO 479.000	Verification of Balances (Foreign Country) UNIQUE	Old Course – (P17M, N17R, M20M) New Course – (M20M)

NAYASA Bank appointed your firm of Chartered Accountants as a branch auditor for the financial year 2016-17. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Hary for verification of Balances in account of the bank situated in foreign country. However, Mr. Hary, being fresh to the bank audits, needs your guidance. Kindly guide.

OR

As an auditor of a nationalised bank, how would you verify the following?
Balances in account of a bank situated in a foreign country.

OR

M/s CAS & Associates have been appointed as one of the statutory central auditors of FDMH Bank., for the Financial Year 2019-20. During the course of the audit, the auditor found that the bank has a balance with a Zurich based bank. The auditor understands that such balance is a matter of important consideration in the audit of the bank. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Ansh for verification of Balances in account of the bank situated in foreign country. However, Mr. Ansh, being fresh to the bank audits, needs your guidance. Kindly guide.

Answer

➢ **Balances in Account of a Bank situated in a Foreign Country:** The following procedure may be followed while verifying balances in account of a bank situated in a foreign country-

- Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.
- Review the reconciliation statements and pay particular attention to the following.
  - Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken. This should be particularly observed when the bills collected, etc., are credited with net amount and entries for commission, etc. are not made separately in the statement of account.
  - Examine that no cheque sent or received in clearing is outstanding. As per the practice prevalent among banks, any cheques returned unpaid are accounted for on the same day on which they were sent in clearing or on the following day.
  - Examine that all bills or outstanding cheques sent for collection and outstanding

	as on the closing date have been credited subsequently. • Examine the large transactions in inter-bank accounts, particularly towards the year-end, to ensure that no transactions have been put through for window dressing. • Check original deposit receipts in respect of balances in deposit accounts in addition to confirmation certificates obtained from banks in respect of outstanding deposits. • Check whether these balances are converted into the Indian currency at the exchange rates prevailing on the balance sheet date and ensure compliance with relevant Accounting Standard.

QNO 479.010	**Foreign Exchange Transaction-** **BHASKAR CNO—AOB.620**	**Old Course – (N19E)** **New Course – (N18E, S21M, N21E)**
	You are the Concurrent Auditor of a Branch of Nationalized Bank which deals in foreign exchange transactions. Give focus areas of your checking in this respect. **OR** **You have been appointed as Concurrent Auditor of a nationalized bank branch. The main business at the branch is dealing in foreign exchange. Suggest the main areas of coverage with regard to foreign exchange transactions of the said branch under concurrent audit**	
Answer	➢ **Focus Areas in case of Foreign Exchange Transactions:** • Check foreign bills negotiated under letters of credit. • Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules. • Check whether inward/outward remittance have been properly accounted for. • Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorized and necessary charges have been recovered. • Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank. • Ensure that the overbought/oversold position maintained in different currencies is reasonable considering the foreign exchange operations. • Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations. • Ensure verification/reconciliation of Nostro and Vostro account transactions/ balances	

QNO 483.050	**Verification of bills payable** **BHASKAR CNO—AOB.490**	**Old Course – (N19M)** **New Course –(N19M)**
	INDO Bank appointed your firm of Chartered Accountants as a branch auditor for the financial year 2018-19. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Pary for verification of bills payable. However, Mr. Pary, being fresh to the bank audits, needs your guidance. Kindly guide.	
Answer	**Bills Payable:** Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following- • Drafts, mail transfers, traveller's cheques, etc. should be made out **in standard printed forms.** • **Unused forms** relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer. • The bank should have a **reliable private code** known only to the responsible officers of its branches, coding and decoding of the telegrams should be done only by such officers. • All the **telegraphic transfers and demand drafts** issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch. • The **signatures on a demand draft** should be checked by an officer with the specimen signature book.	

	Examine an appropriate sample of outstanding items comprised in bills payable accounts with the relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained. Correspondence with other branches after the year-end *(e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and paid by the other branches without advice)*should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.
	Author's Note **ICAI has taken answer of this question directly from module. Question is only about Bills payable but unfortunately answer is a mixed bag covering bills payable, DD, and telegraphic transfer.**

QNO 485.000	**Contingent Liability-** **BHASKAR CNO—AOB.500**	**Old Course – (P17M, M17R, N19R)** **New Course – (N19R, S21M)**
	While auditing APNA Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks. Kindly guide.	

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

QNO 485.005	**Management Representation For Contingent Liability** **BHASKAR CNO—AOB.500**	**New Course – (M22E)**
	Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the financial year 2021-22. During the course of audit your audit team observed that a lump sum amount has been disclosed as Contingent Liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily, concerned with seeking reasonable assurance that all the contingent liabilities are identified and properly valued and the audit firm intends to obtain a representation from the 'management. Highlight the points/checklists that are to be covered in the management representation.	
Answer	**Contingent Liabilities**: In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that: - **(i)** all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place; **(ii)** all off balance sheet transactions have been entered into after following due procedure laid down; **(iii)** all off balance sheet transactions are supported by the underlying documents; **(iv)** all year end contingent liabilities have been disclosed; **(v)** the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements; **(vi)** the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement; **(vii)** in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of	

	section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and (viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities. **Note:** Students may be given due credit for any other relevant point quoted.

QNO 485.010	**Audit of Guarantee Issued** **BHASKAR CNO—AOB.500**	**Old Course – (M18E)** **New Course – Concept Covered in ICAI New Course Module**
	While doing the audit of a Nationalized bank branch, your audit assistant informed you that he suspects some irregularities in Guarantees issued by the Bank. What should be your guidance in the matter to check the same?	
Answer	➢ ***Guarantees Given on Behalf of Constituents:*** • ***(Internal Control System)*** The auditor should ascertain whether there are adequate internal controls over issuance of guarantees, e.g., whether guarantees are issued under proper sanctions, whether adherence to limits sanctioned for guarantees is ensured, whether margins are taken from customers before issuance of guarantees as per the prescribed procedures, etc. The auditor should ascertain whether there are adequate controls over unused guarantee forms, e.g., whether these are kept under the custody of a responsible official, whether a proper record is kept of forms issued, whether stock of forms is periodically verified and reconciled with the book records, etc. • ***(Register)*** The auditor should examine the guarantee register to seek evidence whether the prescribed procedure of marking off the expired guarantees is being followed or not. The auditor should check the relevant guarantee registers with the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this behalf. The auditor should also examine that expired guarantees are not included in this head. • ***(Letter of Guarantee)*** He should verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter-guarantees received from the customers. He should also verify the securities held as margin. If a claim has arisen, the auditor should consider whether a provision is required in terms of the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets". The auditor should obtain a written confirmation from the management that all obligations in respect of guarantees have been duly recorded and that there are no guarantees issued up to the year-end which are yet to be recorded	

QNO 486.000	**LFAR-** **BHASKAR CNO—AOB.680**	**Old Course – (N08E, P17M)** **New Course – Concept Covered in ICAI New Course Module**
	What do you understand by Long-form Audit Report?	
Answer	• Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR). The long form audit report is to be given by statutory branch auditors as well as statutory central auditors. The LFAR for branch auditors is in form of questionnaire where observations/comments have to be provided on range of matters including cash, balance with banks, investments, advances, deposits etc. These are submitted by the statutory branch auditors to statutory central auditors. • The consolidation is done at head office level and LFAR for bank is submitted by statutory central auditors to management. The LFAR, on the bank, after due examination, should be placed before the ACB of the bank indicating the action taken/proposed to be taken for rectification of the irregularities, if any, mentioned therein; and a copy of the LFAR and the relative agenda note,	

	together with the Board's views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

QNO 488.010	Risk Management- BHASKAR CNO—AOB.080	Old Course – (N16E) New Course – Concept Covered in ICAI New Course Module
	Requirements of a Risk Management process/system in a bank.	

Answer

➢ **Understanding the Risk Management Process:**

Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

- **Oversight and involvement in the control process by those charged with governance:**
  Those charged with governance (BOD/Chief Executive Officer) should approve **written risk management policies**.*(Credit Risk / Operational Risk / Market Risk)* The policies should be consistent with the bank's business objectives *(Balancing growth & risk)*and strategies, *(Education Sector)* capital strength, management expertise, *(Real Estate Loans)* regulatory requirements and the types and amounts of risk it regards as acceptable.
- **Identification, measurement and monitoring of risks:**
  Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria. *(Exposure to Real Estate Sector)*
- **Control activities:**
  A bank should have appropriate controls to manage its risks, including
  - **Credit Risk**
    - Verification and approval of transactions, *(Loan approval process)*
    - Setting of limits *(Limits for loan approval)*
  - **Operational Risk**
    - Effective segregation of duties (particularly, between front and back offices),
    - Reconciliation of positions and results, *(Say CASH reconciliation)*
    - Physical security *(Adequate guards for cash & investment certificates)*
  - **Market Risk**
    - Reporting and approval of exceptions *(reporting big losses on investments)*
    - Contingency planning *(war, recession, demonetisation)*
    - Accurate measurement and reporting of positions, *(Bond related data for market risk)*
  - **Monitoring activities:**
    Risk management models, methodologies and assumptions used to measure and manage risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit. *(Internal Audit, Revenue Audit, Concurrent Audit)*
  - **Reliable information systems:**
    Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

QNO 488.500	Bank Audit Report -- Submission, Requirement of Company's Act, Applicability of CARO UNIQUE	New Course – (M21E)
	M/s GH & Associates have been appointed as Central Statutory Auditors of BNH Bank, a nationalized bank, headquartered in New Delhi for the F.Y 2020-2021. Bank functions in automated environment using "FLC Software". While preparing audit report, one of the partners highlighted that some matters	

	covered by Companies Act. 2013 and the requirements of Companies (Auditor's Report) Order, 2020 reporting. You are required to answer the following: - **(i) To** which authority auditors should submit their audit report? **(ii) List the** matters covered under Companies Act. 2013 **and** **(iii) Reporting under** Companies (Auditor's Report), Order, 2020.
Answer	**(i) Authority to whom Auditors to submit their Audit Report -** In the case of a nationalised bank, the auditor is required to make a report to the Central Government. So, GH & Associates, Central Statutory Auditors of BNB Bank- a nationalized bank, would be required to submit their report to Central Govt. **(ii)The auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013.** 1. **Report on adequacy and operating effectiveness of Internal Controls** over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI. 2. **Report on whether any serious irregularity was noticed in the working** of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.) 3. **As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014** the auditor's report shall also include their views and comments on the following matters, namely: **a)** Whether the bank has disclosed the impact, if any, of the pending litigations on its financial position in its financial statements. **b)** Whether the bank has made provision, as required under the law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts. **c)** Whether there has been any delay in transferring amounts, required to be transferred to the Investor Education and Protection Fund by the bank. **(iii) Reporting requirements relating to the Companies (Auditor's Report) Order, 2020** are not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

10 Audit of Insurance Company

Part - 1 INSURANCE COMPANIES (COMMON PORTION)

QNO 505.000	Receipts & Payments Account- BHASKAR CNO—INS.140	Old Course – (M05E, M11R, M14R, M16R, P17M, N17R)
	"In an audit of an insurance company, the Receipts and Payments Account is also subjected to audit". Comment on this statement in brief.	

Answer

Part I -- Relevant Standards & Laws

- Section 11 of the Insurance Act, 1938

Part II -- Requirements of Relevant Standards & Laws

➢ **Receipts & Payments Not Covered under Sec 12 but Sec 11 Considers it as Financial Statements.**

Section 12 of the Insurance Act, 1938 does not cover the requirement for audit of the Receipts and Payments Account of an insurer. However, sub-section (1) of section 11 of the Insurance Act, 1938 requires that every insurer, in respect of insurance business transacted by him and in respect of his shareholders' funds, should prepare, at the end of each financial year, a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments and a Revenue Account in accordance with the regulations as may be specified. Since Receipts and Payments Account has been made a part of financial statements of an insurer, it is implied that the Receipts and Payment Account is also required to be audited.

➢ **Regulation covers Receipts & Payments**

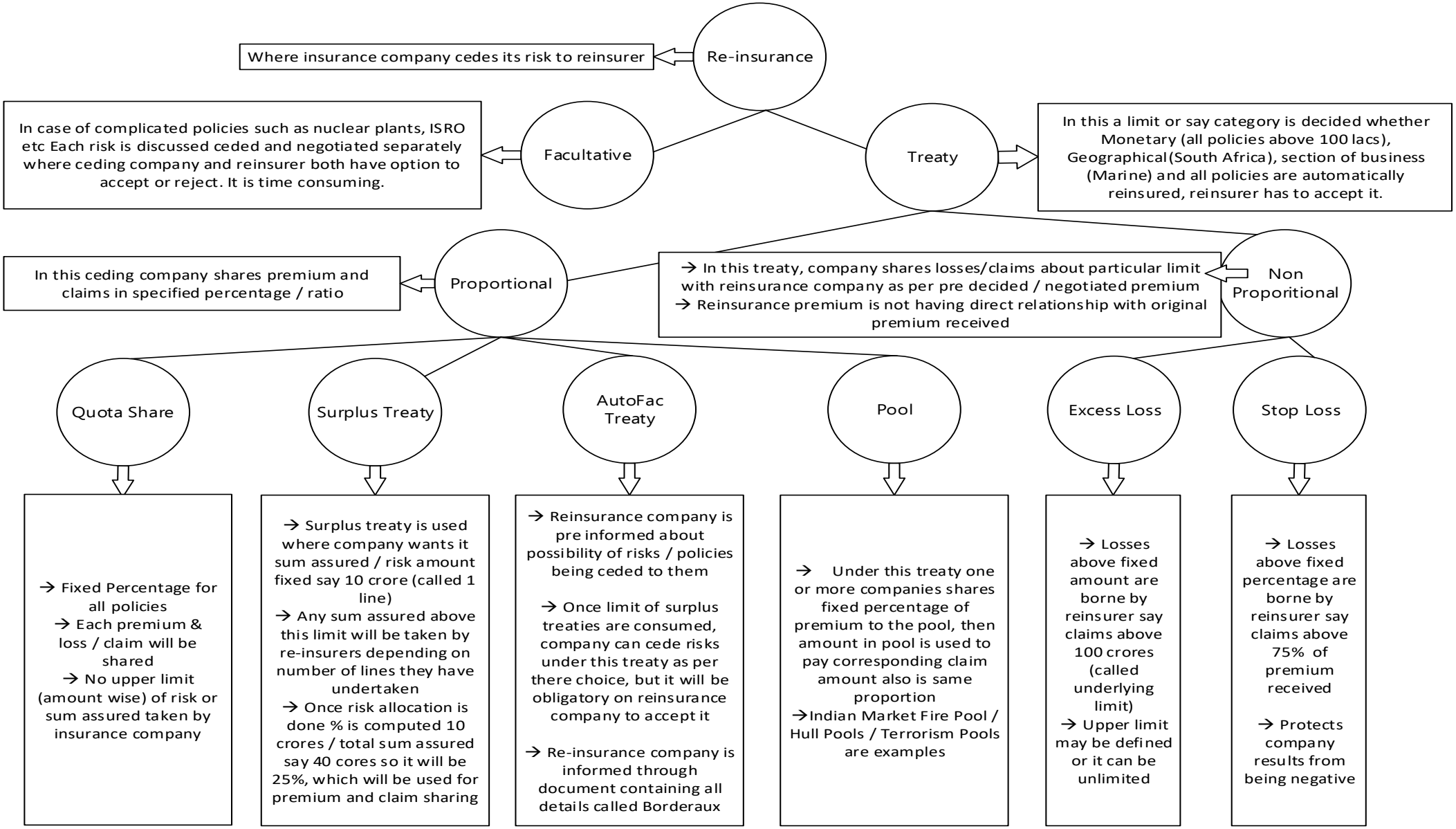
The Authority, in exercise of the powers conferred by the Insurance Act, 1938, issued the IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. These Regulations require the auditor of an insurance company to report.

- Whether the Receipts and Payments Account of the insurer is in agreement with the books of account and returns.
- The auditor is also required to express an opinion as to whether the Receipts and Payments Account has been prepared in accordance with the provisions of the relevant statutes.
- and whether the Receipts and Payments Account gives a true and fair view of the receipts and payments of the insurer for the period under audit. This also implies that the auditor is required to audit the Receipts and Payments Account of the insurer.

QNO 507.100	**Joint Audit & Number of Assignments in Insurance Company** **Bhaskar CNO – INS.180**	**Old Course—(M21M)** **New Course – (M21M)**
	R.O.K. & Co. and TNK & Co. were appointed as the joint statutory auditors at the AGM of Auspic General Insurance Co. Ltd. Apart from the aforesaid audit, R.O.K. & Co. is also being appointed as a joint statutory auditor of one another General Insurance Company and TNK & Co. is appointed as a joint statutory auditor of Life Insurance Company. How many further audits can be accepted by R.O.K. & Co. and TNK & Co., respectively, of either general or life insurance companies?	
Answer	The appointment of statutory auditors in the General Insurance Corporation of India, and its subsidiaries and the divisions as well as other public sector Insurance Companies is made by the Comptroller and Auditor General of India, as in the case of other public sector undertakings. However, in the case of others, auditor is appointed at the AGM after ensuring that the auditor satisfies the compliance requirements with the relevant sections of the IRDAI Guidelines on Corporate Governance. These guidelines pose certain restrictions on the number of insurance companies a statutory auditor can audit. Currently, an auditor can conduct audit only for three insurance companies and not more than 2 life or 2 general. The Guidelines also mandate a mandatory joint audit for all insurance companies. In the given case, R.O.K. & Co. is joint statutory auditor of Auspic General Insurance Co. Ltd. And of one another General Insurance Company. Accordingly, it can now, further, accept only one audit and that too of a Life Insurance Company only. Further, TNK & Co. is joint statutory auditor of Auspic General Insurance Co. Ltd. as well as of one Life Insurance Company. Accordingly, it can now, further, accept only one audit of either a Life Insurance Company or a General Insurance Company.	

QNO 489.000	Co-Insurance Bhaskar CNO – GIC.020	Old Course – (P17M)
	Write a short note on - Incoming and Outgoing Co-insurance.	
Answer	➢ **Incoming and Outgoing Co-insurance:** In cases of large risks, the business is shared between more than one insurer under co-insurance arrangements at agreed percentages. The leading insurer issues documents collects premium and settles claims. Statement of accounts is rendered by the leading insurer to the other co-insurers. The auditor should verify incoming co-insurance and outgoing co-insurance as follows: • **Incoming Co-Insurance**: The auditor should see that the Premium Account is credited on the basis of statements received from the leading insurer. In case, the statement is not received, the premium is accounted for on the basis of advices to ensure that all premium in respect of risks assumed in any year is booked in the same year. It would be advisable for the auditor to scrutinise the communication in the post-audit period and obtain a written confirmation to the effect that all incoming advices have been accounted for. The auditor should also verify claims provisions and claims paid with reference to advice received from the leading insurer. • **Outgoing Co-Insurance:** The auditor should scrutinise the transactions relating to the outgoing business, i.e. where the company is the leader. These should be checked with reference to the relevant risks assumed under policies and correspondingly for debits arising to the co-insurer on account of their share of claims.	

QNO 490.000	Types of Reinsurance (Facultative) Bhaskar CNO – GIC.040	Old Course – (N10R, M14R, P17M)
	Write a short note on - Facultative reinsurance under Insurance Act, 1938.	
Answer	➢ **Facultative Reinsurance –** It is that type of reinsurance whereby the contract relates to one particular risk and is expressed in the reinsurance policy. This is the oldest method of reinsurance and it necessitates consideration of each risk separately. Each transaction under facultative reinsurance has to be negotiated individually. Each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. The main drawbacks of this type of insurance are the volume of work involved and time taken to cover the risk. It is, however, still used even today, mainly when: • Automatic covers have already been exhausted. • The risk is excluded from the Treaties. • The insurer does not want his reinsurance treaties overburdened with particularly heavy and abnormal risks. • The insurer has no automatic cover at his disposal in a particular branch, where he issues policies rarely. • The nature of business is such that technical guidance or consultation with the reinsurer is required at every stage of acceptance of the risk itself or for a type of business where the number of risks is very small, for example, in atomic energy installations, oils rigs, etc.	
	Authors Note **Below page has the master chart to the types of reinsurance. Students can get a quick understanding of the types of reinsurance by going through the chart. It is advisable to read it before starting the reinsurance topic.**	


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

QNO 491.000	Types of Reinsurance (Proportional Vs Non-Proportional)- Bhaskar CNO – GIC.040	Old Course – (N16E)
	Explain the difference between the Proportional Treaties and Non-Proportional Treaties?	
Answer	➢ **Proportional Treaties –** • Proportional treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio. • These treaties can be further classified as Quota Share Treaty, Surplus Treaty, Auto- Fac Treaty and pools. ➢ **Non-Proportional Treaties –** • Non-Proportional treaties are characterised by a distribution of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured, as is the case in proportional reinsurance. • Non-Proportional Treaties can be further classified into Excess of Loss Treaties, Excess of Loss Cover on Prevent basis, Excess of Loss cover on Non-Prevent basis, Stop Loss Treaties.	

QNO 492.000	Re-Insurance (Outward, Audit)- Bhaskar CNO – GIC.060	Old Course –(N05E,N08R,N09E,M12R,N13R,N14R,S17M,P17M, M17M,M18M, N19R) New Course – (S17M, M18M, S21M)
	Enumerate the steps to be taken by an auditor for the verification of Re-insurance outward by a General Insurance Company. **OR** **Steps to be taken by an auditor for the audit of re-insurance ceded**	
Answer	➢ **Verification of Re-insurance Outward** The following steps may be taken by the auditor in the verification of re-insurance outward: • **In the flow of reinsurance outward process** • **Parameters and Guidelines applicable** The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the **parameters and guidelines applicable** to the relevant year. The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk. • **Agreements** The auditor should verify whether the **cessions** have been made as per the **agreements** entered into with various companies. • **Foreign Exchange Payment to Foreign Reinsurers** It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations. • **Commission Receivable** ○ It should also be seen whether the **commission** on cession has been calculated as per the terms of the agreement with the re-insurers. ○ The auditor should verify the computation of **profit commission** for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty. • **Losses Confirmed by Re-insurers** He should see whether provisioning for **outstanding losses** recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified. • **Cash Loss Recoveries (Immediate Payment if loss amount exceeds pre decided limit)** The auditor should examine whether the **cash loss recoveries** have been claimed and accounted on a regular basis.	

- **Records & Accounting**
  - **Underwriting Returns**
    The auditor should verify that re-insurance **underwriting returns** received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.
  - **Accounting**
    Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.
  - **Sub Ledger**
    The auditor should also check that the **re-insurers balance** on cessions and whether the sub edger balances tallies with the general ledger balances.
  - **Opening Outstanding Claims Receivable**
    He should verify whether **opening outstanding claims** not received during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses payable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.
  - **Closing Claims Received Shown as Outstanding**
    The auditor should also verify whether the Claims Received item appears in **Outstanding Claims list** by error. This can be verified at least in respect of major claims.
  - **Confirmation**
    He should verify whether the balances with re-insurers are supported by necessary **confirmation** obtained from them.
  - **Provisioning**
    The auditor should review the **individual accounts** to find out whether any balance requires provisioning / write off or write back.
  - **Subsequent Events**
    Any **major event after the Balance Sheet** date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re - insurance balances will need to be brought out suitably.
  - **Percentage Pattern (Analytical Procedures)**
    The auditor should check **percentage pattern** of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

Author's Note:-
This answer is taken from new study module. It may not match with the old answer.

QNO 493.000	Premium (Audit, GIC)- Bhaskar CNO – GIC.080	Old Course – (N08R, N10R,P17M, N18R) New Course – (S17M, S21M)

What are the steps to be taken while verifying the Premium of General Insurance Company?

OR

While auditing Innocent Insurance Ltd, you observed that a policy has been issued on 31st March, 2020 evening to LMN Company. LMN Company had signed all the papers and taken insurance policy (value insured = ` 11 lac) for its new godown and premium for the same was paid through cheque subject to realization. However, on the night of 31st March, a huge fire accident took place in LMN Company and goods worth `15 lac were destroyed. Further, cheque was also dishonoured due to insufficient fund. The Company informed the incident to Innocent Insurance Ltd and a claim was lodged for the same. The insurance company also made a provision for claim. Advise the Innocent Insurance Ltd in this regard.

Answer

➢ **Most Important Basic Rule -- No Risk Assumption without Premium**
No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is

received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co - insurance premium.

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

- **Internal Control System & Compliance**

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

- **Premium Collection**
  - **Periodical Premium**

    Where policies have been issued with a provision to **collect premium periodically** (i.e., under instalment clause, special declaration policy or periodical declaration under open policies in marine insurance), the auditor should check whether premium are collected as and when they become due.

  - **Collection by Agents**

    The auditor should also check that money **collected by the agents** from the policyholders have been received by the company as quickly as possible.

  - **Outstanding Premiums**

    The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit. Also examine whether instalments of premium falling due in the subsequent year have not been recognised in the accounts as **outstanding premium.**

  - **Advance**

    The auditor should verify the year end transactions to check that amounts received during the year in respect of risks commencing/ instalments falling due on or after the first day of next financial year are not credited to premium account but credited to **Premium Received in Advance Account.**

- **Premium Register**

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

- **Cover Notes**

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

- **Policy Documents**

  The auditor should verify that **policy documents have not been issued,** in case:
  - premium had **not been collected** at all;
  - premium had been collected but the relevant **cheques have been dishonoured**; (refer Cheque Dishonoured Book);
  - premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the **deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit** (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);

- premium had not been collected due to **risk cover being increased** or **where stipulated limits have been exhausted** in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
- instalments of premium **have not been collected** in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in **instalments** (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 per cent of the total premium payable by instalments).

GST

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

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

Accounting

- **Risk Inception**

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

- **Cut Off Date**

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

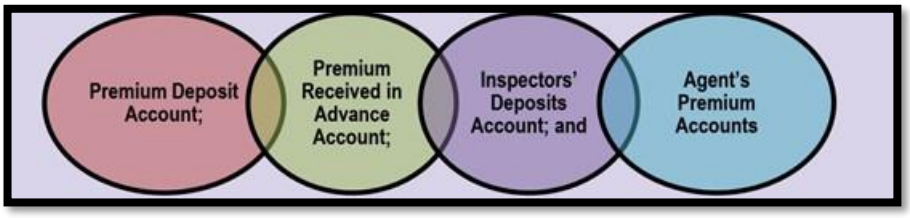
- **After Balance Sheet Date**

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

Special Points

- **Reinsurance**

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



- **Co-Insurance**

  In case of **co-insurance business**, where the company is not the leader, because of the

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

- **Cancellation & Refund**
  - **Cancellation**
    The auditor should also check that in case of **cancellation** of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.
  - **Refund**
    Where premium originally received has been **refunded**, the auditor should verify whether the agency commission paid on such premium has been adjusted.

Authors Note

- **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer. Words in "Headings in Comics font" which are used as heading are only for helping students in retention. Students may or may not write it in the exam.**

QNO 493.500	**Don't Issue Policy Documents in these Circumstances** **Bhaskar CNO – GIC.080**	**New Course – (N21E,N22M)**

CA M has been appointed as an auditor of Life Secure Insurance Ltd. He observed that few insurance policies have been sold by the company in the last month of the financial year ending 31st March, 2021. While recognizing income in the income statement of the company, it is the responsibility of CA M to make an assessment of the reasonability of the risk pattern managed by the management.
Also, it is to be ensured by him that Life Secure Insurance Ltd. should not issue policies, if the risk is not established before the closure of the F.Y.2020-21.
Indicate the circumstances when the company should not issue the policy documents.

Answer

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

QNO 494.000	Premium (Policy Issued Without Actual Receipt) Bhaskar CNO – GIC.080	Old Course – (M13E, M16E, P17M) New Course – (S17M, M18M, M19R, M19E, S21M, N21M, M23M)
	You have been appointed as an auditor of ABC Insurance Co. Ltd. and found that M/s PQR Ltd. got their Plant & Machinery insured on 01-10-2018 but the amount of premium has been paid by them on 15-10-2018. In the meanwhile, on 10-10-2018 a fire has broken out in the factory and the company filed a claim for damages of plant & machinery with the Insurance company. Advise the insurance company in this regard. **OR** **As on 31st March 2020 while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2020 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected later on. As an auditor discuss the steps to be taken while verifying the Premium of Life Insurance Company.**	

Answer

➢ **No Risk Assumption without Premium –**

No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as maybe prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co - insurance premium.

➢ **Calculation of Premium:**

- Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
- Check that system employed as such is equipped to calculate all types of premium modes correctly.

➢ **Accounting of 'Advance Premium':**

- Check, whether system has capability to identify regular and advance premium.
- Check whether there is a process of applying advance premium to a contract when premium is due.

➢ **Collection of Premium:**

- Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.
- Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.

➢ **Recognition of Income:**

- Check that premium is recognised only on the basis of 'Issued Policies' and not on underwriting dates.
- Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies
- Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

➢ **Reporting of Premium figures to IRDA/ Management:**

- Check the methodology for generation of MIS from the system and there is no manual intervention.
- Check the procedure for Maker/ Checker before finalising the MIS.
- Check whether there is a reconciliation process between premium Income as per financials and as reported.

➢ **Other Areas:**

- Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.
- Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits.
- Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
- Check that the Company conducts premium reconciliation on daily basis.
- Check the robustness of interface between administration and accounting system.

Part III – Case Discussion

Therefore, in the instant case, PQR Ltd. signed the insurance documents on 01.10.2018 but did not paid the premium. In case of non-payment of insurance premium if any accidental incident occurs insurance company will have no liability to pay claim.

Part IV – Conclusion

In the given case, fire is occurred on 10th October, 2018 in factory and premium has been paid on 15 October 2018, the ABC Insurance Company Ltd. will not be liable for claim for damages of plant and machinery.

Authors Note

- **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer**
- **Last line of second question is inappropriate, it should be simply insurance company and not life insurance company or ICAI should have removed fire insurance from second line**

QNO 494.500	Premium (Policy Issued Without Actual Receipt) Bhaskar CNO – GIC.080	Old Course – (N20M)

While auditing Innocent Insurance Ltd, you observed that a policy has been issued on 31st March, 2020 evening to LMN Company. LMN Company had signed all the papers and taken insurance policy (value insured = ` 11 lac) for its new godown and premium for the same was paid through cheque subject to realization. However, on the night of 31st March, a huge fire accident took place in LMN Company and goods worth `15 lac were destroyed. Further, cheque was also dishonoured due to insufficient fund. The Company informed the incident to Innocent Insurance Ltd and a claim was lodged for the same. The insurance company also made a provision for claim. Advise the Innocent Insurance Ltd in this regard.

Answer

➢ **Most Important Basic Rule -- No Risk Assumption without Premium**

No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co - insurance premium.

Part III – Case Discussion

➢ Therefore, in the instant case, LMN Company signed the insurance documents on 31.03.2020 and paid the premium through cheque which later on dishonoured due to insufficiency of funds.

Part IV – Conclusion

➢ In such case insurance premium is not being received, thus, if any accidental incident occurs, insurance company will have no liability to pay claim. In the given case, fire is occurred on 31st March night and premium was not received, the Innocent Insurance Ltd. will not be liable for claim for damage of goods amounting rupees 15 lac hence no provision for claim is required.

QNO 495.000	Commission Paid- BHASKAR CNO—GIC.100	Old Course – (N15R, N16M, P17M, M17E, M20R, M21M, N21R) New Course – (N18M, N18E, S21M, M21M,N21R, M23M)

You have been appointed to carry out the audit of Sky Insurance Company Ltd. for the year 2017-18. In the course of your audit, you observed that the commission paid to agents constituted a major expense

	in operating expenses of the Company. Enumerate the audit concerns that address to the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission paid to agents. **OR** **While auditing Secure Insurance Ltd., you observed that the major proportion of expense of the company is the remuneration/commission paid to its insurance agents. As the auditor of the company, what audit procedure would you adopt for verification of such expense?**
Answer	➢ **Commission:** • **Definition of Commission & Its 2 types** The commission is the consideration payable for getting the insurance business. The term 'commission' is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed 'Commission on reinsurance ceded and is reduced from the amount of commission expenditure. • **Internal Control Over Commission** The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules and regulations of the company and in accordance with the agreement with the agent, commission is paid to the agent who brought the business and the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism and provisions of the Insurance Act, 1938 have been complied with. ➢ **Role of Auditor:** The auditor should, *inter alia*, do the following for verification of commission: • Ensure that the agent **is not blacklisted by IRDA** and is not terminated for fraud etc. • Ensure that commission is paid to the **agent/broker who has solicited** the business • Ensure that commission is **paid as per rates** with the agent and rates filed with IRDAI • Test check **correctness of amounts** of commission allowed. • Check whether the **vouchers are authorized by the officers-in–charge** as per rules in force and income tax is deducted at source, as applicable. • Ensure that commission is **not paid in excess** of the limits specified by IRDAI • **Vouch disbursement entries** with reference to the disbursement vouchers with copies of commission bills and commission statements. • Check whether commission outgo for the period under audit been **duly accounted.** • Scrutinize **agents' ledger and the balances**, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
	Authors Note **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer. Words in "Headings in Comics font" which are used as heading are only for helping students in retention. Students may or may not write it in the exam.**

QNO 495.020	**Claim (Provision)-** **BHASKAR CNO—GIC.120**	**Old Course – (N14E, N16R, P17M, M20R)** **New Course – (M18E, M20R, S21M)**
	ABC & Co., Chartered Accountants are the Auditors of Just Care General Insurance Company Limited. As on March 31, 2015 the Management made a provision for claims outstanding. Enumerate the steps to be taken by the Auditor while verifying the "Claims Provision". **OR** **You are the Auditor of Good Luck General Insurance Company. You want to ensure that there exists good system that effectively serves the requirements of true and fair accounting of claim-related expenses and liabilities. Suggest how this can be ensured.**	

Answer

➢ **Claims Provisions –**

- **Verification**

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

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

  In certain circumstances, the claims are incurred by the insurance company but are not reported at the balance sheet date by the insured. Such claims are known as claims **incurred but not reported (IBNR)**. The auditor should check the records for subsequent periods to ascertain that adequate provision has been created for such claims also.
- that in determining the amount of provision, the **'average clause'** has been applied in case of under-insurance by parties.
- that the provision made **is net of payments** made 'on account' to the parties wherever such payments have been booked to claims.
- that the claims are provided for net of **estimated salvage**, wherever applicable
- that in case of **co-insurance** arrangements, the company has made provisions only in respect of its own share of anticipated liability (11) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/ recognizing the claim as attributable to a particular year.
- that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judices in legal proceedings which will determine the quantum of claim, **the amount of provision should also include survey fee and other direct expenses.**

(Year End)

- that provision has been made for **all unsettled claims** as at the yearend on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/ recognizing the claim as attributable to a particular year.
- that **the claims status reports** recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions. The said report should be complete as to material facts to enable the auditor to take a fair view of the provision made.
- that wherever **legal advice** has been sought or the claim is under litigation, the provision is made according to the legal advisor's view and differences, if any, are explained.
- those provisions have been retained as at the year-end in respect of **guarantees**

given by company to various Courts for claims under litigation.

- that in the case of amounts purely in the **nature of deposits with courts** or other authorities, adequate provision is made, and deposits are stated separately as assets and provisions are not made net of such deposits.
- that in determining the amount of provision**, events after the balance sheet date** have been considered, *e.g., (a) claims settled for a materially higher/lower amount in the post -audit period; (b) claims paid by other insurance companies during the year under audit and communicated to company after the balance sheet date where other companies are the leaders in co-insurance arrangements; and (c) further reports by surveyors or assessors & (d), re-insurance cover available is considered.*
- that wherever an **unduly long time has elapsed** after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.
- that **no contingent liability** is carried in respect of any claim intimated in respect of policies issued.

(Special Points)

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

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

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

Authors Note

The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer. Words in "Headings in Comics font" which are used as heading are only for helping students in retention. Students may or may not write it in the exam.

QNO 495.070	Claim (Paid)- BHASKAR CNO—GIC.120	Old Course – (M04E,M10E,M13M, M16M,P17M, N17M, N17R, N18M,M21E)
	You are appointed as an auditor of United India Insurance Company Limited. What are the specific areas to which you will give your attention while examining "Claims Paid" by a General Insurance Company?	

Answer

➢ **Claims Paid**

The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

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

Special Points

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

Authors Note

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QNO 497.000	Claim (Audit Register & Records) # UNIQUE	Old Course – (M17R, M18E) New Course – (S21M)

Register and Records generally prepared in respect of Claims by Insurance Companies.

OR

Your audit assistant seeks your help in checking the claim liability of Bharat Insurance Co. Ltd. and wants to know the registers and records which they should obtain and review in this regard.

Answer

➢ The following register and records are generally prepared in respect of claims

- **P**-Claims **Paid** Register;
- **B**-Claims Disbursement **Bank Book**;
- **I**-Claims **Intimation** Register;
- **R**-**Report** of quality assurance team; and
- **D**-Claims **Dockets,** normally containing the following records:
  Claim intimation, claim form, particulars of policy, survey report, Photograph showing damage, repairer's bills, letter of subrogation, police report, fire service report, claim settlement note, claim satisfaction note, salvage report, salvage disposal note, claims discharge voucher, etc.;
- **S**-**Salvage** register.
  The Claim Account is debited with all the payments including repair charges, firefighting expenses, police report fees, survey fees, amount decreed by the Courts, travel expenses,

	photograph charges, etc. The provision for claims incurred but not reported is not made at Branch/Divisional Office level but at the Head Office level.
	Authors Note **Register is maintained for claims of Pea-cock BIRD (national bird)**

QNO 499.000	Investment (Valuation) BHASKAR CNO—LIC.240	Old Course – (M07E, M09R, P17M)
	State the procedure to determine the value of listed and unlisted equity securities and derivative instruments of an insurance company.	

Answer

Valuation of Investments:

➢ **Actively Traded:**

- **B/S value =Fair Value:**
  - Equity Securities and Derivative instruments that are traded in active markets, shall be measured at Fair Value as at the Balance Sheet Date.
  - Fair Value = Lowest of the last quoted closing price of the Stock Exchanges where the securities are listed.
    Note: active market means a market, where the securities traded are homogeneous, availability of willing buyers and sellers is normal, and the prices are publicly available.

- **Changes In Fair Value:**
  - Unrealized gains/losses arising due to changes in fair value of Listed Equity shares and derivative instruments shall be taken to **Equity under the head "Fair Value Change Account"**
  - "Profit/ Loss on sale of Investments" shall include accumulated changes in the fair value previously recognized in Equity under "Fair Value Changing Account", in respect of those particular securities, and being recycled to P&L account on actual sale of that listed security.
  - Credit balance in "Fair Value Changing Account" will not be available for distribution as dividends. Debit balance in such account will be reducing from Profit/Free Reserves while declaring dividends.

- **Impairment loss:**
  - The insurance shall access on each balance sheet date whether any impairment of Listed Security/Derivative Instruments has occurred.
  - Impairment loss should be recognized as an expense to the extent of difference between the re-measured Fair value of the security and it's Acquisition Cost, as reduce by any Previous Impairment Loss already recognized.
  - Any reversal of any Impairment loss earlier recognized as an expense, should be recognized in Revenue/ P&L a/c.

➢ **Other than Actively Traded:**

- **B/S value = Historical Cost:**
  Unrealized and other than actively traded Equity Securities and Derivative Instruments will be measured at historical cost.

- **Provision for Diminution:**
  - Provision shall be made for diminution in value of such investments.
  - Provision so made shall be reversed in subsequent period if estimates based on external evidence show an increase in value of Investments over its Carrying amount. The increased carrying amount of the investments due to reversal of the provision shall not exceed the Historical Cost.

- **Impairment loss:**
  - The insurance shall access on each balance sheet date whether any impairment of

Listed Security/Derivative Instruments has occurred.

- Impairment loss should be recognized as an expense to the extent of difference between the re-measured Fair value of the security and it's Acquisition Cost, as reduce by any Previous Impairment Loss already recognized.
- Any reversal of any Impairment loss earlier recognized as an expense, should be recognized in Revenue/ P&L a/c.

Authors Note

- **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer**
- **In case of listed securities, if we are already measuring it at fair value then how will the need for impairment ever arise?**
  - **Market value may not be showing true value per share which shareholder may get at the time of liquidation there can be unreasonable price fluctuations because of heavy buying or selling sometimes because of lack of buying or selling quoted price may be old and outdated so investors may compute realistic value by looking at net asset**

QNO 502.000	Outstanding Premium & Agent Balances- BHASKAR CNO—GIC.160	Old Course –(M12M,M13R,M14E,N15E, P17M) New Course – (S17M, M18R ,S21M, M22R)

Mr. Bhavya is appointed as an auditor of General Insurance Company limited. State the verification procedure to be followed by Mr. Bhavya in case of outstanding premium and agent's balances.

Answer

➢ The following are the audit procedures to be followed for verification of outstanding premium and agents' balances:

- **Check age-wise, sector-wise analysis** of outstanding premium.
- Verify whether outstanding premiums have since been **collected.**
- Check the availability of adequate **bank guarantee or premium deposit** for outstanding premium.
- Examine **inoperative balances** and treatment given for old balances with reference to company rules.
- Enquire into the reasons for retaining the **old balances.**
- Scrutinise and review **control account debit balances** and their nature should be enquired into.
- Verify old debit balances which may require **provision or adjustment**. Notes of explanation may be obtained from the management in this regard.

Authors Note

The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer

QNO 503.000	Unexpired Risk Reserve- BHASKAR CNO—GIC.140	Old Course – (M08E, M15R, N19E)

Ordinary Insurance Ltd has made a provision of 25% on unexpired risks reserve in its books Comment.

OR

RQ Insurance Ltd has made a provision of 25% on unexpired risks reserve in its books Comment.

OR

You have been appointed as an auditor of a General Insurance Company. In this context, explain Unexpired Risks Reserve and audit procedures for the same.

Answer

➢ **Unexpired Risks Reserve:**

- **Meaning**

The need for Unexpired Risks Reserve arises from the fact that all policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks

continue. In other words, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end.

- **Section 64V of the Insurance Act, 1938**
  As per section 64V of the Insurance Act, 1938, for the purpose of compliance with the provisions of maintaining control level of solvency margin, a proper value of every item of liability of the insurer shall be placed in the manner as may be specified by the regulations made in this behalf. Reserve for unexpired risk is an important component of liability.

- **Computation**
  According to the requirements of the Insurance Act, 1938, for the purpose of maintaining solvency margin, it is sufficient if:-
  - The provision is made for unexpired risks at 50 per cent for Fire, Marine Cargo and Miscellaneous Business
  - For Marine Hull which has to be 100 per cent.
  - Provision of IT act/ 1961 and IT rules, 1962 permits deduction of above Reserve at the prescribed rates.

- **Income Tax Act, 1961**
  It may be mentioned that the profit and gain of insurance companies are governed by the provisions of section 44 of the Income Tax Act, 1961.

  In this regard, Rule 5 of the First Schedule to the Income Tax Act-Computation of Profit & Loss of General Insurance Business provides for creation of a reserve for unexpired risks as prescribed under Rule 6E of the Income Tax Rules, 1962.

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

Case Discussion & Conclusion

➢ In the given case, the Auditor of Ordinary Insurance Ltd. should qualify his report as the company has made a provision of only 25% against the prescribed minimum of 50% or 100% as mentioned above, thereby resulting in overstatement of profit.

QNO 504.000	**Contingent Liabilities** UNIQUE	**Old Course – (M11E, N12R, P17M)**
	State the disclosure requirements in respect of contingent liabilities in the notes to the Balance Sheet of a General Insurance Company.	
Answer	➢ The following shall be disclosed in the notes to accounts in relation to Contingent Liabilities: • Claims, other than those under policies, not acknowledge the debts. • Re-insurance obligation to the extent not provided in the accounts. • Underwriting commitments outstanding. • Partly paid-up investments. • Guarantees given by or on behalf of the company. • Statutory demands / liabilities in dispute not provided for. • Others (to be specified)	
	Authors Note **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer**	

QNO 506.000	Solvency Margin BHASKAR CNO—GIC.180	Old Course – (N06E, N09R, N11R, M12E, P17M, M19E, N20R) New Course – (N20R, N21M)

M/s MPS & Associates, Chartered Accountants started the statutory audit of their client Contingencies Ltd., a General Insurance company, which has a paid-up capital of ` 16,800/- lac. During the course of the audit, it was found that the Company was not maintaining the required solvency margin as per the provisions of Insurance Act ,1938. When the issue was escalated to the management, they replied that solvency margin needs to be maintained as per limits prescribed only on last day of the financial year. Comment whether reply of management is tenable or not.

OR

Write a short note on - Solvency margin in case of an insurer carrying on general insurance business.

Answer

Part I -- Relevant Standards & Laws

- Section 64VA of the Insurance Act, 1938

Part II -- Requirements of Relevant Standards & Laws

➢ **Solvency Margin in Case of an Insurer Carrying on General Insurance Business:**

Section 64VA of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015 requires every insurer and re-insurer to maintain an excess of the value of assets over the amount of liabilities at all times which shall not be less than 50% of the amount of minimum capital as stated under section 6 (requirement as to capital) of the Act and arrived at in the manner specified by the regulations.

The Authority, by way of regulation, shall specify a level of solvency margin known as 'control level of solvency'. However, in certain special circumstances, the authority may direct application of this provision with some modifications provided this shall not result in the control level of solvency being less than what is stipulated in above para.

If, at any time, an insurer or re-insurer does not maintain the required control level of solvency margin, he is required to submit a financial plan to the Authority indicating the plan of action to correct the deficiency. If, on consideration of the plan, the Authority finds it inadequate, the insurer has to modify the financial plan.

Maintenance of solvency margin has a great importance for an insurance company considering their size and nature of business and also involvement of public money. Sub-section (2) of section 64VA states that if an insurer or re-insurer fails to comply with the prescribed requirement of maintaining excess of value of assets over amount of liabilities, it shall deem to be insolvent and may be wound up by the Court on an application made by the authority.

Part III – Case Discussion

➢ In the said case Contingencies Ltd has not maintained the Solvency Margin throughout the year.

Part IV – Conclusion

➢ Accordingly, contention of Contingencies Ltd. That solvency margin is required to be maintained as per limits prescribed only on last day of the financial year is not tenable.

Author's Note

- **In our notes, Solvency margin is specified as higher of the following –**
  - **50% of minimum capital**
  - **20% of net premium**
  - **30% of net claim**
- **But here in the above answer only the 1st limit i.e. 50% of minimum capital is specified.**
- **It is to bring to your notice that the other 2 limits are specified in regulations and not in Insurance Act, hence it is not specified by ICAI in the answer. If you specify it properly , it is absolutely fine**
- **Control Level Solvency should be 150% of minimum solvency margin**

QNO 507.000	Trade credit BHASKAR CNO—GIC.200	Old Course – (N16E, N18M) New Course – (M22M, N22M)

"Trade credit insurance policy" and basic requirements of a trade credit insurance product.

OR

You are an auditor of Great Insurance Company Ltd. which offers variety of risk management products to business entities wishing to protect their business activities against losses due to various probable risks.

	Great Insurance Company Ltd. is in the process of offering to Uniqu e Ltd., a multinational group having worldwide market, "Trade Credit Insurance Policy" to cover domestic risk, export risk and political risk. You as an auditor of Insurance Company have been requested to ensure that all the requirements have been met by Great Insurance Company Ltd. before Trade Credit Insurance Product is offered to Unique Ltd. List down those requirements.
Answer	➢ "Trade credit insurance" means insurance of suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country as the supplier (domestic risk) or a buyer situated in another country (export risk) against non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due date (protracted default) or non-payment following an event outside the control of the buyer or the seller (political risk cover). Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage. ➢ **Requirements of Trade Credit Insurance**: - • Policyholder's loss is non-receipt of trade receivable **arising out of a trade** of goods or services. • Policyholder is a supplier of goods or services in **consideration for a fair market value.** • Policyholder's trade receivable does **not arise out of factoring or reverse factoring** arrangement or any other similar arrangement. • Policyholder has a customer (i.e. Buyer) who is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder, **in accordance with a policy document filed with the insurer**. • Policyholder **undertakes to pay premium** for the entire Policy Period. • Any **other requirement** that may be specified by the Authority from time to time.

QNO 499.500	Investment (Valuation - Real Estate) Bhaskar CNO – LIC.040	New Course – (M21E)
	CAB Insurance Company Ltd. was incorporated on 01.07.2020. Company is mainly in the area of health insurance and planning to expand in other fields of general insurance. You have been appointed as Chief Financial Officer (CFO) of the Company. The company has made investment as per guidelines in real estate investment property and Equity Securities and Derivatives. Guide CFO as to how the same should be valued?	

Answer

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

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

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

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

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

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

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

- The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.
- Unrealised gains/losses arising due to changes in the fair value of the listed equity shares and the derivative instruments shall be taken to equity under the head 'Fair value change account'. The profit on sale of investments or loss on sale of investment as the case maybe shall include accumulated changes in the fair value previously recognized under equity under the heading 'Fair value changes account' in respect of a particular security and being recycled to the relevant Revenue account or Profit and loss account on actual sale of that security.
- The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the Authority's prescription, no other amount shall be distributed to shareholders out of Fair Value Change Account. Also, any debit balance in Fair Value Change Account shall be reduced from profit/free reserves while

declaring dividends.

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

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

QNO 507.030	**Actuarial Process-** **Bhaskar CNO – LIC.080**	**New Course – (M18R, N18M,S21M)**

Briefly discuss the importance and role of auditor with respect to actuarial process for Life Insurance business

OR

High Life Insurance is into life insurance business and has established presence in this field since last 25 years. Your firm, SR & Co. are appointed auditors of the High Life Insurance company. While conducting its audit, you come across several important actuarial processes being followed in accordance with general regulatory guidelines. You also understand & realise that the actuarial department is calculating and modelling hub of the company. In the above context explain the role of auditors.

Answer

➢ **Actuarial Process:**

(Change in Role from Supervision to Certification)

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

(Affects Pricing & Valuations)

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

➢ **Role of Auditor:**

(Certification of Actuarial Valuation)

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

(Certificate of Actuary & Evaluation of Actuaries Work)

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

➢ **Actuarial department broadly concentrates following key areas of Insurance business:**

- Product Development/ Pricing and Experience analysis.
- Model Development.
- Statutory Valuations and reserving.

- Business Planning.
- Solvency management.
- Management reporting on various business valuations and profitability models of the Life Insurance business.

Authors Note

Actuary concentrates on

Weekdays – "PMS" (portfolio management services)
Weekend -"BMS" (book my show)

QNO 507.040	Premium (Audit, LIC), Premium Collection, Accounting and reconciliation Bhaskar CNO – LIC.170	New Course – (S17M, N18R, S21M)

What are the steps to be taken while verifying the Premium of Life Insurance Company?

OR

Auditors should evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premiums from the policy holders, booking of premium, banking, accounting and reconciliation of the same. In view of above, you are required to briefly discuss some illustrative points, auditors are required to follow during the Audit of Accounting of Premiums in case of Life Insurance Companies.

Answer

➢ **Calculation of Premium:**

- Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
- Check that system employed as such is equipped to calculate all types of premium modes correctly.

➢ **Accounting of 'Advance Premium':**

- Check, whether system has capability to identify regular and advance premium.
- Check whether there is a process of applying advance premium to a contract when premium is due.

➢ **Collection of Premium:**

- Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.
- Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.

➢ **Recognition of Income:**

- Check that premium is recognised only on the basis of 'Issued Policies' and not on underwriting dates.
- Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.
- Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

➢ **Reporting of Premium figures to IRDA/ Management:**

- Check the methodology for generation of MIS from the system and there is no manual intervention.
- Check the procedure for Maker/ Checker before finalising the MIS.
- Check whether there is a reconciliation process between premium Income as per financials and as reported.

➢ **Other Areas:**

- Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.

- Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits.
- Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
- Check that the Company conducts premium reconciliation on daily basis.
- Check the robustness of interface between administration and accounting system.

Authors Note

- **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer.**
- **Can steps for auditing premium of General insurance, be applied to audit of premium of life insurance companies?**
  - **Both are very bulky, majority points in both are same, so I will suggest to remember only one and apply it on both answers. This will be good strategy and feasible also.**

QNO 507.045	**Free Look Cancellation (FLC)** **Bhaskar CNO – LIC.120**	**New Course – (N22R)**
	"Write a short note on:- Free look Cancellation (FRC)	
Answer	Free Look Cancellation (FLC) : As per clause 6(2) of IRDA (Protection of Policyholders Interest) Regulations, 2002, "the insurer shall inform by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy and where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, when he shall be entitled to a refund of the premium paid, subject only to a deduction of a proportionate risk premium for the period on cover and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges". Accordingly, FLC is an option provided to the policyholder wherein he has a period of 15 days from the date of receipt of the policy document to review the Terms & Conditions of the policy and in case of disagreement to any of the terms & conditions, he/ she has the option to return the policy stating the reason for policy's cancellation. FLC requests can be received through any mode –e-mail, fax and letters depending on insurer's policy. In case of written letters, the signature of the policy holder should be matched with the original proposal form. FLC request is processed only when the policy holder is not satisfied with the terms and conditions of the policy document and not for any other reasons. FLC refund is paid either by cheque or in case the policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank account details is submitted.	

QNO 507.050	**Policy Lapse & Revival-** **Bhaskar CNO – LIC.140**	**New Course – (S17M, S21M,M22E)**
	Briefly explain the term policy lapse and revival in case of Life Insurance Company and role of auditor in verifying the same. **OR** **You have been appointed as an auditor of Safe Life Insurance Company Limited. During the course of audit you come across several cases of lapsed policies. Management is flooded with complaints from Agents and Life Assured regarding Policy lapses and Revival. The policy lapsation is tracked over the PMS software. You are requested by the Management to explain in clear terms about Policy lapses and Revival. Also state your role as an auditor in verifying the same.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 113(2) of the Insurance Act,1938 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Policy Lapse and Revival:** ***(How to keep Policy "In Force")*** • In order to keep a life insurance policy "in force" the policy holder is required to pay	

premiums when due (either monthly/ quarterly/annual/bi-annual).

(Grace Period)

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

(Lapse not defined but its treatment is defined)

- "Lapse" is the discontinuance of the policy owing to non-payment of premium dues. The term "lapse" is not defined in the insurance legislation, except stating that "a policy which has acquired a surrender value shall be kept alive to the extent of the paid-up sum assured *(Proportionate Sum Assured)*"-videsection113 (2) oftheInsuranceAct,1938. ***(Policy acquires surrender value when premiums for full 3 years is paid to insurance company)***

(Affects Stakeholders)

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

(Revival)

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

(Monitoring Renewal Premiums)

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

➢ **Role of Auditor:**

(Monitoring / Lapsed & Revival Treatment)

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

Authors Note :

The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer. Words in "Headings in Comics font "which are used as heading are only for helping students in retention. Students may or may not write it in the exam.

QNO 507.055	Audit of Operating Expenses in Insurance Company Bhaskar CNO – LIC.180	New Course – (N20E)

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

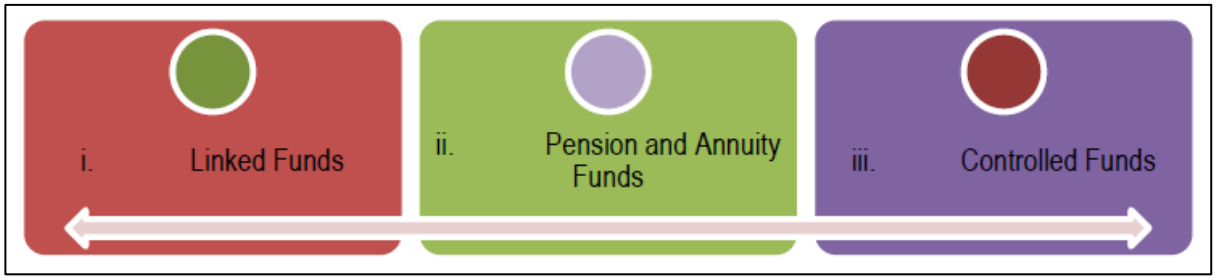
Answer	**Operating Expenses related to Insurance Business (Expenses of Management):** **(i)** Any major expenses (5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately. **(ii)** The auditor should ensure that these expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. **(iii)** The accounting policy should clearly indicate the basis of apportionment of these expenses to the respective Revenue Accounts (i.e., Participating and Nonparticipating policies and in between Linked and Non- Linked business) along with the certificate that all expenses of management, wherever incurred, directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses. **(iv)** Any expenses which are not covered under the 14 heads as mentioned in Schedule 3 are required to be disclosed under the head 'Others'.

QNO 507.060	**Investments (Audit)-** **Bhaskar CNO – LIC.200**	**New Course – (S17M, N19R, S21M)**
	ABC & Co., Chartered Accountants are the Auditors of Just Care Life Insurance Company Limited. Enumerate the steps to be taken by the auditor while verifying the "Investment". **OR** **Auditor's considerations while reviewing of Investment Department of Life Insurance Company.**	

Answer

➢ **Investments:**

The Investment portfolio of Life Insurance companies comprise of Shareholders 'funds and Policyholders' funds. Policyholders' funds can further be segregated as linked and non - linked. Investment regulations are however prescribed separately for the following investment categories:



As Insurers essentially manage the funds for policyholders it becomes imperative for the insurer to have adequate systems and processes that should not only ensure robust internal controls, financial transparency and equity but also bring effective governance so as to serve the interests of the management, stakeholders, consumers and the society, at large.

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

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

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

➢ **Role of Auditor:**

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

Regulation & Split

- **Compliance with Regulations**

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

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

Policy Related Points

- **Investment Policy**
  Review of insurer's Investment policy

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

- **Accounting & Valuation Policy**
  Review and check insurer's Investment Accounting and valuation policy and the controls around this process

Structure & Control Related Points

- **Investment Committee**
  Review of functioning and scope and minutes of Investment Committee.

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

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

- **Policy Management System Vs Investment System**
  Flow of data from PMS to the Investment Accounting system

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

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

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

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

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

Reconciliation related Points

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

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

Other Points

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

	• **Monitoring** Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments. • **Personal, Insider Trading, Front Running Avoidance** Controls around personal dealings, insider trading and front running.
	Authors Note **The answer above has been rearranged in the flow of logical sequence. Students should read it in the same manner to get better understanding of the answer**

507.070	**Commission Payable - Life Insurance Company** **Bhaskar CNO – LIC.178**	**New Course – (S21M, M22M)**
	As an auditor of Life Insurance Company, how will you verify the 'Commission Payable' to its Agents?	
	➢ **Commission payable to Agent:** Insurance business is generally solicited by the Insurance agents. The remuneration of agent is paid by way of commission which is calculated by applying percentage to premium collected by him. Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission. Commission is payable towards generation of new business and towards settlement of renewal premium ➢ **Role of Auditor**: The Auditor during his review of Commission paid to Agents should mainly consider the following: • Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately and processing the same in timely manner. • Review the commission payment system is in sync with the premium collection system. • Check whether commission paid is within the limit prescribed under Insurance Act. • Check whether commission is clawed-back on the cancelled policies. • Check the completeness of commission processing system.	
	Authors Note: **Answer for QNO 495.000 & QNO 507.070, both are similar. Students can write any of the answers, it is expected that institute will give marks for both. However, answer of QNO 495.000 is preferred**	

11 Audit of Non-Banking Financial Companies

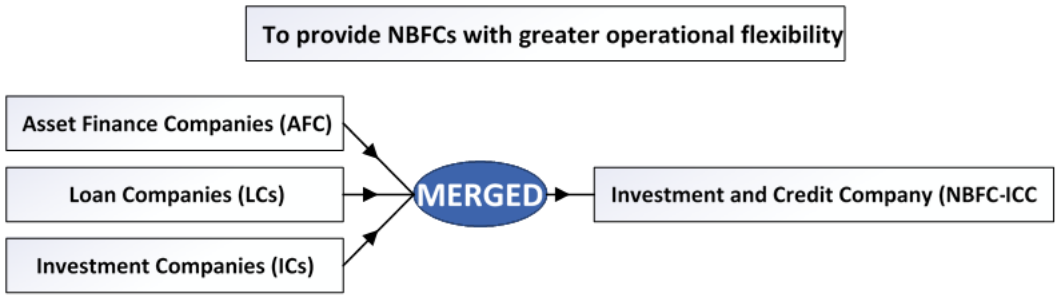
QNO 513.500	Identification of Company as NBFC BHASKAR CNO—NBFC.020	New Course –(S21M)
	Satyam Pvt Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?	
	➢ In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. ➢ The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India. ➢ In the given case, though Satyam Pvt Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.	

QNO 513.800	Identification of Company as NBFC BHASKAR CNO—NBFC.020	New Course –(S21M)
	Krishna Pvt Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?	
	➢ In the given case, Krishna Pvt Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. ➢ The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters : • Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with: • the provisions of Chapter III B of RBI Act (Act 2 of 1934); or • Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or • Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. It shall be the obligation of the auditor to make a report containing the details of such unfavorable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016. • The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.	

QNO 513.900	Identification of Company as NBFC -- Case Study BHASKAR CNO—NBFC.020	New Course –(N21E,N22R)
	ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by Government or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements: (i) Paid-up share capital ` 40.53 Cr. (ii) Non-Current Assets - Loans & Advances ` 55.90 Cr. (iii) Current Assets - Loans and advances ` 344.47 Cr. (iv) Total assets of the company ` 530 Cr. (v) Intangible assets ` 3 Cr. (vi) Profit for the Year ` 7.25 Cr. (vii) Income from interest and dividends ` 52 Cr. (viii) Gross income ` 102.57 Cr. Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.	
Answer	In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's **(i)** Financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and **(ii)** Income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI. In the given case of ABC Ltd, its Financial Assets are = 55.90 + 344.47= 400.37 Cr Total Assets (netted off by intangible assets) = 527 Cr Income from financial assets = 52 Cr Gross Income = 102.57 Cr From the above, it is clear that ABC Ltd.'s financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitutes more than 50 per cent of the gross income. Hence, ABC Ltd. fulfills both these criteria to qualify as an NBFC. Thus ABC Ltd. can apply for registration under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.	

QNO 514.000	Types of NBFC- BHASKAR CNO—NBFC.080	Old Course – (N05E, M11R, M13R, P17M) New Course – (S21M)
	What are the different types of NBFCs registered with RBI?	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 45-I(f) read with Section 45-I (c)of the RBI Act, 1934, as amended in 1997 **Part II -- Requirements of Relevant Standards & Laws** ➢ **NBFC Business** A Non-Banking Financial Company (NBFC) is a company: - ● Registered under the Companies Act, 2013, ● It may receive deposits under any scheme or arrangement in one lump sum or in instalments. ● Its principal business is lending, investments in various types of shares /stocks /bonds /debentures / securities, leasing, hire-purchase, insurance business, chit business etc.	

➢ **Recent Amendment**



➢ **Classification**

Currently, NBFCs registered with RBI are being classified as:

IFFI inaugurated by **CM** sponsored by NBFCs

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

QNO 514.300	**New Activity Based Classification** **BHASKAR CNO—NBFC.065**	**New Course – (M23R)**
	Categorisation of NBFCs carrying out specific activity.	
Answer	**Categorisation of NBFCs carrying out specific activity:** As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs i. NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure. ii. NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer. iii. The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework. iv. Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice	

QNO 514.500	**Registration and Regulation of NBFCs** **BHASKAR CNO—NBFC.040**	**New Course – (S21M)**
	Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.	
	➢ **An auditor should know following points regarding registration and regulation of NBFCs:** Under Section 45–IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without • obtaining a certificate of registration issued by the RBI; and • having a net owned fund (NOF) of ` 25 lakhs (₹ Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify.	

(The RBI (Amendment) Act (1997) provided an entry point norm of ` 25 lakh as the minimum NOF which was revised upwards to ` 2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999).

A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45–IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.

The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.

QNO 515.000	**Compliance with Prudential Norms BHASKAR CNO—NBFC.140**	**Old Course – (N08E, N12E, N13R, M15R, M16R, P17M, M18M, N18E)**
	You are the auditor of IJK Ltd., a NBFC registered with RBI. How would you proceed to ensure the compliance of Prudential Norms directions by it.	

Answer

Compliance of Prudential Norms by NBFC:

➢ Verification by Auditor

The auditor has to verify the compliance of prudential norms relating to

- At the time of giving advances / investment
  - Prohibition on loans and investments for failure to repay public deposits and
  - Prohibition of granting loans against its own shares;
  - Norms for concentration of credit etc.

In case of Investment Company, NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrowers. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended, and investments made by the concerned NBFC are in accordance with the prescribed ceiling.

- The auditor shall ensure that Board of the NBFC shall frame a policy for granting demand/call loans and implement the same.

- After the giving advances / investment
  - Income recognition (Advances);
    Auditor should ensure that unrealized income from non-performing assets has not been taken to Statement of Profit and Loss.
  - Income from investments;
    NBFC prudential norms directions require dividend income on shares of companies and units of mutual funds to be recognized on cash basis.
  - Asset classification

- The auditor should verify the classification of advances and loans as standard/ substandard/doubtful/loss and that proper provision has been made in accordance with the directions.
- The auditor should check all NPAs of the previous years to verify whether during the current year any payments have been received or still they continue to be NPA during the current year also.

o Provision for bad and doubtful debts;

o Capital adequacy norm;

o Investment Valuation

Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

Author's Note

You may see difference in the answer given in PARAM with PM answer. Use our answer. We select best and recent answer whenever there are different answers.

QNO 515.300	**NBFC-General Audit Procedures** **BHASKAR CNO—NBFC.143**	**New Course – (M22M,N22M)**

"OM & Co. is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was a difference of opinion between Mr. O and his partner Mr. M. Mr. O is of the opinion that evaluation of internal control system and verification of registration with RBI should not be the part of audit procedure, as it is the part of interna l audit only. Briefly state what broad areas should mandatorily become part of the audit procedure of OM & Co. for conducting the audit of OTAPS NBFC Ltd.? Also comment whether contention of Mr. O is correct?"

Answer

Following are broad areas that should be mandatorily part of the audit procedure for conducting the audit of NBFC:

1. Ascertaining the Business of the Company - The first step in carrying out the audit of a NBFC is to scan through the Memorandum and Articles of Association of the company, so as to acquaint oneself with the type of business that the company is engaged into. The task of ascertaining the principal business activity of any NBFC is of paramount importance since the very classification of a company as a NBFC and its further classification would all depend upon its principal business activity. Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions.

2. Evaluation of Internal Control System - An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed. In particular, an auditor should review the effectiveness of the system of recovery prevalent at the NBFC. He should ascertain whether the NBFC has an effective system of periodical review of advances in place which would facilitate effective monitoring and follow up. The absence of a periodical review system could result in non-detection of sticky advances at their very inception which may ultimately result in the NBFC having an alarmingly high level of NPAs.

3. Registration with the RBI - Section 45-IA of the RBI Act, 1934, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the

certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. The auditor should ascertain whether investment in prescribed liquid assets have been made and whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.

4. The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results.

5. NBFC Prudential Norms Directions - Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.

In the given situation, OM & Co., is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was difference of opinion between O and his partner M regarding evaluation of internal control and verification of registration with RBI. As discussed above NBFCs are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. Further, auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed. Accordingly, contention of Mr. O regarding evaluation of internal control system and verification of registration with RBI should not be part of the audit procedure as it is part of internal audits only, is not correct.

QNO 515.600	**Audit of Deposit Mobilisation in NBFC** **UNIQUE**	**New Course – (N20E, M22M, M23M)**
	CA Nadar is conducting the statutory audit of RHL Ltd., a non-banking financial company. It has branches in various parts of India. The company with a focus on housing finance, has outstanding non convertible debentures worth 150 Crores. The company reportedly missed interest payments of INR 15 Crores on its debts because of inadequate liquidity. As a result, RHL Ltd. faced a series of downgrades by rating agencies on its debts over the past two months. Rating was cut to D from A4 implying that the company was in default or expected to be in default soon. What aspects CA Nadar should look into in relation to the activity of mobilization of public deposits (particularly in relation to downgrading of credit facilities) by RHL Ltd?	
Answer	**CA Nadar has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-** ➢ The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI inwriting.	

	➢ In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder: • With immediate effect, stop accepting fresh public deposits and renewing existing deposits; • all existing deposits shall run off to maturity; and • report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered. • No matured public deposit shall be renewed without the express and voluntary consent of the depositor.

QNO 517.000	Investment Co (Audit)- BHASKAR CNO—NBFC.160	Old Course – (M08R, N15E, N18R, M19M) New Course – (S17M, N18R, M19M)
	You are appointed as the auditor of a NBFC which an Investment company is registered with RBI. What shall be the special points to be covered for the audit of NBFC in case of Investment companies?	
Answer	**INVESTMENT COMPANIES: -** ***(Buying & Selling)*** ➢ Verify the **Board Minutes for purchase and sale of investments**. Ascertain from the Board resolution or obtain a management certificate to the effect that the **investments so acquired are current investments or Long-Term Investments.** ➢ Test **check bills/contract notes** received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates. ***(Conditions while Purchasing)*** ➢ NBFC Prudential Norms stipulates that NBFCs **should not lend more than** 15% of its Owned funds to any single borrower and not more than 25% to any single group of borrowers. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended, and investments made by the concerned NBFC are in accordance with the prescribed ceiling. ➢ Obtain a list of subsidiary/group companies from the management and verify the **investments made in subsidiary/group companies** during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares. ➢ Check whether **investments in unquoted debentures/bonds** have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification. ***(Income)*** ➢ Verify that securities of the **same type or class are received back** by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.) ***(Verification / Confirmation / Valuation)*** ➢ **Physically verify** all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified. ➢ In respect of shares/securities held through a depository, obtain a **confirmation from the depository** regarding the shares/securities held by it on behalf of the NBFC. ➢ Check whether the investments have been **valued in accordance with the NBFC Prudential Norms Directions** and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions. ➢ An auditor will have to ascertain whether the **requirements of AS 13 "Accounting for Investments"** (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC. ***(Securities Lending / Borrowing)*** ➢ Verify **charges received or paid** in respect of securities lend/borrowed. ➢ **Obtain a confirmation** from the approved intermediary regarding securities deposited with/ borrowed from it as at they earned.	

QNO 518.000	Hire Purchase Co (Audit)- BHASKAR CNO—NBFC.200	Old Course – (M09E, N13R, P17M, M17R) New Course -- (S17M)
	You are appointed as the auditor of a Hire-Purchase Finance Company. Enumerate the verification procedures in relation to audit of such Non-Banking Financial Company.	
Answer	**HIRE PURCHASE FINANCE COMPANY** ***(Internal Control System)*** ➢ Ascertain whether the NBFC has an **adequate appraisal system** for extending hire purchase finance. The system of appraisal is basically concerned with obtaining information regarding the **credit worthiness** of the hirer, his experience in the field, assets owned, his past track record and future projections of his income. ***(Acquisition of Asset)*** ➢ Verify that the **payment for acquiring an asset** should be made directly to the supplier/dealer and that the original invoice has been drawn out in the name of the NBFC. ***(Registration Certificate)*** ➢ If the hire purchase finance is against vehicles, check **whether the registration certificate contains an endorsement** in favour of the hire purchase company. ***(Insurance)*** ➢ Verify that the assets given on hire purchase have been **adequately insured** against. ***(Installation & Valuation Report)*** ➢ In the case of high value hire purchase items relating to machinery/equipment, an auditor should ascertain whether **the valuation reports and installation reports are called** for. In case of some high value items, he should also physically verify the asset in possession of the hirers, particularly in a situation where he has any doubts as regards the genuineness of the transaction. ***(Instalments)*** ➢ Check whether **hire purchase instalments are being received regularly** as and when they fall due. Check whether adequate provision has been made for overdue hire purchase instalments as required by the NBFC Prudential Norms directions. ***(Method of Accounting)*** ➢ Examine the **method of accounting followed by the hire purchase finance company** for appropriation of finance charges over the period of the hire purchase contract. Ascertain that there is no change in the method of accounting as compared to the immediately preceding previous year. ***(Verification)*** ➢ The auditor should verify whether the NBFC has a system in place for **verifying the hire purchase assets periodically** to ensure that the hirers have not sold the assets or otherwise encumbered them.	

QNO 519.000	Equipment Leasing Co (Audit)- BHASKAR CNO—NBFC.220	Old Course – (M07E, M10E,N10R, N15R, N16M, P17M)
	Write a short note on the special points that may be covered in the audit of equipment leasing finance company.	
Answer	**EQUIPMENT LEASING FINANCE COMPANY** ***(Internal Control System)*** ➢ Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance. ***(Agreement)*** ➢ Verify the lease agreement entered into with the lessee in respect of the equipment given on lease. ***(Insurance)*** ➢ Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by the lessee.	

	(Installation & Valuation Report) ➢ The auditor should verify whether there is an adequate system in place for ensuring installation of assets and their periodical physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created. ***(Accounting)*** ➢ An auditor should verify whether the AS issued by the Institute of Chartered Accountants of India in respect of "Accounting for Lease" has been compulsorily followed.

QNO 520.000	**Loan Co (Audit)-** **BHASKAR CNO—NBFC.180**	**Old Course – (M15R, N16M)**
	An auditor has been appointed for the audit of a loan financing company, registered as an NBFC. You are required to state special points to be kept in mind while auditing such company.	
Answer	**This question is deleted refer note given in preface.**	

QNO 520.050	**NBFC-Investment & Credit Company-** **BHASKAR CNO—NBFC.160**	**Old Course – (N19R, N19M)** **New Course – (N19R, N19M, S21M)**
	Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC).	

Answer

Investment Business Related Points

Buying & Selling

- Verify the **Board Minutes for purchase and sale of investments**. Ascertain from the Board resolution or obtain a management certificate to the effect that the **investments so acquired are current investments or Long-Term Investments.**
- Test **check bills/contract notes** received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.

Conditions while Purchasing

- Obtain a list of subsidiary/group companies from the management and verify the **investments made in subsidiary/group companies** during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- Check whether **investments in unquoted debentures/bonds** have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.

Dividend & Interest

- Verify that **dividend income wherever declared** by a company, has been **duly received by an NBFC** and **interest wherever due** [**except in case of NPAs**] **has been duly accounted for**.
- NBFC **Prudential Norms directions** require **dividend income on shares of companies and units of mutual funds to be recognised on cash basis**.
- However, the NBFC has an **option to account** for dividend income **on accrual** basis, if the same has been **declared by the body corporate in its Annual General Meeting** and its right to receive the payment has been established.
- **Income from bonds/debentures of corporate bodies** is to be accounted on **accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears**.

Verification / Confirmation / Valuation

- **Physically verify** all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- In respect of shares/securities held through a depository, obtain a **confirmation from the depository** regarding the shares/securities held by it on behalf of the NBFC.
- Check whether the investments have been **valued in accordance with the NBFC Prudential Norms**

Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

- An auditor will have to ascertain whether the **requirements of AS 13 "Accounting for Investments"** (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.

Securities Lending / Borrowing

- Verify **charges received or paid** in respect of securities lend/borrowed.
- **Obtain a confirmation** from the approved intermediary regarding securities deposited with/ borrowed from it as at they earned.
- Verify that securities of the **same type or class are received back** by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)

Loan Company Related Points

(Own Shares)

- Check whether the NBFC has not advanced any loans against the security of its **own share.**

(Internal Control System)

- An auditor should verify whether the NBFC has an **adequate system of proper appraisal and follow up of loans and advances**. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.

(Sanction & Conditions Attached)

- An auditor should examine whether each loan or advance has been **properly sanctioned**. He should verify the **conditions attached to the sanction** of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- Check whether the NBFC has not lent/invested **in excess of the specified limits** to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.

(Security & Agreement)

- An auditor should verify the **security obtained and the agreements entered into**, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower / guarantor to determine the extent to which an advance could be considered realisable.

(Classification)

- Check the **classification of loans and advances** (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, doubtful assets and loss assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions

(Confirmation)

- Obtain **balance confirmations** from the concerned parties. *(2 Special Lending)*

(Bill Discounting)

- As regards bill discounting, verify that **proper records/documents** have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

Author's Note:-
In this answer the points are simply combination of QNO 517.000 and 520.000.

QNO 522.000	Report to BOD- BHASKAR CNO—NBFC.280	Old Course – (N07E, M16E, P17M, M17E) New Course – (S21M)

List the matters to be included in the 'Auditor's report' in the case of Non-Banking Financial Companies (NBFCs).

OR

What are the specific matters to be included in auditor's report in an audit of Non -Banking Financial Company (NBFC) not accepting public deposits?

OR

	Karma Pvt Ltd is a Non-Deposit Taking Non-Systemically Important NBFC registered with Reserve Bank of India. The Statutory Auditor of the company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board.
Answer	➢ **Matters to be Included** Material to be included in the Auditor's report to the Board of Directors: The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely. **All NBFCs** • In the case of all Non-Banking Financial Companies ***(COR)*** • Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the Bank is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the Bank's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the Bank. ***(Principal Business Test)*** • In case of a company holding CoR issued by the Bank, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year. ***(Net Owned Fund)*** • **3.** Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction Non-Banking Financial Company Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction Non-Banking Financial Company Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. *Systematically Important if Asset Size above 500 Crore* *Non-Systematically Important & Non-Deposit taking NBFC (ND-NBFC)* *Systematically Important & Not Deposit taking NBFC (SI-ND-NBFC)* *Systematically Important & Deposit taking NBFC (SI-D-NBFC)* ***(Certificate from Statutory Auditor)*** • Note: Every non-banking financial company shall submit a **Certificate from its Statutory Auditor** that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-A of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31st may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, **within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year.** The format of Statutory Auditor's Certificate (SAC) to be submitted by NBFCs has been issued by RBI. **NBFCs holding Deposits** • In the case of a non-banking financial companies accepting/holding public deposits Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely- ***(Regularization of Deposits)*** • Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularized in the manner provided in the said Directions;

(Rating)

- In respect of non-banking financial companies referred to in clause (iii) above, whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and

(MIGR)

- Whether the non-banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(Limit as per Credit Rating Agency)

- whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;

(Deposits within the limit?)

- **5.** Whether the public deposits accepted by the company together with other borrowings indicated below viz.
    - from public by issue of **unsecured non-convertible debentures/bonds;**
    - from its **shareholders (if it is a public limited company);** and
    - which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(Computation of CAR)

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

(Liquidity Norms)

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

(Default of Interest)

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

(Compliance with Prudential Norms)

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

(Return of Deposit)

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

(Quarterly Report)

- Whether the company has furnished to the Bank within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial

Company Returns (Reserve Bank) Directions, 2016;

(Violation of Public Deposit Direction)

- Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(New Branches)

- Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/ offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions,2016.

NBFCs Not Accepting Deposits

- **(C)** In the case of a non-banking financial company not accepting public deposits Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: -

(Board Resolution)

- Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;

(Acceptance of Deposit)

- Whether the company has accepted any public deposits during the relevant period/year;

(Classification)

- whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

(Systematically Important NBFC)

- In respect of Systemically Important Non-deposit taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016:
  - Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in form NBS- 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank;
  - Whether the company has furnished to the Bank the annual statement of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period.

(Prudential Norms)

- Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company – No Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;

NBFC not required COR

- **(D)** In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions Apart from the matters enumerated in (A) (I) above where a company has obtained a specific advice from the Bank that it is not required to hold CoR from the Bank, the auditor shall include a statement that the company is complying with the conditions stipulated as advised by the Bank.

Reasons

- Reasons to be stated for unfavourable or qualified statements Where, in the auditor's report, the statement regarding any of the items referred to in

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

Exception Report

- **2.** Obligation of auditor to submit an exception report to the Bank
  - **(I)** Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:
    - the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
    - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
    - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

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

- The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions

QNO 523.000	**Exception Report** **BHASKAR CNO—NBFC.280**	**Old Course – (N16E, M20M, M21E)** **New Course – (S21M, N21M,N22M)**

What are the obligations of auditor to submit Exception Report to RBI in case of nonbanking financial companies?

OR

Kammo & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Briefly explain.

Answer

Exception Report

Obligation of auditor to submit an exception report to the Bank.

- Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:
  - the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
  - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
  - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the obligation of the auditor to make a report containing the details of such

	unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Nonbanking Supervision of the Bank under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016. ➢ The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions

QNO 524.000	**Frauds- BHASKAR CNO— NBFC.240**	**Old Course – (M14E, M16M, N16R, N16M, P17M, N17R, N17M, N17E, N17M, N18M,N20R) New Course – (M19R ,N20R)**
	Under what heads can the frauds committed by Non-Banking Financial Companies (NBFCs) be classified? OR Classification of frauds by NBFC.	
Answer	➢ **Classification of Frauds by NBFC (RBI Circular July 2015)** In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code: • Misappropriation and criminal **breach of trust.** • Negligence and cash **shortages.** • **Fraudulent encashment** through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property. • **Unauthorized credit facilities** extended for reward or for illegal gratification. • **Cheating and forgery.** • Irregularities in **foreign exchange** transactions. • **Any other type** of fraud not coming under the specific heads as above. Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (b) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly: (a) cases of cash shortages more than Rs 10,000/- and (b) cases of cash shortages more than Rs 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash. NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.	

QNO 525.000	**NBFC -Applicability & differences in the presentation requirements between Division II & Division III of Schedule III BHASKAR CNO—NBFC.340/ NBFC.360/ NBFC.380**	**Old Course – (M20R, M21M) New Course –(N19E,M20R,S21M, M21M)**
	Mr. G has been appointed an auditor of LMP Ltd, T a NBFC company registered with RBI Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affaire (MCA) dated October 11, 2018 The notification prescribed the format in Envision III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Help Mr. G.	
Answer	➢ **Applicability of Indian Accounting Standards (IND- AS) on NBFCS** • **Accounting periods beginning 1 April 2018:** Listed and unlisted NBFCs having a net worth of Rs 500 crore or more and holding, subsidiary, joint venture or associate companies of such NBFCs;	

- **Accounting periods beginning 1 April 2019:**
  - **All other listed NBFCs, unlisted NBFCs having a net worth of Rs 250 crore or more but less than Rs 500 crore** and holding, subsidiary, joint venture or associate companies of such NBFCs.
  - The **net worth** shall be calculated in accordance with the standalone financial statements of the NBFCs as on **31st March 2016** or the first audited financial statements for accounting period which ends after that date.
  - **Format for preparation of financial statements by NBFCs under Ind- AS –**
    The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced **Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind-AS has been prescribed.**

➢ **Differences Between Division Ii (Ind- AS- Other Than NBFCS) And Division Iii (Ind- AS- NBFCS) of Schedule III**

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- **Classification & Order in Balance Sheet**
  NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
- **Material Items Disclosure**
  An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or Rs10 lakhs, whichever is higher.
- **Separate Disclosures**
  - NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.
  - Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.
  - The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.
- **Common Point**
  NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes

12 Audit under Fiscal Laws

Authors Note

- **We have experienced from our interaction with the students that they find this chapter difficult One of the reason we found out was students find the answers in this chapter very lengthy and difficult to understand. So to deal with it we have done certain changes in the answer such as changing the flow and style of presentation of the answers. Some answers have also been summarized where we thought was required, so that it becomes easy for the students to read and understand the topic.**
- **GST audit - PARAM covers those question which are asked by ICAI in EXAMS, RTP, MTP, SM, PM. It has question on GST audit too which were issued by ICAI. ICAI collection is most important and that itself is huge, so we didn't include new questions from our side we may issue new questions in future.**

QNO 526.000	Applicability (Multiple Items Adjustment, Numerical, Concession Ltd)- Bhaskar CNO – TAXAUD.040	Old Course – (N13E, N14R, M15E, P17M, M19M) New Course – (S17M, M18R, M18M, M19M, S21M, N21M)

Concession Ltd. is engaged in the business of manufacturing of threads. The company recorded the turnover of Rs 1.13 crore during the financial year 2017-18 before adjusting the following:

Discount allowed in the Sales Invoice Rs 8,20,000
Cash discount (other than allowed in Cash memo/ sales invoice) Rs 9,20,000
Trade discount Rs 2,90,000
Commission on Sales Rs 6,00,000
Sales Return (F.Y. 2016-17) Rs 1,60,000
Sale of Investment Rs 6,60,000

You are required to ascertain the effective turnover to be considered for the prescribed limit of tax audit under the relevant Act and guide the company whether the provisions relating to tax audit applies.

OR

Comment with respect to computation of total sales, turnover or gross receipts in business exceeding the prescribed limit under Section 44 AB of Income Tax Act, 1961.

(i) Discount allowed in the sales invoice
(ii) Cash discount
(iii) Price of goods returned related to earlier year
(iv) Sale proceeds of fixed assets.

OR

Mr. A engaged in business as a sole proprietor presented the following information to you for the FY 16-17. Turnover made during the year Rs 124 lacs. Goods returned in respect of sales made during FY 14-15 is Rs 20 lacs not included in the above. Cash discount allowed to his customers Rs 1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount Rs 5 lacs. Kindly advise him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

Answer

Part I -- Relevant Standards & Laws

- Section 44AB of Income Tax Act 1961

Part II -- Requirements of Relevant Standards & Laws

➢ As per section 44AB of income tax act 1961 if total sales, turnover or gross receipts exceeds the limit prescribed the person shall be liable for tax audit.

Section 44AB of the Income Tax Act, 1961 applies to every person carrying on business or profession, if his total sales, turnover or gross receipts in case of:

- Business exceeds the limit of Rs 1 crore and
- Profession, if his gross receipts exceed the limit of Rs 50 lakhs (w.e.f. A.Y. 2017-18) in any previous year.

The term "sales", "turnover" or "gross receipts" are not defined in the Act however the institute has given some guidance on calculation of total sales, turnover or gross receipt

Part III – Case Discussion & Conclusion

Particulars	Amount	Amount	Treatment
Turnover	1.13 crore	113 lakhs	Total Turnover
Discount in invoice	8.20 lakhs	(8.20 lakhs)	To be deducted from T/O-As it reduces the sale price
Cash discount	9.20 lakhs		Not to be deducted- not related to turnover, are of nature financing charge nature
Trade discount	2.90 lakhs	(2.90 lakhs)	Deducted: if it is in the nature of trade discount. Not Deducted: If it is in the nature of commission on sales
Commission on Sales	6 lakhs		Deducted: if it is in the nature of trade discount. Not Deducted: If it is in the nature of commission on sales
Sales Return (F.Y. 2016-17)	1.60 lakhs	(1.60 lakhs)	To be Deducted- even if the sales returns is related to earlier year/s.
Sale of Investment	6.60 lakhs		Include in T/O-If held as stock-in-trade Not to be included in T/O- If Held as investment.
Total Turnover		100.30	The effective turnover of Concession Ltd exceeds the prescribed limit of 1 crore for tax audit under section 44AB of the Income Tax Act, 1961. Thus, the provisions related to tax audit are applicable to the company and is therefore liable for tax audit

Author's Note

Note 1:

- **Why sale of investment Rs6,60,000 is not deducted to arrive at TO? It is not Stock in trade; It is investment.**
  - Turnover given is before giving adjustments, so we ignored it. If turnover would have been after giving adjustment, we would have deducted.

Note 2:

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

QNO 526.500	Tax Audit Applicability -- Application of 5% Criteria Bhaskar CNO – TAXAUD.040	Old Course – (M21M) New Course – (M21M)

Mr. Abhinandan engaged in business as a sole proprietor presented the following information to you for the FY 2020-21. Turnover expected to be made during the year Rs. 1024 lacs. Goods returned in respect of sales made during FY 2019-20 is Rs. 20 lacs not included in the above. Cash discount allowed to his customers Rs. 1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount Rs. 5 lacs. Further, the aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount and aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment. Kindly advise him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

Answer

Turnover limit for the purpose of Tax Audit: The following points merit consideration as stated in the Guidance note on Tax Audit issued by the Institute of Chartered Accountants of India –

(i) Price of goods returned should be deducted from the figure of turnover even if the return are from the sales made in the earlier years.

(ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.

(iii) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount.

Applying the above stated points to the given problem,

Sr. No.	Particulars	Amount
1	Total Turnover	1042 Lac
2	Less- (i) Good Returned	20 Lac
	(ii) Special rebate allowed to customer in the nature of trade discount would be deducted	5 Lac
3	Balance	999 Lac

Since the aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount and aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment, limit for tax audit is ten crore rupees. In the given situation, Abhinandan would not be required to get his accounts audited under section 44AB of the Income Tax Act, 1961 as Rs. 999 lac is below prescribed tax audit limit i.e. ten crore rupees.

QNO 526.600	Tax Audit Applicability -- Application of 5% Criteria Bhaskar CNO – TAXAUD.040	New Course – (N22R)

Billimoria & Billimoria, a partnership firm, is engaged in providing engineering consultancy services to insurance corporates in automobile sector. The firm conducts risk inspection of vehicles and submit their reports to insurance companies. Both the partners are Chartered Engineers. The Firm is one of your regular tax audit clients. The following information is culled out from the account books of the company for financial year 2021-22 by the firm:

Particulars	Rupees in Crore
Turnover	8.50
Receipt on account of sales/debtors	6.00
Cash receipt from debtors	0.10
Expenditure during year	7.00
Cash expenditure	0.21
Cash loan repayment	0.05

	The partner of said firm informs you that due to changes in income-tax laws, their firm is not liable for audit under section 44 AB of Income tax Act (commonly called as tax audit). How would you deal with the matter? Is contention of partner in accordance with law?
Answer	Section 44 AB(a) of the Income Tax Act, 1961 prescribes that a person carrying on business shall get his accounts audited if his total sales, turnover or gross receipts exceed ` 1 crore in any previous year. However, this limit was enhanced to ` 10 crore in the following case where: - a. aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and b. aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment. However, section 44 AB(b) of the Income Tax Act, 1961 states that in case of profession, every person shall get his accounts audited, if his gross receipts in profession exceed ` 50 lakh. The above said firm is engaged in providing engineering consultancy services to insurance corporates. Hence, the benefit of enhanced threshold limit is not available to persons engaged in professional activities. The information regarding cash receipt and payment although falling within 5% of total receipts/payments is not relevant in the instant case. Hence, contention of partner is not correct, and firm is required to get its accounts audited under income tax law.

QNO 528.000	**Applicability (Non-Resident)-** **Bhaskar CNO – TAXAUD.020**	**Old Course – (M15R, M16M, P17M, N17M)**
	Liquim Ltd., a non-resident company, is engaged in the business of extraction of mineral oils having turnover of Rs. 20 lakhs during the financial year 2015-16. The company claims that its profits and gains chargeable to tax under the head "Profits and gains of business or profession" is lower than the deemed income chargeable under section 44BB of the Income Tax Act, 1961. Therefore, it decided to get its accounts audited under section 44AB of the Income tax Act, 1961. As a tax auditor, how would you report under Form 3CD?	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 44AB of Income Tax Act 1961 ▪ Section 44BB of Income Tax Act 1961 ▪ Clause (8) and (12) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ **As per income tax Act 1961** Tax audit is compulsory in the following cases: -Business-If T/O >1crore. -Profession-If G.R >50 lakh -If assesse is covered by sec 44AD or 44ADA and assessee claims income less than 8%/6% or 50% & his total income is more than basic exemption. -If assesse is covered by sec 44AE, 44BB, 44BBB and assessee claims income under PGBP less then income deemed under those sections. ➢ **Reporting Requirement under Clause (8) and (12) of Form 3CD:** • **Clause (8) of Form 3CD,** The auditor is required to mention relevant clause of section 44AB under which the audit has been conducted. Mention clause (c) if the audit is conducted under section 44AB by virtue of section 44AE, 44BB and 44BBB. • **Clause (12) of Form 3CD,** If the P&L of the assessee includes any profits and gains assessable on presumptive basis, the tax auditor has to indicate: The amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section).	

Part III – Case Discussion

- **In the given case,**

  Liquim Ltd. is a non-resident company which is engaged in the business of extraction of mineral oils and has turnover is ofRs.20 lakhs. Therefore, the company is not required to get its accounts audited under section 44AB of the Income Tax Act, 1961.

  However, such business is covered under 44BB & the company is claiming lower income in comparison to deemed income under section 44BB of the said Act, thus, the company needs to get its accounts audited.

Part IV – Conclusion

- As per the facts of the case, provisions and explanations given above,
  - The tax auditor of Liquim Ltd. is required **to mention clause (c) of section 44AB under clause (8) of Form 3CD.**
  - In addition to above, the tax auditor has **to indicate under Clause (12) of Form 3CD**, the amount of profits and gains credited/debited to the Profit & Loss Account.

Author's Note

Examples of significant deficiencies arising during the course of audit

- **Significant Deficiencies**
  - Purchase order approval, good received and payment approved by same person
  - No attendance records of employees
  - All directors and senior management has access to company bank accounts and passwords, even though many of them are not required to make any payments and don't have its any use

QNO 528.500	Applicability (Multiple Clients) Bhaskar CNO – TAXAUD.020	Old Course – (N21R) New Course – (N21R)

UT & Co. is a Chartered Accountant Firm, that provides consultancy services. Recently, it got queries from different clients with respect to applicability of tax audit provisions to their businesses.
In response to such queries, UT & Co., asked from them details such as turnover, total receipts and total payments made during the year respectively along with mode of receipt/payment, whether filing return of Income under normal tax provisions or presumptive tax provisions such as section 44AD, 44AE, etc.

So, in the trailing mail, UT & Co., got the aforesaid details from different clients, which it classified into following categories for ease of framing an opinion, as follows:

Client Sr. No.	Turnover (in crore)	% of Cash Receipts in Total Receipts	% of Cash Payments in Total Payments	Remarks
1	9.5	5%	5%	Has been filing return as per the regular provisions of income tax.
2	1.8	7%	4%	Has declared business income as per presumptive taxation under section 44AD of the Income-tax Act, 1961.
3	0.85	6%	4%	Has declared business income as per presumptive taxation under section 44AD of the Income-tax Act, 1961 during last 2 previous years but during current previous year has declared income lower than as per section 44AD and the total income is less than basic exemption limit.
4	3.2	8%	6%	Has declared business income as per presumptive taxation under section 44AE of the Income-tax Act, 1961 during last 4 previous

				years but during current previous year has declared income lower than as per section 44AE and the total income is less than basic exemption limit.

On behalf of UT & Co., please provide your opinion, along with reasons, as a consultant in case of aforesaid clients that whether tax audit is applicable to them or not?

Answer

Applicability of Tax Audit:

Client Sr. No.	Opinion(Tax Audit Applicable or not)	Reason
1	No	As the turnover is upto ` 10 crore, Cash Receipts and Cash Payments are upto 5% of total receipts & total payments, respectively, and has been filing return as per the regular provisions of income tax, so tax audit is not applicable.
2	No	Even though turnover exceeds ` 1 crore and Cash Receipts are greater than 5% of Total Receipts but as the business income has been declared as per presumptive taxation under section 44AD of the Income-tax Act, 1961, so tax audit is not applicable.
3	No	Even though business income as per presumptive taxation under section 44AD of the Income-tax Act, 1961 has been declared during last 2 previous years but has not been declared during the current previous year but as the total income is less than basic exemption limit, so tax audit is not applicable.
4	Yes	Has been declaring total income as per presumptive taxation under section 44AE of the Income-tax Act, 1961 during last 4 previous years but during current previous year has declared income lower than as per section 44AE, so tax audit is applicable.

QNO 529.000 | **Ceiling Limit-** **Bhaskar CNO – TAXAUD.120** | **Old Course – (N16E)**

A member of the institute shall not accept in a year more than the specified number of tax audits under section 44AB of the Income Tax Act.
Mr. Gaurav is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners. During the assessment year 2015-16, Mr. Gaurav alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

Answer

Part I -- Relevant Standards & Laws

- Section 44AB of Income Tax Act 1961
- Council Guidelines 2008

Part II -- Requirements of Relevant Standards & Laws

➢ ***Ceiling limit of tax audit***

- Ceiling limit per CA is 60 (Council Guidelines 2008)
- In case of CA Firm
  - 60 x Number of Partner.
  - Total tax Audit per Ca in a firm <Total limit of firm in aggregate.

➢ ***As per Institute on Tax Audit Assignments,***

Tax audit reports may be signed by the partners in any manner within the specified audit limits. Thus, individual partner can sign all the tax audit reports on behalf of all the partners in the firm of CA's in practice subject to Total limit of firm in aggregate or
all the partners of the firm can collectively sign tax audit reports.

Part III – Case Discussion

Mr. Gaurav is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners.
During the assessment year 2015-16, Mr. Gaurav alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

Part IV – Conclusion

There are 6 partners in M/s XYZ & Co., a Chartered Accountants firm,
Max Limit of Firm is 60 tax audit assignments per partner X 6 partners = 360.
Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports.
This maximum limit of 360 tax audit assignments may be used by the partners as per their wish.
For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report.

➢ **Assumption**

Mr. Gaurav has signed 290 tax audit reports on behalf of firm and remaining partners are signing the rest of the audit reports within the maximum limit allowed u/s 44AB i.e. up to 70. (360-290)
Hence, Mr. Gaurav shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360.

Author's Note:

- **CEILING LIMIT OF TAX AUDIT**
  - Ceiling limit per CA is 60 (Council Guidelines 2008)
  - In case of CA Firm 60 x Number of Partners
  - In case of partnership in multiple firms then in totality it should not exceed 60 per CA
  - One partner can sign on behalf of other.
  - Limit for part time COP is Zero.
  - Audit u/s 44AE / 44AD / 44ADA shall be excluded.
    (From Clause (c) 44BB & 44BBB not excluded as these are big audits of non-residents)
  - Only for audit under section 44AB
  - Corporate non-corporate both are included.
  - Branches and HO will be counted as one.
  - Multiple branches will be counted as one.

QNO 529.050	Ceiling Limit (44AB and 44AD)- Bhaskar CNO – TAXAUD.120	Old Course – (N19E)

M/S PQR & Co. is a partnership firm of 3 partners P, Q and R. All partners are exclusively associated with the firm in practice and are not doing practice in individual capacity. For the year ended 31st March 2019, the partners have undertaken audits and signed audit reports under section 44AB / 44AD of the Income Tax Act, 1961 as under:

Under section	44AB	44AD
P	10	15
Q	60	5
R	100	5

Discuss whether there is any professional misconduct by the firm in regard to the aforesaid audits.

Answer

Part I -- Relevant Standards & Laws

- Section 44 AB of the Income-tax Act, 1961
- Chapter VI - Council General Guidelines 2008

Part II -- Requirements of Relevant Standards & Laws

➢ **As per the Council General Guidelines 2008, under Chapter VI :**

- A member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961.
- **For the above purpose, "the specified number of tax audit assignments" means.**
  - In the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 60 tax audit assignments, in a financial year, whether in respect of corporate or non-corporate assesses.
  - In the case of firm of Chartered Accountants in practice, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.
- **In computing the "specified number of tax audit assignments":**
  - The number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice

or firm of such Chartered Accountants, shall be taken into account.

- Where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the "specified number of tax audit assignments" in the aggregate.
- In addition, where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

- **Exclusions**

  It may be noted that the audits conducted under Section 44AD, 44AE and 44AF of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".

Part III – Case Discussion

➢ **In the instant case,**

- M/s PQR & Co. is a partnership firm of Partner P, Q and R.
- All the partners are exclusively associated with the firm and are not doing practice in individual capacity.
- Here, in the instant case, 60 tax audit assignments per partner in the firm, in a financial year will be considered for "specified number of tax audit assignments" i.e.,180 tax audits = 3 Partners x 60 tax audits.
- In the given situation, number of tax audit reports signed under
  - **Section 44AB are 170**
    - 10 reports signed by Mr. P,
    - 60 reports signed by Mr. Q and
    - 100 reports were signed by Mr. R
  - **Section 44AD are 25**
    - 15 reports signed by Mr. P,
    - 5 reports signed by Mr. Q and
    - 5 reports were signed by Mr. R.

    (It may be noted that the 25 audits conducted under Section 44AD, of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".)

Part IV – Conclusion

➢ In view of above provisions, partner Mr. P, Mr. Q and Mr. R of PQR & Co. have undertaken 170 audits which is not more than 180 tax audits i.e., "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. Therefore, there is no professional misconduct in regard to the above said audits.

QNO 530.500	**Matters tax auditor should consider to while furnishing the particulars in Form No, 3CD** **Bhaskar CNO – TAXAUD.258**	**New Course – (N19E, S21M)**
	Mr. PK is conducting the Tax audit under section 44 AB of the Income Tax Act, 1961 of MG Ltd. for the year ended 31st March, 2019. There is a difference of opinion between Mr. PK and the Management in respect of certain information to be furnished in Form No. 3CD. As a tax auditor, Mr. PK has to report whether the statement of particulars in Form 3CD are true and correct and the same is to be annexed to the report in Form No. 3CA. Advise on the matters to be considered by Mr. PK while furnishing the particulars in Form No. 3CD.	
Answer	➢ The statement of particulars given in Form No. 3CD as annexure to the audit report contains 44 clauses (counting wise 50). The tax auditor has to report whether the particulars are true and correct. This Form is a statement of particulars required to be furnished under section 44AB. The same is to be annexed to the reports in Forms No. 3CA and 3CB in respect of a person who carries on business or profession and whose accounts have been audited under any other law and in respect of person who carries on business or profession but who is not required by or under any	

other law to get his accounts audited respectively.

- **While furnishing the particulars in Form No. 3CD it would be advisable for the tax auditor to consider the following:**
  - If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.
  - If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.
  - If any particular clause in Form No. 3CD is not applicable, he should state that the same is not applicable.
  - In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.
  - In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.
  - The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.
  - In case the auditor relies on a judicial pronouncement, he may mention the fact as his observations in clause (3) of Form No. 3CA or clause (5) provided in Form No. 3CB, as the case may be.

QNO 531.000	**Cl 4--Service Tax Default-** **Bhaskar CNO – TAXAUD.240**	**Old Course – (M15R, M16E, P17M, N17R)**

As a tax auditor, how would you report on the following situations?
Mr. Deepesh, is a renowned criminal lawyer, practising in Meerut. During the previous year, he collected service tax of 25 lakhs but utilized it for his personal use. The Commissioner of Central Excise issued a show cause notice to him as to why the tax, collected by him, is not deposited to the government account. He appeared before the Commissioner and stated his inability to pay the sum due to financial crisis. The proceedings are still pending before the Commissioner.

Answer

Part I -- Relevant Standards & Laws

- Clause (4) of Form 3CD
- As per SA-580

Part II -- Requirements of Relevant Standards & Laws

- Mr. Deepesh has defaulted in payment of service tax for the previous year. Consequently, the Commissioner of Central Excise issued a show cause notice for such non-payment of tax. The arguments are still going on between the department and assessee. He also restrained his tax auditor from disclosing service tax registration details in tax audit report.
- **Reporting Requirement**
  - **Part A of Form No. 3CD**
    Requires the auditor to give the factual details of the assessee.
  - **Under Clause (4) of Part A:**
    In case the assessee is liable to pay indirect taxes like excise duty, service tax, sales tax, customs duty, etc, a tax auditor is required to mention the Reg.No or any other identification No. of the assessee, if any allotted to assessee.

The reporting to be done in the following manner or format: -

Sr. No	Relevant Indirect tax Law which requires Registration	Place of Business / profession / service unit for which registration is in place / or has been applied for	Registration/ Identification number

➢ **As per SA-580**

Furthermore, the auditor has to keep in mind the provisions of Standard on Auditing 580 "Written Representation".

Part III – Case Discussion

➢ Mr. Deepesh is a lawyer. He collected service tax of 25 lakhs but utilized it for his personal use. Show because notice was issued. The proceedings are still pending before the Commissioner.

➢ **Assumed by institute while answering:**

He restrained his tax auditor from disclosing service tax registration details in tax audit report

Part IV – Conclusion

➢ In case the auditor is of the opinion that any indirect tax laws is applicable on the business or profession of the assessee but the assessee is not registered under the said law, the auditor should report the same appropriately.

The tax auditor of Mr. Deepesh is required to furnish S.Tax Reg No. under Clause (4) of the Form 3CD. Thus, contention of Mr. Deepesh not to disclose the service tax details is not tenable.

QNO 532.000	Cl 11--Stock Register Not Maintained- Bhaskar CNO – TAXAUD.240	Old Course – (N09E, N11R, M13R, P17M, M20R) New Course – (S17M, M20R, S21M)

ABC Printing Press, a proprietary concern, made a turnover of above Rs 1.03 crore for the year ended 31.03.2018. The Management explained its auditor Mr. Z that it undertakes different job work orders from customers. The raw materials required for every job are dissimilar. It purchases the raw materials as per specification/ requirements of each customer, and there is hardly any balance of raw materials remaining in the stock, except pending work-in-progress at the year end. Because of variety and complexity of materials, it is rather impossible to maintain a stock-register. Give your comments.

Answer

Part I -- Relevant Standards & Laws

- Clause 35(b) of Form 3CD
- Clause 11(b) of Form 3CD

Part II -- Requirements of Relevant Standards & Laws

➢ The explanation given by the entity for the use of varieties of raw materials for different jobs undertaken may be valid.

But the auditor needs to verify:

- The job-orders received, and the different raw materials purchased for each job separately.
- The use of different papers (quality, quantity and size) ink, colour etc.

  If possible, the auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom.

➢ **Reporting Requirement**

- **Under the clause 35(b) and clause 11(b) of Form 3CD:**

  Auditor has to report and certify under the clause 35(b) and clause 11(b) of Form 3CD about the details of stock and account books (including stock register) maintained. He must verify the closing stock of raw materials, work-in-progress and finished goods of the concern, at least on the date of its balance sheet.

Part III – Case Discussion

➢ Non-maintenance of stock register due to variety and complexity of materials.

Part IV – Conclusion

➢ In case the said details are not properly maintained, he has to specifically mention the same with reasons of non-maintenance of stock register by the entity.

QNO 534.000	Cl 13--Method of Accounting- Bhaskar CNO – TAXAUD.240	Old Course – (M07E, M09R,P17M) New Course—(S17M, S21M)

Write a short note on - Method of accounting in Form No. 3CD of Tax Audit.

Answer

Part I -- Relevant Standards & Laws

- Clause 13 of Form No. 3CD
- ICDS
- Section 145

Part II -- Requirements of Relevant Standards & Laws

Method of accounting in Form No. 3CD of Tax Audit:

➢ **Clause 13 of Form No. 3CD** of the tax audit requires to state:

- **Method of Accounting:**
  - Method of accounting employed in the previous year.
  - Whether there had been any change in the method of accounting employed with respect to preceding year.
  - If there had been any change in the method of accounting employed,
    -Details of change and
    -Effect on the P&L is to be stated.
- **ICDS:**
  - Whether any adjustment is required in the P&L, to comply with ICDS.
  - If any adjustment is required in the P&L to comply with ICDS.
    -Give Details of such change

  Section 145 provide that method of accounting be either cash or mercantile. Hybrid system is 4not permitted**.**

QNO 535.000 | **Cl 13--Adjustment to be made to the Profits or Loss for complying with ICDSs –** **Bhaskar CNO – TAXAUD.240** | **Old Course – (M17R, N17M)**

A leading manufacturing concern valued its inventory following a method not in line with the provisions of Income Computation and Disclosure Standard (ICDS) – 2 'Valuation of Inventories'.
In such a situation, discuss the relevant clause of Form No. 3CD under which the tax auditor is required to report?

Answer

Part I -- Relevant Standards & Laws

- Clause 13 of Form No. 3CD
- ICDS II-Valuation of Inventories

Part II -- Requirements of Relevant Standards & Laws

Clause 13 of Form No. 3CD of the tax audit requires to state:

- Whether any adjustment is required in the P&L, to comply with ICDS.
- If any, adjustment is required in the P&L to comply with ICDS.
  -Give Details of such adjustment.

➢ **Details of such adjustments are to be given as follows:**

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect (Rs.)
ICDS II	Valuation of Inventories			

➢ **Furthermore, Clause 13 also requires the tax auditor for disclosure of the following as per ICDS:**

(ii)	ICDS II-Valuation of Inventories

Part III – Case Discussion

➢ Inventory is valued following a method not in line with ICDS.

Part IV – Conclusion

➢ Since the Inventory is valued following a method not in line with ICDS the **auditor shall**

- **Report for Adjustment** to be made in the P&L for complying with ICDS along with details of such adjustment.
- Furthermore, the tax auditor shall **disclose** "Valuation of Inventories as per ICDS II"

➢ **Reporting for Adjustment to be made in the P&L for complying with ICDSs:**
Clause of Form No. 3CD of the tax audit report requires the tax auditor to state whether any

adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2) of the Income Tax Act, 1961.

Further, the tax auditor is also required to report under Clause 13(e), if answer to Clause 13(d) above is in the affirmative i.e. the auditor is required to give details of such adjustments as follows:

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
	Total			

➢ **Furthermore, Clause 13(f) also requires the tax auditor for disclosure of the following as per ICDS:**

(i)	ICDS I-Accounting Policies
(ii)	ICDS II-Valuation of Inventories
(iii)	ICDS III-Construction Contracts
(iv)	ICDS IV-Revenue Recognition
(v)	ICDS V-Tangible Fixed Assets
(vi)	ICDS VII-Governments Grants
(vii)	ICDS IX Borrowing Costs
(viii)	ICDS X-Provisions, Contingent Liabilities and Contingent Assets".

QNO 535.010	**Cl 14--Change in Method of Stock Valuation- Bhaskar CNO – TAXAUD.240**	**Old Course – (M09R, M11R, M13R, P17M)**

A leading jewellery merchant used to value his inventory at cost on LIFO basis However, for the current year, in view of requirements of AS 2, he changed over to FIFO method of valuation The difference in value of stock amounted to Rs 55 lakhs which is higher than that under the previous method In such a situation, what are the reporting Responsibilities of a Tax Auditor under Section 44AB of Income-tax Act, 1961

OR

T Ltd's previous year ended on 31st March 2012 T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 14 of Form 3CD which requires reporting on change in accounting method employed. Comment.

Answer

➢ **Reporting for change in the method of valuation of stock:**

- The change in the method of valuation of stock is not a change in method of accounting, as it is only a change in accounting policy. However, in the Income-tax Act, 1961 this is considered under method of valuation.
- Under the Income-tax Act, 1961, if the change in method of valuation is bonafide, and is regularly and consistently adopted in the subsequent years as well, such change would be permitted to be made for tax purposes. In the instant case, the change in the valuation of stock from LIFO basis to FIFO basis is pursuant to mandatory requirements of the AS 2'Valuation of Inventories' and therefore should be viewed as bonafide change.

- This apart, the tax auditor in his report has to specifically refer to the method of valuation of stock under Clause 14 in Form 3CD.
  - Method of valuation of closing stock employed in the previous year.
  - Details of deviation, if any, from the method of valuation prescribed under section 145Aand the effect thereof on profit or loss.

- The auditor has to see that the method of stock valuation is followed consistently from year to year. It is also necessary to ensure that method followed for valuation of stock results is correct profits or gain. The change from LIFO to FIFO is bonafide, the disclosure of which would have to be made the financial statements. As far as section 145A is concerned, the tax auditor need not change the method of valuation of purchases, sales and inventories which is regularly employed by the assessee. All that he has to do is to adjust the valuation for any tax, duty, cess or fee actually paid or incurred by the assessee, if the same had not already been adjusted.

Authors Note

In clause 13 — method of accounting means only 2 things Accrual Vs Cash, if there is change from accrual to cash or vice versa then only clause 13 will be applicable. now clause 14 is specifically for inventory valuation as per section 145A — it says that method of valuation should be consistent, it should be same as regularly followed. change is allowed if its justified.

Here when we talk about method of valuation for inventory, which includes accounting principles (cost or NPV whichever is lower) as well as method of their application (FIFO / weighted average) Now in this case change to comply with AS-2 is justified, so no contravention of Sec 145A which asks for consistency so no reporting under clause 14

QNO 536.000	Cl 16--Escalation Claim- Bhaskar CNO – TAXAUD.240	Old Course – (M11E, N12M, N13R, N16R, P17M, M19M) New Course – (M19M)

While conducting the tax audit of A & Co. you observed that it made an escalation claim to one of its customers, but which was not accounted as income. What is your reporting responsibility?

Answer

Part I -- Relevant Standards & Laws

- Clause 16 of Form 3CD

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause 16 of Form 3CD:**

If any **escalation claim accepted** during the previous year and such **amount** is not credited to the P&L A/c, **the fact should be reported by the tax auditor.**

However, the system of accounting followed shall also be considered.

If assessee is following cash basis acceptance of claims during the relevant previous year without actual receipt has no significance hence it should be clearly brought out

➢ **When to consider a claim as an accepted claim:**

Mere making claims by the assessee or claims under negotiations cannot constitute accepted claims.

-Escalation claims should arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract.

-Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims.

Part III – Case Discussion

➢ An escalation claims to one of its customers was made but was not accounted as income.

Part IV – Conclusion

➢ Hence a decision whether to report or not, can be taken only after ascertaining the relevant factors as outlined above

QNO 537.000	Cl 16--Examples of Capital Receipts Which may not be Credited to P&L- Bhaskar CNO – TAXAUD.240	Old Course – (M13E, N15E, N16M,P17M, M19M) New Course – (M19M, M19E)
	While writing the audit program for tax audit in respect of A Ltd., you wish to include possible instances of capital receipt if not credited to Profit & Loss Account which needs to be reported under clause 16(e) of form 3CD. Please elucidate possible instances.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause 16 of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ If there is any capital receipt during the previous year and such amount is not credited to the P&L A/c, then it should be reported by the tax auditor. • **Guidance for reporting capital receipts:** Capital receipts are not generally credited to profit and loss account hence the auditor should take enough care to check out any transaction generating the capital receipts by – o Enquiring whether the assessee is in receipt of any amount of capital nature during the previous year. o Going through the financial statements, in particular reserve account, to ascertain whether the assessee has received any such receipts and credited them directly to reserve account. o Enquiring whether the assessee has credited such receipts to profit and loss account. o Checking that any such receipts is accounted for in terms of method of accounting followed by the assessee. • **Following is an illustrative list of capital receipts which, if not credited to P&l, are to be stated under clause 16 of Form 3CD-** o Government grants received in the form of Capital subsidy, which are in the nature of promoters' contribution i.e., they are given. o With reference to the total investment of the undertaking or o By way of contribution to its total capital outlay. *For e.g.- Capital Investment Subsidy Scheme*. o Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value. o Compensation for surrendering certain rights. o Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.	

QNO 537.500	Cl 16--Refund of Customs Duty Note Recorded Bhaskar CNO – TAXAUD.240	Old Course – (M12E, M13E, M14R)
	T Ltd's previous year ended on 31st March 2012 During that period it made a claim for refund of customs duty which was admitted as due by the customs authorities during April 2012 T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 16(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year .Further T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 13(b) of Form 3CD which requires reporting on change in accounting method employed Comment	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause 16 of Form 3CD ▪ Clause 13(b)of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ **As per Clause 16(b) of Form 3CD**, The details of the Refund duty of custom, if admitted as due by the concerned authorities but not credited to the profit and loss account, are to be stated. But the Credits/Claims which have been admitted as due after the relevant previous year need not be reported in Form 3 CD. ➢ **Further Clause 13(b) of Form 3CD**, Requires reporting when there has been any change in the method of accounting employed vis-a-	

vis the accounting method employed in the immediately preceding year.

Part III – Case Discussion

- T Ltd.'s made a claim for refund of customs duty which was admitted as due by the customs. T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 16(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year.
- Further T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 13(b) of Form 3CD which requires reporting on change in accounting method employed .

Part IV – Conclusion

- In the instant case, the action of T Ltd in not crediting the claim to the profit and loss account and also not reporting of the same in Clause 16(b) of Form 3CD is in order.
- However, change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under Clause 13(b). It may be noted that change in the method of valuation of stock will amount to a change in accounting policy. However, it should be disclosed in the financial statements.

QNO 537.600	**Cl 16--Duty Drawback Case study** **BHASKAR CNO-- TAXAUD.240**	**New Course –(M23R)**

CA. Gunjan is conducting tax audit of a company. The client is engaged in business of manufacturing and export of carpets (Turnover `100 crore in year 2021-22). The financial statements of the company show amount of `4 crore credited in Statement of Profit and Loss on account of "Duty Drawback".

a) How should she perform audit procedures to comply with specific reporting requirements under Form 3CD in this respect?

b) It was noticed that amount of ` 5 lac of duty drawback pertaining to few export shipments has not been credited in Statement of Profit and loss. The above noted amount was admitted by customs authorities in month of March 2022. However, it was electronically transferred to bank account of the company in next financial year. How should she deal with the matter?

Answer

a) Under Clause 16(b) of Form 3CD, proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned and not credited to the profit and loss account are to be reported.

The details of the following claims, if admitted as due by the concerned authorities but not credited to the profit and loss account, are to be stated under clause 16(b)

i. Pro forma credits
ii. Drawback
iii. Refund of duty of customs
iv. Refund of excise duty
v. Refund of service tax
vi. Refund of sales tax or value added tax or GST

All relevant correspondence, records and evidence should be examined to determine whether any refund/claim has been admitted as due and accepted during the relevant financial year. The words' admitted by the concerned authorities' would mean 'admitted by the authorities within the relevant previous year'.

Therefore, the tax auditor may need to scrutinise the relevant files or subsequent records, including copies of shipping bills, etc., relating to such refunds while verifying the particulars. Besides, appropriate management representation should also be obtained.

b) A drawback of `5 lac is noticed as admitted by customs authorities, which has not been credited to the Statement of Profit and loss. A company has to maintain accounts on accrual basis in accordance with section 128 of Companies Act, 2013. As admitted drawback has not been credited in the statement of Profit and loss, the same should be reported under clause 16(b) of Form 3CD

QNO 539.000	Cl 17--Difference in Sale Price and Stamp Duty Value- Bhaskar CNO – TAXAUD.240	Old Course – (M15R, M16R, P17M, M17M, N19E) New Course – (S21M)

As a tax auditor, how would you report on the following situations?

M/s. N.S. Enterprises, a manufacturing concern, sold a house property in Mumbai for a consideration of Rs 48 lakh, to Mr. Gunaj on 1.8.2015. M/s. N. S. Enterprises had purchased the house property in the year 2013 for Rs 40 lakh. The stamp duty value on the date of transfer, i.e., 1.8.2015, is Rs 85 lakh for the house property.

OR

A is the proprietor of a firm M/s ABC & Co. The firm is expecting a turnover of ` 900 lakhs during the financial year ending 31/03/2021. The firm sold C during the year for a consideration of ` 15 lakhs, whose value for stamp duty purposes was ` 16 lakhs. As' the Tax Auditor of the said firm, is the above required to be reported? If yes, how will you report the same?

Answer

Part I -- Relevant Standards & Laws

- Clause 17 of Form 3CD
- Section 43CA or 50C of Income Tax Act 1961

Part II -- Requirements of Relevant Standards & Laws

➢ In this case, M/s N.S. Enterprises is a manufacturing concern and sold the house property in Mumbai for a consideration of Rs 48 Lakh which is less than value assessed by Government i.e. Stamp Duty value of Rs 85 Lakh.

Provisions and Explanations:

As per Clause 17 of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C**.**

(Amendment- Difference will be taxed only if stamp act value exceeds 110% of consideration. E.g. if Consideration is 100 and Stamp Act value is 103 then difference will not be taxable.) as under:

Details of Property	Consideration received or accrued	Value adopted or assessed or assessable	**Whether provisions of second proviso to subsection (1) of section 43CA or fourth proviso to clause (x) of sub-section (2) of section 56 applicable? [Yes/No]**

The Auditor should obtain a list of all properties transferred by the assessee during the previous year. He may also verify the same from the statement of profit and loss or balance sheet, as the case may be. Further, the auditor has to furnish the amount of consideration received or accrued, during the relevant previous year of audit, in respect of land/building transferred during the year as disclosed in the books of account of the assessee.

For reporting the value adopted or assessed or assessable, the auditor should obtain from the assessee a copy of the registered sale deed in case, the property is registered. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation to satisfy the compliance of section 43CA / section 50C of the Act. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report 3CA/CB.

Part III – Case Discussion

➢ House property sold in Mumbai to Mr. Gunaj on 1.8.2015. For a consideration of 48 lakh, stamp duty value on the date of transfer, i.e., 1.8.2015, is Rs 85 lakh.

➢ House property was purchased by M/s. N. S. Enterprises in the year 2013 for Rs 40 lakh.

Part IV – Conclusion

➢ As already discussed in fact of the cases, M/s. N. S. Enterprises, has sold the house property to Mr. Gunjan which is less than stamp duty value. Hence, tax auditor is required to report on the same under Clause 17 of Form 3CD.

Authors Note

The answer speaks about the amendment that has taken place in section 50C and 43CA of the Income Tax Act 1961 , but it is to be noted that such amendment even though introduced by Finance Act 18 is

	applicable from 1-4-19 . **No change has been made in the Form 3 CD yet, it may be done later to match up with the section 50C and 43 CA.** **For Exam -If any question specifies the transaction date after 1/4/19 then only this amendment shall be applicable.**

QNO 540.000	**Cl 19--Scientific Research Asset-** **Bhaskar CNO – TAXAUD.240**	**Old Course – (M09R, N12E, P17M)**
	As an auditor of a partnership firm under section 44AB of the Income Tax Act, 1961, how would you report on the following: **Capital expenditure incurred for scientific research assets**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 35 of the Income- Tax Act, 1961 **Part II -- Requirements of Relevant Standards & Laws** ➢ Section 35 of the Income- Tax Act, 1961 covers expenditure on Scientific Research (capital as well as revenue). The tax auditor is required to report the same under clause 19 of Form 3CDin the following manner: • amount debited to the P&L, and • amounts ○ admissible as per the provisions of the Income-tax Act, 1961 **and** ○ also fulfils the conditions, if any specified under the relevant provisions of Income-tax Act, 1961 **or** ○ Income-tax Rules, 1962 or any other guidelines, circular, etc., issued in this behalf**.**	

QNO 542.000	**Cl 21--Cash Payment Exceeding Prescribed Limit (Hotel Payments)** **Bhaskar CNO – TAXAUD.240**	**Old Course – (N14E, P17M)**
	XYZ Ltd. pays Rs 90000 for its 6 employees to a Hotel as boarding and lodging expenses of such employees for a conference. The Company pays the amount in cash to the Hotel. The Hotel gives 6 bills each amounting to Rs 15000. The Company contends that each bill is within the limit, so there is no violation of the provisions of the Income Tax Act, 1961. As the tax auditor, how would you deal with the matter in your tax audit report for the Assessment Year 2015-16?	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 44AB of the Income Tax Act, 1961 ▪ Section 40A (3) of the Income Tax Act, 1961 to be read with Rule 6DD ▪ Clause 21(d)(A) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ **Section 44AB of the Income Tax Act, 1961** As per section 44AB of the Income Tax Act, 1961, the tax auditor should report whether in his opinion the particulars in respect of Form 3CD are true and correct. It is the primary responsibility of the assessee to prepare the information in form 3CD. ➢ **Section 40A (3) of the Income Tax Act, 1961 to be read with Rule 6DD** Disallowance under section 40A(3) of the Income Tax Act, 1961 is attracted if the assessee incurs any expenses in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft, exceeds Rs 10,000. ➢ **Rule 6DD** However, exemption is provided in respect of certain expenditure in Rule 6DD. In such cases, disallowance under section 40A (3) would not be attracted. ➢ **Clause 21(d)(A) of Form 3CD** Furthermore, under clause 21(d)(A) of Form 3CD, the tax auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clause.	

Part III – Case Discussion

- In the given case, the tax auditor found that a hotel issued 6 bills to XYZ Ltd. each amounting to Rs 15,000 for boarding & lodging expenses of 6 employees. XYZ Ltd. in aggregate has paid Rs 90,000 to the hotel in cash.

Part IV – Conclusion

- Contention of the company that each bill is within the limit is not tenable since aggregate of payments need to be considered. Consequently, no expenditure shall be allowed for deduction as per the provisions of section 40A (3), the payments made by the XYZ Ltd. are inadmissible under section 40A (3) of the Income Tax Act, 1961 and hence, needs to be reported under clause 21(d) (A) of Form 3CD.

QNO 543.000	Cl 21--Cash Payment Exceeding Prescribed Limit (Transporter)- Bhaskar CNO – TAXAUD.240	Old Course – (N15R, N16M, P17M, M18M, N18E) New Course – (N21M)

Ploy Ltd., engaged in the leasing of goods carriage, appointed you as the tax auditor for the financial year 2017-18. How would you deal with the following payments relating to the leasing transactions in your tax audit report?

(i) Payments of 6 invoices of Rs 5,000 each made in cash to Mr. X on 4th July, 2017.

(ii) Payments of 2 invoices of Rs 18,000 each made in cash to Mr. Y on 5th July, 2017 and 6th July, 2017 respectively.

(iii) Payment of Rs 40,000 made in cash to Mr. Z on 7th July, 2017 against an invoice for expenses booked in 2016-17.

Answer

Part I -- Relevant Standards & Laws

- Section 44AB of the Income Tax Act, 1961
- Section 40A (3) & Section 40A (3A) of the Income Tax Act, 1961
- Clause 21(d)(A) of Form 3CD

Part II -- Requirements of Relevant Standards & Laws

➢ **Section 44AB of the Income Tax Act, 1961**

As per section 44AB of the Income Tax Act, 1961, the tax auditor should report whether in his opinion the particulars in respect of Form 3CD are true and correct.

It is the primary responsibility of the assessee to prepare the information in form 3CD.

➢ **Section 40A (3) of the Income Tax Act, 1961 to be read with**

Disallowance under section 40A(3) of the Income Tax Act, 1961 is attracted if the assessee incurs any expenses in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft, exceeds Rs 10,000. However, in case of payment made for plying, hiring or leasing of goods carriage, limit is Rs 35,000 instead of Rs 10,000.

➢ **Section 40A (3A) of the Income Tax Act, 1961**

Further, as per section 40A(3A) of the Income Tax Act, 1961, where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payments made to a person in a day, exceeds Rs 10,000 (Rs 35,000 in case of plying, hiring or leasing of goods carriages).

➢ **Rule 6DD**

However, exemption is provided under Rule 6DD having regard to nature and extent of banking facilities available and other relevant factors.

➢ **Clause 21(d)(A) and 21(d)(B) of Form 3CD**

Subsequently, under clause 21(d) (A) and 21(d) (B) of Form 3CD, the tax auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A (3) and 40A (3A) respectively read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clauses.

	Part III – Case Discussion & Conclusion ➢ Therefore, as per the provisions and explanations discussed above, the given cases are dealt as under- • Payments of 6 invoices of Rs 5,000 each aggregating Rs 30,000 made in cash on 4th July, 2017 need not be reported as the aggregate of payments do not exceed Rs 35,000. • Payments of 2 invoices of Rs 18,000 each made in cash on 5th July, 2017 and 6th July, 2017 respectively aggregating Rs 36,000 need not be reported as the payment does not exceed Rs 35,000 in a day. • Payment of Rs 40,000 made in cash against an invoice for expenses booked in 2016-17 is likely to be deemed to be the profits and gains of business or profession under section 40A(3A) of the Income Tax Act, 1961. Thus, the details of such amount need to be furnished under clause 21(d) (B) of Form 3CD.
	Author's Note Limit of 35000 is applicable when payment is made for plying, hiring or leasing goods carriage, such payment can be made by any business, it can be transporter or anyone else. Purpose should be seen and not the nature of assesses business. Further question clearly specifies that payment is for leasing, so limit of 35000 is relevant.

QNO 544.000	**Cl 21--Entrance fees paid to Clubs-** **Bhaskar CNO – TAXAUD.240**	**Old Course – (N11E, M12R, N12E, P17M, N20R)** **New Course –(N20R)**
	Case 1 **As an auditor of a partnership firm under section 44AB of the Income Tax Act, 1961, how would you report on the following:** **Expenditure incurred at clubs.** **OR** **Case 2** **M/s PQRS & Associates is appointed for conducting tax audit as per Income Tax Act ,1961 of QW Ltd., a cotton textile company. The Company had incurred ` 6 lac towards advertisement expenditure on a brochure/ pamphlet published by a political party in Pune. Advise the auditor whether such expenditure should be included in the tax audit report or not.**	
Answer	**Part I -- Relevant Standards & Laws** ➢ Clause 21(a) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ **Case 1** As per Clause 21(a) of Form 3CD, the amount of expenditure incurred at clubs by the assessee during the year being entrance fees and subscriptions and being cost for club services and facilities used should be indicated. The payments made may be in respect of directors and other employees in case of companies, and for partners or proprietors in other cases. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. The tax auditor is required to furnish the details of amounts debited to the profit and loss account, being in the nature of capital, personal, advertisement expenditure etc. ➢ **Case 2** As per Clause 21(a) of Form 3CD, the auditor is required to furnish the details of amounts debited to the Profit and Loss Account, being in the nature of advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like published by a political party in his tax audit report. In the given situation, M/s PQRS & Associates is appointed for conducting tax audit as per Income Tax Act, 1961 of QW Ltd., a cotton textile company. The Company had incurred ` 6lac towards advertisement expenditure on a brochure/ pamphlet published by apolitical party. Therefore, advertisement expenditure of ` 6 lac on brochure/pamphlet published by a political party shall be reported in the tax audit report as per Clause 21 (a) of Form3CD.	

QNO 545.000	Cl 21--No Bank Account Facility- Bhaskar CNO – TAXAUD.240	Old Course – (N10E, N12R, N12M, M14R, P17M, N18M)
	Mr. R, the Tax Auditor finds that some payments inadmissible under Section 40A (3) were made and advised the client to report the same in form 3CD. The client contends that cash payments were made since the other parties insisted upon the same and did not have Bank Accounts. Comment.	

Answer

Part I -- Relevant Standards & Laws

Section 44AB of the Income Tax Act 1961

Part II -- Requirements of Relevant Standards & Laws

- **Section 44AB of the Income Tax Act 1961**

  The audit under section 44AB of the Income Tax Act 1961 requires that the tax auditor should report whether in his opinion the particulars in respect of Form 3CD are true and correct. It is the primary responsibility of the assessee to prepare the information in form 3CD.The auditor has to examine whether the information given is true and correct. The form 3CD is not a report of Tax Auditor. The report is in the form of 3CA or 3CB depending on the nature of the organization of the entity. If the tax auditor is satisfied that the information contained in form 3CD is true and correct, then he can give unqualified report in form 3CA or 3CB saying" in my opinion and to the best of my information and according to the explanations given to me and considering the materiality the particulars given in form 3CD are true and correct."

- **Section 40A (3) of the Income Tax Act, 1961**

  Disallowance under section 40A(3) is attracted if the assessee incurs any expenses in respect of which payment of aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft exceeds Rs 10,000.

  - **Rule 6DD**

    However, exemption is provided in respect of certain expenditure in Rule 6DD. In such cases, disallowance under section 40A (3) would not be attracted.

  - **Clause 21(d)(A) of Form 3CD**

    Under clause 21(d)(A) of Form 3CD, the tax auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clause.

Part III – Case Discussion

- Mr. R, the Tax Auditor finds that some payments inadmissible under Section 40A(3) were made, contends that cash payments were made since the other parties insisted upon the same and did not have Bank Accounts hence no reporting is required in Form 3CD.

Part IV – Conclusion

- **In the given case the tax auditor has found that the form 3CD contains the incomplete, misleading and false information as cash payment made on insistence of other parties on the contention that they do not have bank accounts is not covered under the list of exceptions provided under Rule 6DD.** Therefore, Mr. R has to report the payments inadmissible under section 40A (3) under clause 21(d) (A) of Form 3CD.

QNO 545.400	Cl 21--Expense Related to Exempt Income Bhaskar CNO – TAXAUD.240	New Course – (M22E)
	"M/s PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s PQR Auto for the Assessment Year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income-tax Act, 1961. CA S observed following: **(ii) Interest payment 10,000 was incurred in relation to earning exempt interest income from Tax Relief bonds.**	

Answer

- As per Clause 21(h) of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income-tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total income.

	➢ Therefore, CA. S, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount and mention against the clause. ➢ Thus, in the given situation, CA. S is required to report the same as per clause 21 (h) of Form 3CD of the Income-tax Act, 1961.

QNO 545.500	**Cl 22--Interest under MSMED Act** **Bhaskar CNO – TAXAUD.240**	**New Course – (M22E)**
	"M/s PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s PQR Auto for the Assessment Year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income-tax Act, 1961. CA S observed following: **(i) Interest of 50,000 paid to Vendor X who was registered under MSME Act, 2006.**	
Answer	➢ As per Clause 22 of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income-tax Act,1961. ➢ Accordingly, the CA. S is required to report the payment of interest of ` 50,000 to Vendor X who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income-tax Act, 1961.	

QNO 546.000	**Cl 23--Rent paid to Brother-** **Bhaskar CNO – TAXAUD.240**	**Old Course – (N08R, N11E, N12R,N14R, M16M, P17M,N17E)**
	The assessee has paid rent of Rs 5 lakhs for premises to his brother.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause 23 of Form 3CD ▪ Section 40A(2) of the Income Tax Act, 1961 ▪ Clause 34 of Form 3CD ▪ Clause 21(b) & 21(d) of Form 3CD. **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause 23 of Form 3CD & Section 40A(2)(b) of the Income Tax Act, 1961** A tax auditor has to report under Clause 23 of Form 3CD which deals with the particulars of payments made to persons specified under section 40A(2)(b) of the Income Tax Act, 1961. Where the assessee is an individual, the specified persons include any relative of the assessee (i.e. Husband, Wife, Brother, Sister or any other Lineal Ascendant or Descendant). ➢ **Section 40A(2)(a) of the Income Tax Act, 1961** As per section payments to persons specified under section 40A(2)(b) of the Income Tax Act, 1961 may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to: • the fair market value of the goods, services or facilities for which the payment is made; or • for the legitimate needs of business or profession of the assessee; or • the benefit derived by or accruing to the assessee from such expenditure **Part III – Case Discussion** ➢ In the present case, an assessee has paid rent to his brother Rs 5,00,000 **Part IV – Conclusion** ➢ Hence, if the payment is made to a person specified under 40A(2)(b) reporting under Clause 23 of Form 3CD is required to be done, whether excessive or not. ➢ **Beside above following shall also be taken into consideration:** • **Clause 34(a) of form 3CD** Details of TDS (if applicable) will required to be reported under clause 34(a) of form 3CD. • **Clause 21(b) of Form 3CD** In case if there is noncompliance with TDS provisions, details of disallowance of expenditure will required to be reported under clause 21(b) of Form 3CD.	

- **Clause 21(d) of Form 3CD**
  Moreover, if the payment is made in cash reporting will also be required under clause 21(d) of Form 3CD.

QNO 546.050	Cl 25-- Bad Debts Recovered Bhaskar CNO – TAXAUD.240	New Course – (M21E)
	M/s RB Ltd. is engaged in the trading of engineering goods. Turnover of the Company for the year ended 31.03.2021 was Rs. 150.00 crores. During the F.Y. 2018-2019, the Company claimed deduction of bad debts amounting to Rs. 100.00 lakhs while filing income tax return (Out of total debts of Rs. 150.00 lakhs due from Mr. X). However, during the F.Y. 2020-2021, the Company was able to recover Rs. 75.00 lakhs from Mr. X through legal means and correctly credited to its profit and loss account. As a tax auditor, is it required to report such transactions in Tax Audit report under Income Tax Act, 1961?	

Answer

Part I -- Relevant Standards & Laws

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

Part II -- Requirements of Relevant Standards & Laws

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

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

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

Bad debts recovered are chargeable to tax under section 41, so details should be given irrespective whether it is credited to P&L.

Part III – Case Discussion

Company was able to recover Rs. 75.00 lakhs from Mr. X through legal means and correctly credited to its profit and loss account.

Part IV – Conclusion

Bad debt recovery should be reported under clause 25

QNO 546.100	Report under clause 26(A) and 26(B) in reference of section 43 B- Bhaskar CNO – TAXAUD.240	Old Course – (N19R, N19M) New Course –(N19M, N19R)
	"You are doing Tax Audit of Private Limited Company for the financial year ending 31st March, 2019. During audit, you notice that the company is not regular in deposit of VAT/GST and there remains pendency every year. The details of VAT/GST payable are: **(i) GST payable as on 31/03/2018 of FY 2017-18 was Rs 200 Lakh and out of which Rs 100 Lakh was paid on 15/09/2018 and Rs 50 Lakh on 30/03/2019 and balance of Rs 50 Lakh paid on 16/09/2019.** **(ii) GST payable of current financial year 2018-19 was Rs 100 lakh and out of this, Rs 40 Lakh was paid on 25/05/2018 and balance of Rs 60 Lakh remained unpaid till the due date of return.** **The date of Tax Audit report and due date of return was 30th September.** **Now as a Tax Auditor, how/where the said transaction will be reflected in Tax Audit Report under Section 43B (a)?"**	

Answer **Reporting in Tax Audit Report**:

Any amount of GST/Tax payable on the last day of previous year (opening balance) as well as on the last day of current year has to be reported in Tax Audit Report under clause 26(A) and 26(B) in reference of section 43 B.

Clause 26 (A) dealt GST/VAT payable on the pre-existed of the first day of the previous year but was not allowed in the assessment of any preceding previous year and was either paid {clause 26(A) (a)}/ or/ and/ not paid during the previous year {clause 26(A)(b)}

The details will be as under in regard to opening balances:

Liability Pre-existed on the previous year.

Sr. No.	Section	Nature of Liability	Outstanding Opening balance not allowed in previous year	Amount paid/set-off during the year	Amount written back to P&L Account	Amount unpaid at the end of the year
01	43B(a)	VAT/GST	100 lakh	50 lakh	0	50 lakh

It has been assumed that 100 lakh was allowed in last year as it was paid before the due date of return

Liability incurred during the previous year

Sr. No.	Section	Nature of Liability	Amount incurred in previous year but remaining outstanding on last day of previous year.	Amount paid/set-off before the due date of filing return/date upto which reported in the tax audit report, whichever is earlier	Amount unpaid on the due of filing of return/date upto which reported in the tax audit report, whichever is earlier
01	43B(a)	VAT/GST	100 lakh	40 lakh	60 lakh

Author's Note

We are doing reporting for FY 18-19

i) **Details of Opening Balance & How much is paid during the current financial year ?**

100 lakhs from last year is outstanding and 50 lakhs is paid by 31ist March 2019, Remaining is paid after year end.

ii) **Details of CY GST Payable**

CY GST 100 lakhs Out of that 40 Lakhs is paid before filing return and 60 lakhs is outstanding.

In case of opening balance they are taking 31st March as cutoff dateand incase CY GST return date is taken as cut-off

QNO 546.500	Report under clause 27(b) of 3CD Bhaskar CNO – TAXAUD.240	Old Course – (N19E) New Course – (S21M)
	How will you verify the Income & Expenditure of earlier years credited/debited in current year for reporting under clause 27(b) of 3CD while carrying out Tax Audit u/s 44AB of the Income Tax Act, 1961?	
Answer	➢ **Clause 27(b) of 3CD- Particulars of income or expenditure of prior period credited or debited to the profit and loss account to be verified as:** • It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting. • Under cash system of accounting, expenses debited/ income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years. • The tax auditor should obtain the particulars of expenditure or income of any earlier year debited or credited to the profit and loss account of the relevant previous year when mercantile system of accounting is followed. • In the case of a person whose accounts of the business or profession have been audited under any other law, the information may be available from annual accounts. • In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, however, a close scrutiny of the ledger in regard to the period for which expenditure or income is entered in the account books may be necessary. • The tax auditor should maintain the following information in his working papers file for the purpose of reporting in the format provided in the e-filing utility:	

QNO 546.600	Cl 29A & Others--(Case Study) BHASKAR CNO—TAXAUD.240	New Course – (M23M)
	M/s Vrinda Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA Mahaveer was appointed as the Tax Auditor of M/s Vrinda Auto for the Assessment year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income Tax Act, 1961. CA Mahaveer observed following: **i. Interest of ` 50,000 paid to Vendor Ghanshyam who was registered under MSME Act, 2006.** **ii. Interest payment ` 10,000 was incurred in relation to earning exempt interest income from Tax Relief bonds.** **iii. Sum of ` 1,00,000 was received from Mr. Ghanshyam, for sale of one plant and machinery. But due to non-compliance of one of the conditions as specified in the contract with Mr. Ghanshyam, M/s Vrinda Auto forfeited ` 1,00,000 during AY 2022-23 as per forfeiture clause mentioned in the contract** **Guide CA Mahaveer in reporting the above transactions under the relevant clauses in Form No. 3CD.**	
Answer	i. As per Clause 22 of Form 3CD of the Income Tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income Tax Act,1961. Accordingly, the CA. Mahaveer is required to report the payment of interest of 50,000 to Vendor Ghanshyam who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income Tax Act, 1961. ii. As per Clause 21(h) of Form 3CD of the Income Tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income Tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total income. Therefore, CA. Mahaveer, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount and mention against the clause. Thus, in the given situation, CA. Mahaveer is required to report the same as per clause 21 (h) of Form 3CD of the Income Tax Act, 1961	

iii. As per Clause 29(A) of Form 3CD of the Income Tax Act, 1961 of the Income Tax Act, 1961, the auditor is required to report,

a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income Tax Act, 1961

b) If yes, to provide the nature of income and amount thereof.

The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year and ex amine whether any amount of such advances has been written back during the year and examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance and such conditions have occurred, then should verify whether the amount has been actually forfeited.

Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income Tax Act, 1961

QNO 547.000	Cl 29B --Shares Received 1,000- Bhaskar CNO – TAXAUD.240	Old Course – (M16E, P17M) New Course— (S17M, N19E, M18M)

ABC Pvt. Ltd. and XYZ Pvt. Ltd. are the companies in which public are not substantially interested. During the previous year 2018-19, ABC Pvt. Ltd. received some property, being shares of XYZ Pvt. Ltd., the details of which are provided below:

No. of Shares: 1,000
Aggregate fair market value of shares: Rs 75,000
Consideration value: Nil

The management of the company contends that the shares need not to be furnished in Form No. 3CD. As the tax auditor of ABC Pvt. Ltd., how would you deal with the matter?

OR

While doing Tax Audit, under section 44AB of the Income Tax Act, 1961, of the accounts of Glue Private Limited for the Assessment Year 2018-19, it was found that during the Financial Year 2017-18, Glue Private Limited had received 9,000 shares, the market value of which was Rs 90,000 on the date of transfer, at a price of Rs 45,000 from Stick Private Limited. The Management of Glue Private Limited maintained that the transaction was as per the terms of negotiations and there would be no cause for the Auditor to bring this matter in his Tax Audit Report-Comment.

Answer

Part I -- Relevant Standards & Laws

- Clause 29B of Form 3CD
- Section 56(2)(x) of Income Tax Act, 1961

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause 29B of Form 3CD**

A tax auditor has to furnish the details of shares received during the previous year, under clause 29B of Form 3CD, in case, the assessee has received any property, being share of a company not being a company in which public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2) (x) of the Income Tax Act, 1961.

➢ **Section 56(2)(x) of Income Tax Act, 1961**

Where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year any property being shares of a company not being a company in which the public is substantially interested,

- without consideration, the aggregate fair market value of which exceeds Rs 50,000, the whole of the aggregate fair market value of such property;
- for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration, shall be chargeable to income-tax under the head "Income from other sources".

  The fair market value of shares means the value as determined in accordance with the method prescribed in Income Tax Rules, 1962.

Part III – Case Discussion

➢ In this case, ABC Pvt. Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2018-19, the company received property, being shares, for no

consideration, the aggregate fair market value of which is s Rs 75,000.

Part IV – Conclusion

- As per the facts of the case, provisions and explanations given above, the income generated by ABC Pvt. Ltd., being whole of the aggregate fair market value of shares received (i.e. Rs 75,000), is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(x) of the Income Tax Act, 1961.

  Therefore, the tax auditor of ABC Pvt. Ltd. is required to furnish the details of such shares received under clause 29B of Form 3CD. The contention of the management of the company, for not reporting such receipt of shares, is not acceptable.

Author's Notes:
Clause 28 was relevant till 1st April 2017, now such cases are covered in Clause 29B

QNO 548.000	Cl 29--Shares Issued 1,00,000- Bhaskar CNO – TAXAUD.240	Old Course – (M16R, P17M) New Course – (N18M)

AB Ltd. is a company in which public are not substantially interested. During the previous year 2014-15, the company issued shares to residents of India and provides you the following data related to such issue:

No. of shares issued	**1,00,000**
Face Value	**Rs 10 per share**
Fair Market Value (FMV)	**Rs 60 per share**
Consideration received	**Rs 80 per share**

The management of the company contends that, it is a normal issue of shares, thus, needs not to be reported. As the tax auditor of AB Ltd., how would you deal with the matter in your tax audit report?

Answer

Part I -- Relevant Standards & Laws

- Clause 29 of Form 3CD
- Section 56(2)(vii b) of the Income Tax Act, 1961

Part II -- Requirements of Relevant Standards & Laws

- **Clause 29 of Form 3CD**

  A tax auditor has to furnish the details of shares issued during the previous year, under clause 29 of Form 3CD, in case, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib) of the Income Tax Act, 1961.

- **Section 56(2)(vii b) of the Income Tax Act, 1961**

  Section 56(2) (viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

  Since section 56(2) (viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assessee. The auditor should obtain from the auditee, a list containing the details of shares issued, if any, by him to any person being a resident and verify the same from the books of accounts and other relevant documents.

Part III – Case Discussion

- In this case, AB Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2014-15, it receives consideration for issue of shares (i.e. Rs 80 per share) which exceeds the face value (i.e. Rs 10 per share) and fair market value of the shares (i.e. Rs 60 per share).

Part IV – Conclusion

- As per the facts of the case, provisions and explanations given above, the income generated by AB Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961.

  Therefore, the tax auditor of AB Ltd. is required to furnish the details of shares issued under clause

	29 of Form 3CD. The contention of the management of the company, behind non-reporting, that it is a normal issue of shares, is not acceptable.

QNO 548.500	Cl 29A-- Forfeiture of Advance for Capital Asset- Bhaskar CNO – TAXAUD.240	New Course – (M22E)
	M/s PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s PQR Auto for the Assessment Year 2022-2023. While carrying out the Tax Audit under section 44AB of the Income-tax Act, 1961. CA S observed following: **(I) Sum of 1,00,000 was received from Mr. X, for sale of one plant and machinery. But due to non-compliance of one of the conditions as specified in the contract with Mr. X, M/s. PQR Auto forfeited 1,00,000 during AY 2022-23 as per forfeiture clause mentioned in the contract.** **Guide CA S in reporting the above transactions under the relevant clauses in Form No. 3CD**	
Answer	As per Clause 29(A) of Form 3CD of the Income-tax Act, 1961 of the Income-tax Act, 1961, the auditor is required to report, (a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income-tax Act, 1961. (b) If yes, to provide the nature of income and amount thereof. The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year and examine whether any amount of such advances has been written back during the year and examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance and such conditions have occurred, then should verify whether the amount has been forfeited. Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income-tax Act, 1961.	

QNO 549.000	Cl 31--Theory of Cl 31- Bhaskar CNO – TAXAUD.240	Old Course – (N11E, M16M, P17M, N17E)
	As an auditor appointed under section 44AB of the Income Tax Act, 1961, how would you verify and report on the following: **The assesse has borrowed Rs 50 lakhs from various persons-partly in cash and partly by account payee cheque.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause 31(a) of Form 3CD ▪ Clause 31(c) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause 31(a) of Form 3CD** As per Clause 31 of Form 3CD the particulars of each loan or deposit exceeding the limit specified in Section 269SS taken or accepted during the previous year have to be stated in the Tax Audit Report. ➢ **Clause 31(c) of Form 3CD** In addition, as per Clause 31(c) the tax auditor has to state whether the taking or accepting loan or deposit, or repayment of the same were made by account payee cheque drawn on a bank or account payee bank draft based on the examination of books of account and other relevant documents. The tax auditor has the responsibility to verify the compliance with the provisions of section 269SS and 269T of the Income Tax Act. **Part III – Case Discussion** ➢ Assessee has borrowed Rs 50 lakhs from various persons-partly in cash and partly by account payee cheque. **Part IV – Conclusion** ➢ Therefore, in the present case, where the assessee has borrowed Rs 50 Lakhs by way of cash and partly by way of Account payee cheque, needs to be verified and to be reported in compliance with Clause 31(a) & 31 (c) of Form 3CD.	

QNO 549.500	Cl 18 -- Foreign currency gain loss should be adjusted in cost of asset. Cl 31 -- Cash payment for capital goods Bhaskar CNO – TAXAUD.240	Old Course – (M21E)

As an auditor of a partnership firm under section 44 AB of the Income Tax Act, 1961, how would you report on the following:

(i) M/s WAR wants to purchase a new machine which is available for Rs. 45,000, if purchased on 45 days credit and for Rs. 40,000, if purchased by cash. The machine is purchased by paying cash on 01/05/2019 and depreciation on it charged to profit and loss account is Rs. 6000.

(ii) Technical support is received from Mr. DND, a non-resident for installation of a new machinery. He has raised invoice dated 01/05/2019 in USD equivalent to Rs. 5,00,000. The entire dues are cleared through appropriate banking channel on 25/06/2019.

Answer

Case (i) As per section 43(1) to the Income-tax Act, 1961, the expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds Rs.10,000, such expenditure shall not form part of actual cost of such asset.

In the given case, M/s. WAR purchased a new machine by paying cash amounting rupees 45,000 and charged the depreciation of rupees 6,000 to profit and loss account on the same. According to section 43(1), rupees 45,000 paid in cash will not form part of actual cost of such asset. Therefore, depreciation on the same is also not allowable.

The tax auditor is required to report on the same in accordance with Clause 18.

As per Clause 18 of Form 3CD, tax auditor is required to report the particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form: -

Clause 18 (d)	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of –
Clause 18 (e)	Depreciation allowable.
Clause 18 (f)	Written down value at the end of the year.

Case (ii) In the given case, technical support received from Mr. DND, a non-resident, is for installation of new machinery and therefore, it would have been capitalized as the cost of machinery. It is assumed that amount paid through bank was after complying with TDS requirements.

Therefore, the tax auditor will report the same in accordance with Clause 13 (f) of Form 3CD i.e., Disclosure as per ICDS.

Clause 13 (f): Disclosure as per ICDS:

S. No.	ICDS	Disclosure
ICDS V	Tangible Fixed Assets.	Addition of Rs5,00,000 technical support fee to Non-resident being capitalized as the cost of machinery.

QNO 549.600	Cl 31--Cash Receipts Exceeding 2,00,000 Bhaskar CNO – TAXAUD.240	Old Course – (N20E) New Course—(M22M, M23M)

Mr. KK is a contractor dealing in food catering, flower decorating and light decorating activities. He has received contract in respect of food catering and flower decorating from one NGO for holding Annual Talent evening event to celebrate completion of 25 years of their establishment. For the said event Mr. KK has received in cash ` 1,85,000 for food catering and ` 1,25,000 for flower decoration. As a tax auditor

	how would you deal and report on the above?
Answer	Section 269ST provides that no person shall receive sum of ` 2 lakh or more a) in aggregate from a person in a day; or b) in respect of a single transaction; or c) in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee demand draft or by use of electronic clearing system through a bank account. Further, the tax auditor has the responsibility to verify the compliance with the provisions of 269T of the Income Tax Act. Furthermore, the tax auditor is required to report under Clause 31 (ba) particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account:- (i) Name, address and Permanent Account Number (if available with the assesses) of the payer (ii) Nature of transaction (iii) Amount of receipt (in `) (iv) Date of receipt  In the present case, Mr. KK, contractor dealing in food catering, flower decorating and light decorating activities, received in cash ` 1,85,000 for food catering and ` 1,25,000 for flower decoration from one NGO for holding one event, by way of cash which is exceeding prescribed amount of ` 2,00,000. Thus, tax auditor is required to report the same in compliance with Clause 31 (ba) of Form 3CD.

QNO 549.700	**Exemptions under Sec 269SS** **Bhaskar CNO – TAXAUD.240**	**Old Course – (N20E)**
	The provisions of Sec. 269SS of Income Tax Act, 1961 are not applicable to some organisations. Mention those organisations.	
Answer	As per the proviso to section 269SS, the provisions of section 269SS shall not apply to any loan or deposit taken or accepted from, or any loan or deposit taken or accepted by- **a.** Government **b.** any banking company, post office savings bank or co-operative bank; **c.** any corporation established by a Central, State or Provincial Act; **d.** any Government company as defined in section 2(45) of the Companies Act, 2013; Section 617 of the Companies Act. 1956 has been replaced with section 2(45) in the Companies Act, 2013 with effect from 1.4.2014. **e.** such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette. The auditor should maintain the prescribed information in his working papers for the purpose of reporting against this clause in the format provided in the e-filing utility. These particulars need not be given in case of a Government Company, a banking company or a corporation established by a Central, State or Provincial Act.	

QNO 550.000	**Cl 32--Speculation Loss-** **Bhaskar CNO – TAXAUD.240**	**Old Course – (M15R, P17M, M18E)**
	SL Pvt. Ltd. is a company engaged in the production of wool. Along with its production business, the company is also engaged in buying and selling of securities with the expectation of a favourable price change. It reports the following data for the current financial year:	

S. No.	Particulars	Amount (in Rs)
1	Paid up Share Capital	100 lakhs
2	Capital Reserve	33 lakhs

	3 4 5	Capital Redemption Reserve Revaluation Reserve Speculation Loss on account of Purchase and Sales of Securities	45 lakhs 32 lakhs 12 lakhs

Answer

Part I -- Relevant Standards & Laws

- Clause (32)(e) of Form 3CD
- Explanation to section 73 of Income Tax Act, 1961.

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (32)(e) of Form 3CD**

A tax auditor has to furnish the details of speculation loss incurred during the previous year, under Clause 32(e) of Form 3CD, regarding whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73.

➢ **Explanation to section 73 of Income Tax Act, 1961.**

The Explanation to section 73 provides that where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources" or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Part III – Case Discussion

➢ SL Pvt. Ltd. is engaged in production business and side by side dealing in buying and selling of securities with the intention of speculation. During the current financial year, the company has made Speculation Loss of Rs 12 lakhs.

Part IV – Conclusion

➢ Therefore, the tax auditor of SL Pvt. Ltd. is required to furnish the details under Clause 32(e) of Form 3CD with respect to the speculation loss of Rs 12 lakhs made during the year.

QNO 550.500	Cl 34--Not furnished statement on list of details not reported in Statement of TDS Bhaskar CNO – TAXAUD.240	New Course – (M22M,N22M)

While conducting the tax audit of RRR Ltd. you observed that company has timely filed ETDS return for TDS deducted on salary under section 192 of the Income Tax Act, 1961 in form 24Q in respect of fourth quarter period from 1st January 2021 to 31st March 2021. The company has not furnished list of details which are not reported in the statement of tax deducted at source under the pretext that TDS statements are furnished within the prescribed time. As a Tax Auditor of RRR Ltd. How you would deal and report?

Answer

➢ As per Clause 34 (b) of the Form 3CD, the auditor has to report whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details:

Tax deduction and collection Account Number (TAN)	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported	If not, please furnish list of details/transactions which are not reported

➢ Accordingly, clause 34 (b) requires, a list of details/transactions which are not reported in the statement of tax deducted at source and statement of tax collected at source are required to be furnished. The reporting requirement is notwithstanding the fact that the assessee has furnished the statements of tax deducted at source and tax collected at source within the prescribed time.

➢ In the given situation, RRR Ltd., has timely filed ETDS return for TDS deducted on Salary under section 192 of the Income Tax Act in Form 24Q in respect of 4th quarter. The company has not furnished list of details which are not reported in the statement of tax deducted at source under

	the pretext that TDS Statements are furnished within the prescribed time. Therefore, in view of above, RRR Ltd. is required to furnish list of details which are not reported in the statement of tax deducted at source.

QNO 553.000	Cl 37--Cost Audit Report Consists Disqualifications- Bhaskar CNO – TAXAUD.240	Old Course – (N15R, P17M,N17R,N18M) New Course – (N18M)
	Beam Ltd., having principal place of business in Gujarat, is engaged in the generation, transmission, distribution and supply of electricity throughout the India. The management of the company came to know that the provisions related to maintenance of cost records and cost audit are applicable to the company. The company, therefore, appointed a cost auditor for the financial year 2016-17. The cost auditor reported certain disqualifications in Form CRA-3 of the cost audit report to which the management of the company disagreed. The management of Beam Ltd. ingeniously instructed its tax auditor not to reveal any of the disqualifications related to the cost audit while filling particulars to be furnished in Form No. 3CD contending that the disqualifications are not relevant and there is no correlation between tax audit and cost audit as well.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (37) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ A tax auditor is required to ascertain under Clause (37) of Form 3CD whether cost audit was carried out and if yes, provide the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor. The tax auditor should obtain the copy of cost audit from the assessee. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out. **Part III – Case Discussion** ➢ In the given case, the cost auditor of Beam Ltd. has reported certain disqualifications in Form CRA-3 of the cost audit report. **Part IV – Conclusion** ➢ Therefore, the tax auditor of Beam Ltd. is required to provide the details of disqualifications reported by the cost auditor under Clause (37) of the Form 3CD. Thus, the contention of the management of Beam Ltd. not to reveal any of the disqualifications related to the cost audit on the belief that there is no correlation between tax audit and cost audit is not acceptable.	

QNO No. 554.000	Cl 40--Accounting Ratios (Short Note)- Bhaskar CNO – TAXAUD.240	Old Course – (N05E, N07E, M13M, P17M)
	As a tax auditor, which is the accounting ratios required to be mentioned in the report in n case of manufacturing entities? Explain in detail any one of the above ratios and how does it help the tax auditor in his analytical review.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (40) of Form 3CD **Part II -- Requirements of Relevant Standards & Laws** ➢ A tax auditor is required to provide details regarding turnover, gross profit, etc., for the previous year as well as for the preceding previous year in **Clause (40) of Form 3CD**. The ratios which are to be calculated for manufacturing entities are: • Gross profit / Turnover • Net Profit / Turnover • Stock-in-trade/Turnover • Material consumed / Finished goods provided. ➢ Ratio analysis constitutes a substantive auditing procedure designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. Such assessment is necessary in organisation having large volumes of transactions and in the organisation following mechanised accounting system where it is not possible to check each and	

every transaction. It has the merit of bringing to focus the abnormal deviations and unexpected variations which the normal routine checking in auditing may fall to reveal. Ratios highlight only symptoms and that too as of a particular day and the auditor should study these symptoms properly, correlate them and reach definite conclusions or identify areas for further enquiries. The auditor should by relating sales with the net profit, various items of direct and indirect costs and gross profit gather information about the profitability and operating efficiency of an enterprise; variations in any of these ratios in a particular year should be inquired by the auditor. The fall in the gross profit ratio and profitability ratio should alert the auditor who should ask the management for the reasons thereof and which should be carefully examined by him.

These ratios have to be given for the business as a whole and not product wise. While calculating these ratios, the tax auditor should assign a meaning to the terms used in the above ratios having due regard to the generally accepted accounting principles. All the ratios mentioned in the clause are to be calculated in terms of value only.

- The relationship of **stock-in-trade to turnover** over a period of time would reveal whether the entity has been accumulating stocks or there is a decline in the same. The auditor may obtain data for about 7-10 years, compute ratio of stock-in-trade/turnover and plot it on a graph paper over a period of time. This may give rise to several possibilities such as parallel horizontal lines, vertical rising line or a vertical falling line. A study of this relationship would reveal whether stocks are being accumulated or they are dwindling over a period. Such information would provide an input to tax auditor as to whether figures of either stock or turnover are being manipulated. Sometimes, while studying the relationship, it may show sudden decline or increase at a point of time which reflect that there is definitely something wrong with the figures of stock. Therefore, a close examination of such ratios helps the tax auditor to focus on major deviations and consequently reasons for the same.

QNO 555.000	**Cl 41--Demand Order- Bhaskar CNO – TAXAUD.240**	**Old Course – (M15R, P17M)**

Saurabh International Ltd. (SIL) was engaged in providing certain services on which it did not pay any service tax. As per SIL, said services were not liable to service tax. However, Department issued a show cause notice to SIL demanding service tax along with interest worth Rs 5,45,000 on the same and such demand was also confirmed. An appeal was filed to the Commissioner of Central Excise (Appeals) which passed an order which upheld the demand on SIL. SIL, being aggrieved by the order of the Commissioner of Central Excise (Appeals), decided to file an appeal to the CESTAT against such order. SIL has also requested the tax auditor not to report as those services were not liable for service tax and it has also filed an appeal for the same.

Answer

Part I -- Relevant Standards & Laws

- Clause (41) of Form 3CD

Part II -- Requirements of Relevant Standards & Laws

- **Clause 41 of Form 3CD**

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

Part III – Case Discussion

- In the instant case, Saurabh International Ltd. (SIL) is engaged in providing certain services on which it did not paid any service tax. Therefore, Department issued a show cause notice and demand for Service Tax along with interest thereon. SIL has also filed an appeal mentioning that said services are not liable to service tax, but Central Excise (Appeals) has passed an order confirming the demand and SIL being aggrieved by the order of Commissioner of Central Excise (Appeals) decided to file an appeal against the same. SIL also requested the tax auditor not to report on the same as the concerned services were not liable for any service tax and they have also decided to file an appeal to CESTAT against the order of Commissioner of Central Excise (Appeals).

Part IV – Conclusion

- Therefore, the tax auditor should obtain a copy of all the demand/ refund orders issued by the governmental authorities during the previous year under any tax laws other than Income Tax Act and Wealth Tax Act along with its proceeding. It may be noted that even though the

	demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause. In the instant case, reporting of the demand raised by Department and proceeding relating to it including appeal filed by SIL and decision thereon is required to be made by tax auditor as per Clause 41 of Form 3CD. Hence request of SIL, not to report on the same is not acceptable.

QNO 555.500	**Cl 41--Demand Notice under Excise Act** **Bhaskar CNO – TAXAUD.240**	**New Course – (N20E,N22M)**
	M/s. NKB Ltd. is engaged in the manufacturing of textile products having an annual capacity of producing 1,00,000 units of garments. NKB Ltd. is covered under the provisions of Goods and Service Tax Act with an applicable rate of 12%. During the financial year 2019-2020, NKB Ltd. received a demand notice of ` 15.00 Lacs pertaining to the F.Y 2013-14 when the provisions of Central Excise Act were applicable. NKB Ltd. deposited the demand amount after discussing with its legal department. Are you, as a tax auditor of NKB Ltd., required to report the same?	
Answer	NKB Ltd. Is a manufacturer of textile products and is covered under GST Act. During financial year 2019-2020 NKB has received a demand notice of 15 lakhs which pertains to financial year 2013-2014 when the Central Excise Act was prevalent. As a tax auditor of NKB Ltd., reporting would be under Clause 41 which is given hereunder: "Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 along with details of relevant proceedings. " It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause. If there is any adjustment of refund against any demand, the auditor shall also report the same under this clause. In this case, liability is of excise duty i.e. under Central Excise Act, other than Income Tax Act and Wealth Tax Act, thus this clause gets attracted and the reporting has to be done as per format:	

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

QNO 555.600	**Cl 42--Form 61 & 61A Submitted** **Bhaskar CNO – TAXAUD.240**	**(N21E)**
	CA Nitesh, while carrying out the Tax audit of PQR Ltd. observed that PQR Ltd. has entered into specified financial transactions covered under Section 285BA of the Income tax Act, 1961. PQR Ltd. has furnished statement of the specified financial transaction in Form No 61 & Form No. 61A.Guide CA Nitesh with reporting requirements under clause 42 of Form 3CD? The management contends that tax auditor need not report, if the transactions are not covered in the ambit of Section 269ST. Comment.	
Answer	Clause 42 has been introduced where the tax auditor has to report that whether the taxpayer is required to furnish a statement of the specified financial transaction (in Form No.61 or Form No. 61A or Form No. 61B). With respect to Form 61, the tax auditor should verify whether the taxpayer has enter ed into any transaction where the other party was required to quote PAN. He should verify whether the taxpayer has obtained declaration in Form No. 60 where the other party has not furnished his PAN. Wherever the taxpayer has received declarations in Form No. 60, the auditor should verify if the taxpayer has filed Form No. 61 including therein all the necessary particulars. With respect to Form 61A, the tax auditor should ascertain whether the taxpayer is required to report any transactions under Section 285BA read with Rule 114E. It may be noted that specified transactions under Section 285BA include the issue of bonds, issue of shares,buy-back of shares by a listed company, etc.	

These transactions may not happen every year and hence special attention should be given in the year when a company taxpayer issues any security or a listed company undertakes buyback of shares. While verifying the same, the tax auditor should ensure that the provisions of Rule 114E(3) have been properly considered and applied. Failure to do so may result in a certain transaction not being reported. It may be noted that the payment may be received for various transactions and on different dates, and hence these may not be covered under Section 269ST but will have to be reported under Section 285BA.

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

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

S. No.	Income Tax Department Reporting entity Identification No.	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the form contains information about all details/ transactions which are required to be reported	If not please furnish list of the details/ transactions which are not reported

QNO 556.000	**Disqualification-** **Bhaskar CNO – TAXAUD.060**	**Old Course – (M16R)**
	Circumstances in which Chartered Accountant in practice or firm of Chartered Accountants cannot conduct Tax Audit u/s 44 AB of the Income Tax Act, 1961 of the concern.	

Answer

- **Individual**
  Assesses Himself***
- **HUF**
  Family member of HUF***
- **AOP**
  Member of AOP***
- **Trust /Institution**
  Author / Founder / Substantial Contributor i.e. exceeding Rs 50,000 / Trustee or Manager***
  If author / founder is HUF, then members of HUF***
- **Firm**
  Partner of firm***
- **Company**
  Who is disqualified to do statutory audit under Sec 141 (3)?
- **All Assesses (Other than Company)**
  Who can verify return u/s 139*** (Mentally Ill – Guardian, Political Party- CEO, Other- Power of Attorney Holder etc.)
  (All points below are similar to company audit disqualifications but there are changes so be careful)

→Officer or employee of Assessee
→Partner or Employee of Employee or Officer
→Direct / Indirect Business Relationship with assessee

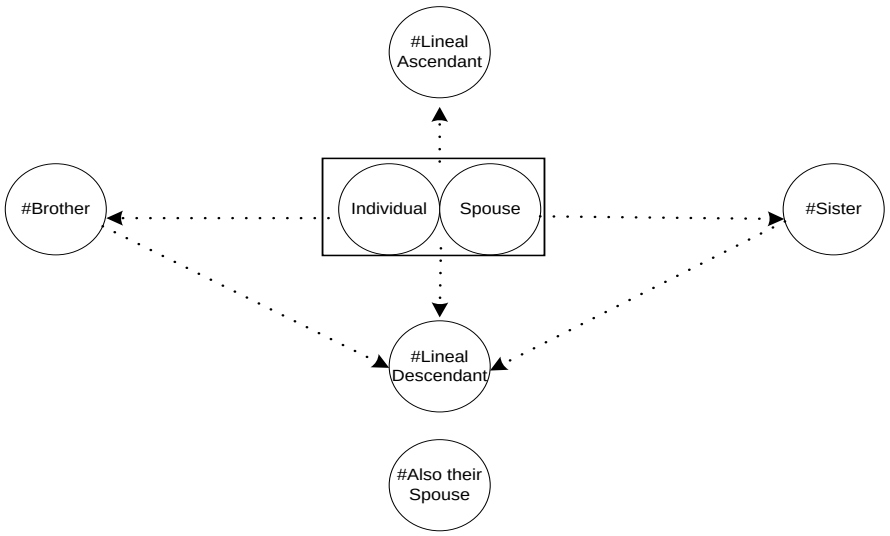
→Convicted by court for fraud, 10 years from date of conviction.

→@Holding any Security or Interest in assessee (Only Relative exempt up to FV 1,00,000)
→@Indebted to assessee for any amount (Only Relative exempt up to Rs 1,00,000)

→@Guarantee or Security of assessee for third party for any amount (Only Relative exempt up to Rs 1,00,000)

*** Including Relatives

@By individual or His partner or His Relative



QNO 557.010	ICDS & AS- Bhaskar CNO – TAXAUD.240	Old Course – (M09E, N13R, N16R, P17M) New Course – (M18E, M22R))

ABC Ltd. is consistently following Accounting Standards as required under section 133 of the Companies Act, 2013. During your fax audit under section 44AB of the Income Tax Act, 1961, the Board of Directors informed you that profits of the Company is properly arrived at and the Accounting Standards applicable to it have been followed consistently and as such, there need not be any adjustments to be made as per Income Computation and Disclosure Standards notified under section 145 of Income Tax Act, 1961. Based on the requirements of Law in this regard, examine the validity of the stand of Management in this regard.

OR

Discuss briefly Income Computation and Disclosure Standards (ICDS) to be followed by assessee under the Income-tax Law.

Answer

Part I -- Relevant Standards & Laws

- Clause 13 of the form 3CD

Part II -- Requirements of Relevant Standards & Laws

➢ **As per Clause 13 of the form 3CD assesse shall disclose**

(d) Whether any **adjustment** is required to be made to the profits or loss for complying with the provisions of **income computation and disclosure standards** notified under section 145(2)

(e) If answer to (d) above is in the affirmative, give details of such adjustments:

		Increase in profit (₹)	*Decrease in profit (₹)*	*Net effect (₹)*
ICDS I	*Accounting Policies*			
ICDS II	*Valuation of Inventories*			
ICDS V	*Tangible Fixed Assets*			
ICDS VI	*Changes in Foreign Exchange Rates*			
ICDS VII	*Governments Grants*			
ICDS VIII	*Securities*			
ICDS IX	*Borrowing Costs*			
ICDS X	*Provisions, Contingent Liabilities and Contingent Assets*			
	Total			

(f)Disclosure as per ICDS:

(i)	*ICDS I-Accounting Policies*
(ii)	*ICDS II-Valuation of Inventories*
(iii)	*ICDS III-Construction Contracts*
(iv)	*ICDS IV-Revenue Recognition*
(v)	*ICDS V-Tangible Fixed Assets*
(vi)	*ICDS VII-Governments Grants*
(vii)	*ICDS IX Borrowing Costs*
(viii)	*ICDS X-Provisions, Contingent Liabilities and Contingent Assets".*

- **Income Computation and Disclosure Standards (ICDS):**

Section 145 of the Income Tax Act, 1961 deals with the method of accounting.

Under **section 145(1),** income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assesses **(other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44(AB)), following the mercantile system of accounting**, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources". from the A.Y. 2017-18.
All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of **conflict between the provisions of the Income-tax Act, 1961 and the notified ICDSs**, the provisions of the Act shall prevail to that extent.
The Central Government has prescribed 10 Income Computation and Disclosure Standards (ICDSs) as under:
See List Given Above.

Conclusion

- In the instant case, ABC Ltd. is consistently following Accounting Standards in compliance with section 133 of the Companies Act, 2013 but not complying with the provisions of Income Computation and Disclosure Standards notified under section 145 of the Income Tax Act, 1961. Contention of the management that they are following Accounting Standards and need not to make any adjustments as per ICDS, is not correct. Thus, ABC Ltd. is required to adjust the profits in compliance with ICDS.

Authors Note

- **Clause 13 of form 3CD has not been inserted by the institute in this answer but since clause 13 of form 3CD is the clause that speaks about ICDS we have included it in the answer.**

Ajay devgan white colour ki **V**an leke **C**onstruction site pe pahuch tha hai. Wahake labour logo se puch tha hai kita **R**evenue kamate ho. Fir bolta hai jinke paas **F**ixed Assets nahi hai aur **F**oreign exchange nahi unki list banao. List le jaata hai aur **G**overnment grant mangta hai, jab tak government grant nahi deti khud ka ghar as **S**ecurity jama karata hai, **B**orrowing cost aur **P**rovisions khud bear karta hai.

Ajay devgan white colour ki (Accounting Policy)
Van leke (Valuation of Inventory)
Construction site pe pahuch tha hai. Wahake labour logo se puchtha hai kita (Construction Contracts)
Revenue kamate ho. Fir bolta hai jinke paas (Revenue Recognition)
Fixed Assets nahi hai aur (Tangible Fixed Assets)
Foreign exchange nahi unki list banao. List le jaata hai aur (Changes in Foreign Exchange Rate)
Government grant mangta hai, jab tak government grant nahi deti khud ka ghar as (Government Grants)
Security jama karata hai (Securities),
Borrowing cost aur (Borrowing Cost)

Provisions khud bear karta hai. (Provisions, Contingent Liabilities and Contingent Assets

- **First table comes under sub clause (e) where we have to explain impact on profits because of ICDS and next table comes under sub clause (f) which gives disclosures. Yes, 2 clauses are missing in 2nd table, department has done same in original form 3CD also, may be because they don't need disclosure on them.**

QNO 558.010	Applicability of Revision of Audit- Bhaskar CNO – TAXAUD.200	Old Course – (N08E, N13R, P17M, N18R, N19R) New Course – (S17M, N18R, N19R, S21M,N22E)

TP Ltd. a government company engaged in providing tourism services, has failed to get its accounts audited by Statutory Auditor for the financial year 2021-22. You have been appointed as Tax Auditor for the same period and management provided the unaudited financial statements which have been adopted in the Annual General Meeting. Subsequently, the Statutory Auditor while auditing observed that there is a material misstatement in providing depreciation on fixed assets due to which financial statements have been revised. Now the company is requesting you to revise the tax audit report. You are required to state whether Tax Audit Report can be revised and if so, under what circumstances?

OR

You are doing the tax audit of a Limited Company. After submission of Tax Audit Report, management notices that there was apparent mistake of law and due to this mistake, revised the final accounts. As a tax auditor, company seeks your opinion whether the tax audit can also be revised or not.

OR

State whether a Tax audit report can be revised and if so state those circumstances.

Answer

➢ **Revision of Tax Audit Report:**

Normally, the report of the tax auditor cannot be revised later.
However, when the accounts are revised in the following circumstances, the tax Auditor may have to revise his Tax audit report also.

- Revision of accounts of a company after its adoption in the annual general meeting.
- Change in law with retrospective effect.
- Change in interpretation of law (e.g.) CBDT Circular, Notifications, Judgments, etc. The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report.

➢ **Amendment in Rule 6G**

The CBDT has, vide this notification, amended Rule 6G to provide that the audit report furnished

may be revised by the person by getting revised report of audit from a chartered accountant

- The **report of audit furnished under this rule may (option) be revised**
- by the person *(assessee)* **by getting revised report of audit from an accountant**, duly signed and verified by such accountant, and
- furnish it **before the end of the relevant assessment year** for which the report pertains,
- **if there is payment by such person after furnishing of report under subrule (1) and (2) which necessitates recalculation of disallowance under section 40 or section 43B.**

Part III – Case Discussion

➢ **Case 1**

In the given case of TP Ltd., a government company failed to get its accounts audited by statutory auditor therefore, unaudited financial statements were provided for tax audit by the management which have been adopted in AGM. However, it was observed during statutory audit that there was a material misstatement in providing depreciation on fixed assets, accordingly, financial statements have been revised.

➢ **Case 2**

After submission of Tax Audit Report, management notices that there was apparent mistake of law and due to this mistake, revised the final accounts. Tax auditor wants to know whether tax audit report can be revised or not.

Part IV – Conclusion

➢ **Case 1**

The Tax Auditor should state it is a revised report, clearly specifying the reasons for such revision with a reference to the earlier report.

In view of above, tax auditor is required to revise his tax audit report as it is revision of accounts of a company after its adoption in the annual general meeting

➢ **Case 2**

The Tax Auditor should state it is a revised Report, clearly specifying the reasons for such revision with a reference to the earlier report. Thus, the Tax Audit Report can be changed under the given circumstances.

QNO 558.020	**Applicability of SAs & GNs in Tax Audit** UNIQUE	**Old Course – (N18M)**

The Statutory Auditor of P Ltd. is also appointed to undertake its Tax Audit. After the completion of Statutory Audit, he finalizes Tax Audit without referring to Standards on Auditing and Guidance Notes of Institute as he is of the opinion that Tax Audit relates only to tax matters with which the Income tax department is concerned. Moreover, the assesse furnishes to the auditor only the requisite information and records for the purpose of Tax Audit.

Answer

➢ **Applicability**

In the case of an audit, the tax auditor is required to express his opinion as to whether the financial statements give a true and fair view of the state of affairs of the assessee in the case of the balance sheet and in the case of the profit and loss account/income and expenditure account, of the profit/loss or income/expenditure.

He would be well advised to refer to the "Standards on Auditing (SAs issued by ICAI, as well as the "Guidance Note on Audit Reports and Certificate for Special Purposes"). If the statutory auditor is also appointed to undertake tax audit, it is advisable to carry out both the audits concurrently.

➢ **SA 210**

"Agreeing the Terms of Audit Engagements" requires an auditor to establish whether the precondition for an audit is present so as to accept or continue an audit engagement. As per para 6(b)(iii) the auditor is required to obtain agreement of management that it acknowledges and understands its responsibilities to provide the auditor with:

- Access to all information of which the 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 the 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. Moreover, since the appointment of the tax auditor is made by assessee, it will be in the interest of the assessee to furnish all the information and explanation and produce books of account and records required by the tax auditor. The audit report given under section 44AB is to assist the income-tax department to assess the correct form of the assessee. In order that the tax auditor may be in a position to explain any question which may arise later on, it is necessary that he should keep necessary working papers about the evidence on which he has relied upon while conducting the audit and also maintain all his necessary working papers.
	Author's Note **Why SA 210 is used in the answer?** Last line of question it is specified that assessee is giving limited information, so we are reminding that under 210 engagement letter client promises to give all the information which is relevant for audit

QNO 560.000	**Tax Audit of Co-Operative** **UNIQUE**	**Old Course – (N09E, N11R, M13R, P17M, N17E)** **New Course—(S17M)**
	A Co-operative society having receipts over Rs 2 crores has appointed Mr. D as the statutory auditor - Mr. D is eligible to do the same under the state Co-operative Societies Act. Mr. D is not a chartered accountant. Mr. D is also appointed to conduct the tax audit of the society under section 44 AB of the Income Tax Act, 1961. Comment	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 44AB read with Explanation to Section 288(2) of the Income Tax Act, 1961, ▪ Section 141 of the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** ➢ As per Section 44AB read with Explanation to Section 288(2) of the Income Tax Act, 1961, "accountant" means a chartered accountant within the meaning of the Chartered Accountants Act, 1949, and includes, in relation to any State, any person who by virtue of the provisions of section 141 of the Companies Act, 2013, is entitled to be appointed to act as an auditor of companies registered in that State. **Part III – Case Discussion** ➢ Co-operative society receipts are over Rs 2 crores and has appointed Mr. D as the statutory auditor - Mr. D is eligible to do the same under the state Co-operative Societies Act. Mr. D is not a chartered accountant. Mr. D is also appointed to conduct the tax audit of the society under section 44 AB of the Income Tax Act, 1961. **Part IV – Conclusion** ➢ Accordingly, the person who a Chartered Accountant is not as mentioned in the question, though is eligible to act as auditor of Cooperative Society under the Cooperative Society Act, 1912, but is not eligible to carry out tax audit under Sect ion 44AB of the Income Tax Act, 1961. Hence, such audit report cannot be furnished as tax audit report under Section 44AB of the Income-tax Act, 1961.	

QNO 561.000	**Tax Audit of Public Charitable Trust** **Bhaskar CNO – TAXAUD.260**	**Old Course – (N08R, M09E, N10R, M16R,P17M)** **New Course – (S17M, S21M)**
	Draft an Audit programme for conducting the audit of a Public Trust registered under section 12A of the Income-tax Act, 1961.	
Answer	An auditor should conduct routine checking during the course of audit of a public trust, in the following manner: ➢ Check the **books of account and other records** having **regard to the system of accounting and internal control.** ➢ **Vouch the transactions** of the trust to satisfy that • **all incomes** due to the trust have been **properly accounted** for on the basis of the system of accounting followed by the trust; • **all expenses and outgoings** appertaining to the trust have been **recorded** on the basis of	

	the system of accounting followed by the trust; and • the transaction **falls within the ambit of the trust**; • the transaction is properly **authorized by the trustees or other delegated authority** as may be permissible in law; • amounts shown as applied towards the object of the trust are **covered by the objects of the trust** as specified in the document governing the trust. • Obtain a **trial balance** on the closing date certified by the trustees. • Obtain the **Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees** and check the same with the trial balance with which they should agree.

QNO 562.000	**Tax Audit Report When Stat Audit is not Complete** **Bhaskar CNO – TAXAUD.100**	**Old Course – (M17E)**
	M/s. SB & Co. has been appointed as tax auditor under section 44 AB of Income Tax Act, 1961 by Woodcraft Interior Consultants, a professional partnership firm, having turnover 1.25 Crores. M/s. RS & Co. are the statutory auditors of the firm, but they are unable to give their report on the financial statements of the firm. M/s. SB & Co., have, however, completed their tax audit and wants to issue their reports. Comment.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 44AB of Income Tac Act,1961 ▪ Form No. 3CA/ Form No. 3CB/ Form No. 3CD **Part II -- Requirements of Relevant Standards & Laws** **Tax Audit Report:** Section 44AB requires the tax auditor to submit the audit report: ➢ in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, in **Form No. 3CA;** ➢ in the case of a person who carries on business or profession, but not being a person referred to in clause (i), in **Form No. 3CB**. Further, the statement of particulars should be given **in Form No. 3CD**. Form No. 3CA requires the Tax auditor to enclose a copy of the audit report conducted by the statutory auditor or the auditor of the financial statements as the case may be. Where a statutory auditor has not been appointed under the statute or where the report of the statutory auditor is not available for whatever reasons, it will be possible for the Tax auditor to give his report in Form No. 3CB and to certify the relevant particulars in Form No. 3CD. It may however, be noted that the Tax auditor in such cases will have to conduct the financial audit as well in order to enable him to certify whether or not the accounts reported upon by him give a true and fair view of the state of affairs of the assesse whose accounts are audited by him under Sec 44AB. **Part III – Case Discussion & Conclusion** ➢ In the instant case, M/s SB & Co. has been appointed as tax auditor under section 44AB of Income Tax Act, 1961 by Woodcraft Interior Consultants, a professional partnership firm. Here it may be noted that there is no statutory audit requirement for a professional partnership firm, therefore M/s SB & Co. may issue their report in Form No. 3CB.	

13 Audit of Public Sector Undertakings

QNO 597.000	Powers of C&AG UNIQUE	Old Course-- (N07E, N11E, N12E, N13R, M15R, M16R, N16M, P17M, M20M) New Course-- (S17M, M18R, M20M, S21M)

Ceta Ltd. is a company in which 58% of the paid-up share capital is held by Rajasthan Government. The company is engaged in the business of providing consultancy services in relation to construction projects. The audit of the financial statements of Ceta Ltd. for the financial year ended 31 March 2019 got completed with lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas. Further, it also received comments from C&AG on the audit report of the auditors. Ceta Ltd is seeking advice to go against C&AG so that they can avoid unnecessary interference of C&AG. You are required to advise Ceta Ltd. with respect to role of C&AG in the audit of a Government company.

OR

Being an expert in the field of government audit, you are required to briefly explain the powers of Comptroller and Auditor General of India with respect to supplementary audit and test audit as stated under section 143(6) and 143(7) of the Companies Act, 2013.

OR

Enumerate the right of C&AG of India to conduct a supplementary audit of the financial statement of a company, or comment upon or supplement audit report provided under section 143(6) of the Companies Act, 2013.

Answer

➢ **Powers of Comptroller and Auditor-General of India.**

- **Appointment of the auditor in the case of a Government company:** In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such 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 section 19A 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 599.000	Comprehensive Audit Bhaskar CNO – PSU.120	Old Course-- (M09R, N10R, N11R, N12R, M14R, N14R, N15R, M16M, N16R, P17M, M17M, N17R, M18M, N18R, M19R, N19M, M20R, N20M, M21M) New Course-- (M18M, N18E, M19R, N19M, M20R, N20M, N20E, S21M, M21M, N21M, M22M,N22M)

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

OR

The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness for managements' information. Explain stating clearly the issues examined in comprehensive audit.

OR

The areas covered in comprehensive audit vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. You are required to list down some of the broad areas to be examined in comprehensive audit.

OR

XYZ & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of ABC Public undertaking. C&AG advised to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc.
Discuss stating the issues examined in comprehensive audit.

OR

Solar Limited is a public sector undertaking engaged in production of electricity from solar power. It has started a new project near Pondicherry with a new technology for a cost of` 9,750 crore. Though there is delay in commencement of project and accordingly, there has been overrun in the cost. State the matters C&AG while conducting Comprehensive Audit may cover in reporting on the performance and efficiency of this project.

Answer

- The Comptroller and Auditor General assist the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness and extravagance for managements' information
- The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. However, in general, the covered areas are those of investment decisions, project formulation, organizational effectiveness, capacity utilization, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc.
- **Areas to be covered:**
  The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the issues examined in comprehensive audit are: ***(Below points should be explained in sentence form to make answer more presentable)***

- Research and development programmes.
- Project planning.
- Systems of project formulation and implementation.
- Comparison of the overall capital cost of the project with the approved planned costs.
- Accepted production or operational outputs been achieved? Has there been underutilization of installed capacity or shortfall in performance?
- Cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.
- Undue waste, unproductive time for men and machines, wasteful utilization or even non-utilization of resources.
- Effective and economical.
- Planned rate of return.
- System of repairs and maintenance.

➢ The efficiency and effectiveness audit of public enterprises is conducted on the basis of certain standards and criteria. Profit is not the key criterion on performance; management's performance in the economical and efficient use of public funds and in the achievement of objectives is more relevant. Public enterprises have been set up with certain socio-economic purposes and for fulfillment of certain objectives. The objectives vary from enterprise to enterprise. Audit appraisal analyses the performance of an enterprise to bring out the extent to which the objectives for which the enterprise was set up have been served.

QNO 599.200	**Performance Audit Planning** **Bhaskar CNO – PSU.180**	**Old Course-- (M14E, P17M, N17R)** **New Course-- (S17M, M18M, S21M, M22R)**

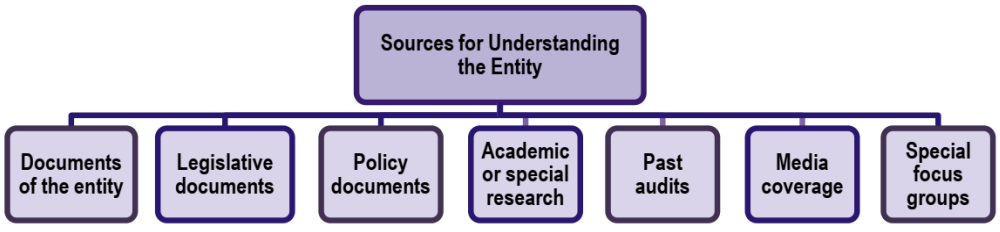
The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:
(i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
(ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
(iii) metering, billing and collection was managed efficiently and effectively;
(iv) monitoring and internal controls were efficient.
What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

Answer

➢ In the given scenario, in view of the objectives discussed, performance audit is being referred.

The following steps are suggested to the auditors for planning while conducting the performance audit:

(A) Understanding the Entity/Programme - It is the starting point for planning individual performance audit.



➢ The auditor may use the following sources for understanding the entity:
(i) Documents of the entity: Documents on administration and functions of the entity, policy files, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases and MIS reports, RTI material etc.
(ii) Legislative documents: Legislation, parliamentary questions and debates, reports of the Public

	Accounts Committee, the Committee on Public Undertakings, the Estimates Committee, and letters from Members of Parliament. (iii) Policy documents: Documents of Planning Commission, Ministry of Finance etc. (iv) Academic or special research: Independent evaluations on the entity, academic research and similar work done by other governments and other SAIs. (v) Past audits: Past financial and performance audits of the entity provide a major source of information and understanding. (vi) Media coverage: Print and electronic media - their systematic documentation on regular basis in a transparent manner. (vii) Special focus groups: Audit Advisory Committee concerns, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.

QNO 600.000	**Performance Audit- Issues addressed** **Bhaskar CNO – PSU.160**	**Old Course-- (N15R, M16R, M16E, M17R, N18E, M20R)** **New Course-- (N18R, M20R, S21M)**
	"A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG. **OR** **Write short notes on Issues addressed in Performance Audit of PSUs?**	

Answer

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:

➢ **Economy-**

- It is **minimising the cost of resources** used for an activity, having regard to appropriate quantity, quality and at the best price.
- Judging economy implies forming an opinion on the resources (e.g. human, financial and material) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

➢ **Efficiency-**

It is the **input-output ratio.** In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

- Auditing efficiency embraces aspects such as whether:
  - sound **procurement practices** are followed;
  - resources are properly **protected and maintained**;
  - public sector programmes, entities and activities are efficiently **managed, regulated, organised and executed**
  - efficient **operating procedure**s are used;
  - **optimum amount of resources** (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner; human, financial and other resources are **efficiently used**;
  - the objectives of public sector programmes are met **cost-effectively**.

➢ **Effectiveness-**

It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

- In auditing effectiveness, performance audit may, for instance:
  - assess **compliance with laws and regulations** applicable to the program; and
  - assess whether the **objectives of and the means** provided (legal, financial, etc.) for a new or ongoing public sector programme are **proper, consistent, suitable or relevant to the policy**;
  - **identify factors inhibiting satisfactory performance or goal-fulfilment**;
  - assess the adequacy of the **management control system** for measuring,

	monitoring and reporting a programme's effectiveness; • determine the extent to which a program achieves a **desired level of program results**; • assess and establish with evidence whether the observed direct or indirect **social and economic impacts** of a policy are due to the policy or to other causes; • assess the effectiveness of the program and/or of individual program **components**; • determine whether management has considered **alternatives** for carrying out the program that might yield desired results more effectively or at a lower cost; • identify **ways of making programmes work more effectively**. • assess whether the programme complements, duplicates, overlaps or counteracts **other related programmes**;
	Author's Note **There is controversy in this question — Answer provided as per May 16 RTP / Nov 18 RTP / Nov 18 exams differ from each other, I think answer of Nov 18 RTP is best and recent, answer for Nov 18 Exams is too short Above is the answer as per Nov 18 RTP which should be followed.**

QNO 600.005	**Performance Audit - Audit Report Rejected #Unique**	**New Course-- (N22R, M23M)**
	"Comptroller & Auditor General appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG."	
Answer	In the given scenario, C&AG appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit. A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG. Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities. Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action. Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.	

QNO 600.010	Efficiency Audit Bhaskar CNO – PSU.160	Old Course-- (M18E)
	In carrying out efficiency audit of a Public Sector Undertaking (PSU), what important aspects are required to be looked into, to assess the efficiency?	

Answer

➢ **Efficiency Audit**

- It is measurement of input-output. It is said to be achieved when the output is maximized at the minimum of inputs, or input is minimized for any given quantity and quality of output.
- Examining efficiency embraces aspects such as whether:
  - sound procurement practices are followed; *(Good Quality)*
  - resources are properly protected and maintained;
  - human, financial and other resources are efficiently used; *(Well Trained)*
  - optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner; *(Minimum without compromising results)*
  - public sector programmes, entities and activities are efficiently managed, regulated, organized and executed; *(Overall)*
  - efficient operating procedures are used; and*(Process)*
  - the objectives of public sector programmes are met cost-effectively.

QNO 601.000	Propriety Audit Bhaskar CNO – PSU.140	Old Course-- (P17M, N18M)
	Write a short note on - Propriety Audit.	

Answer

➢ **Meaning:** -Propriety Audit stands for verification of transactions on the tests of –

- Public Interest
- Commonly accepted customs and Standards of Conduct

➢ **Emphasis/Scope:** Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.

Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances.

➢ **Principles:** -

Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:

• that the expenditure is **not prima facie more than the occasion demand and** • that every official exercise the **same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;**	• ***(E.g.-Car of 1 crore for MPs)*** • ***(E.g. 50 cars were ordered without quotations)***
• that the authority exercises its power of sanctioning expenditure to pass an order which **will not directly or indirectly accrue to its own advantage;**	• ***(E.g. Cars were used by government employees or given for rent)***
• that funds are not utilized for the **benefit of a particular person or group of persons** and	• ***(E.g. Benefit was given only to ruling parties)***
• that, apart from the agreed remuneration or	• ***(E.g. Bribes were paid to***

		reward, no other avenue is kept open to **indirectly benefit the management personnel, employees and others.**	***government employees)***

QNO 602.000	**Propriety Audit (General Principles)** Bhaskar CNO – PSU.140	**Old Course-(M08R, N08E, M11R, M11E, M12R, P17M) New Course-- (S17M, S21M)**
	What are the principals involved regarding "Propriety audit' in the case of Public Sector Undertaking?	
Answer	➢ **Principles: -** Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are: ⩔ that the expenditure is **not prima facie more than the occasion demands** ***(E.g. Car of 1 crore for MPs)***and that every official exercise the **same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;** ***(E.g. 50 cars were ordered without quotations)*** ⩔ that the authority exercises its power of sanctioning expenditure to pass an order which **will not directly or indirectly accrue to its own advantage;*****(E.g. Cars were used by government employees or given for rent)*** ⩔ that funds are not utilized for the **benefit of a particular person or group of persons** and ***(E.g. Benefit was given only to ruling parties)*** ⩔ that, apart from the agreed remuneration or reward, no other avenue is kept open to **indirectly benefit the management personnel, employees and others.** ***(E.g. Bribes were paid to government employees)***	

QNO 603.000	**Propriety Audit (Company Act)-** Unique	**Old Course-- (M04E, M12R, N12E, M15R, N16M, P17M, M19M, N19R) New Course-- (S17M, M18E, N19R, M19M, S21M)**
	Write a short explanatory note on – Areas of propriety audit under Section 143(1) of the Companies Act, 2013	
Answer	➢ **Areas of propriety audit under Section 143(1):** Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to ⩔ 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; ⩔ whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made; ⩔ where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company; ⩔ whether loans and advances made by the company have been shown as deposits; ⩔ whether personal expenses have been charged to revenue account; ⩔ where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading. A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.	

QNO 604.000	C&AG (Audit Report)- Bhaskar CNO – PSU.240	Old Course-- (N17E, M19E) New Course—(N21E)
	Contents of audit report given by Comptroller & Auditor-General of India.	
Answer	➢ **Contents of Audit Report of the Comptroller and Auditor General:** ⩔ For facility of consideration, the reports of the Comptroller and Auditor General on the public sector undertakings of the Central Government are presented to the Parliament in several parts consisting of the following: • **Introduction** containing a general review of the working result of Government Companies, Deemed Government Companies and Corporations • Result of **comprehensive appraisals** of selected undertakings conducted by the **Audit Board**. • Resume of the **company auditor's reports** submitted by them under the directions issued by the CAG and that of comments on the accounts of the Government Companies. • Significant results of audit of the undertakings **not taken up for appraisal by the Audit Board.** ⩔ For certain specified states, the Comptroller and Auditor General submit a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, comments noticed in Government audit in the audit functions of certification of accounts and a general review of the working results of Government companies and corporations.	
	Author's Note **Above answer has been explained and summarized below to make it answer easy to understand.** • **Out of Audit Reports by CAs and Audit Reports by CAG Teams submitted to CAG Departments some are taken for appraisal by Audit Boards. So some audit reports are analyzed by audit reports and some are left out.** • **First Section of Answer is Parts of Audit Report on Government Undertaking** **1st Part — Introduction of Government Entity** **2nd Part — Result of Comprehensive Appraisal of Audit Board (If Selected by audit board)** **3rd Part — Summary of Company Auditor's Report on Government Entity** **4th Part — Significant Results of Audit Report by CAG Team on Government Entity (If not selected by audit board)** **So Either 2nd Part will Come or 4th Part will come** • **Second section says that in big industrial states like Maharashtra there can be separate report on commercial activities by government or it can be included in main report as separate chapter. State wise reports will also explain instances of irregularities and wastage.**	

QNO 604.010	Functioning of Finance Committee & Role of C&AG – Unique	New Course-- (N18M)
	The Comptroller &Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognized as a 'friend, philosopher and guide' of the Committees. In view of above, you are required to list down any four roles.	
Answer	➢ The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognized as a 'friend, philosopher and guide' of the Committees. ⩔ His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports; ⩔ He scrutinizes the notes which the Ministries submit to the Committees and helps the	

Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;

- The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.
- The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;
- In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

Author's Note

Explanation & Corresponding Summary

There are 2 committees, Public Accounts Committee and Committee on Public Sector Undertakings which read, study reports of CAG on government department and government corporations and then ask for explanations from ministries.

Now answer
(Intro same as question)
The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognized as a 'friend, philosopher and guide' of the Committees.

Step 1: - Reports of CAG are discussed in Financial Committees & Questions are asked to ministries
His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;
Step 2: - Replies from ministries are received and CAG checks correctness of replies and helps committees to understand there replies
He scrutinizes the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;

Step 3: - Committees send their reports to parliament
The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.

Step 4: - Ministers has to submit action taken report to parliament as per recommendations of committees
The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;

Extra Points
(Treatment of Confidential Audit Reports)
In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

(Because of these committee's government doesn't take CAG reports lightly)
This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

QNO 605.000	Draft Audit Criteria Bhaskar CNO – PSU.220	New Course-- (S21M, N21M)
	You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?	
	➢ **Determining Audit Criteria** ⩔ Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed. ⩔ The audit criteria may be sought to be obtained from the following sources: • procedure manuals of the entity. • policies, standards, directives and guidelines. • criteria used by the same entity or other entities in similar activities or programmes. • independent expert opinion and know how. • new or established scientific knowledge and other reliable information. • general management and subject matter literature and research papers	

QNO 605.500	"Government Company" definition- Unique	New Course-- (S21M)
	BT Ltd, a company wholly owned by central government was disinvested during the previous year, resulting in 40% 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. **Sam, the FM 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.**	
	➢ **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. • The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct	

14 Liabilities of Auditor

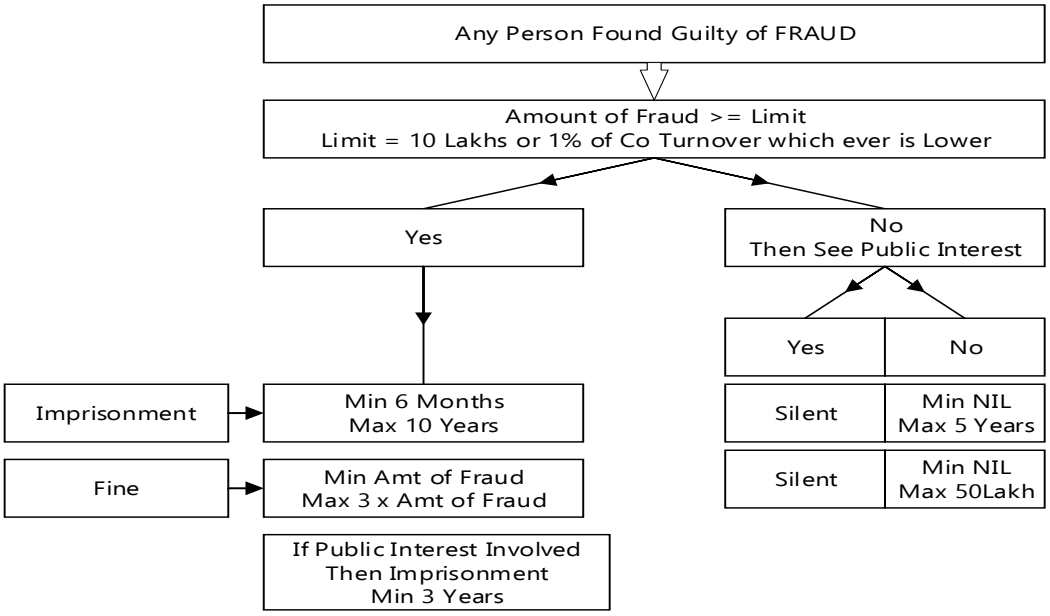
QNO 370.000	Criminal Liabilities Bhaskar CNO – LOA.060	Old Course – (N13E, M15R, M16R, M16M, M16E, P17M, N17M, N18R) New Course – (S17M, M18M, S21M)
	Mr. Fresh, a newly qualified chartered accountant, wants to start practice and he requires your advice, among other things, on criminal liabilities of an auditor under the Companies Act, 2013. You are required to briefly explain the same to Mr. Fresh. **OR** **Briefly explain the criminal liabilities of an auditor under the Companies Act, 2013.**	

Answer

The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

- **Sec 34**
  - **Criminal liability for Misstatement in Prospectus-** As per Section 34 of the Companies Act, 2013, **where a prospectus, issued, circulated or distributed** includes any statement which **is untrue or misleading** in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447
  - ***(Relief)***
    This section shall not apply to a person if he proves that such statement or omission was **immaterial** or that he had **reasonable grounds to believe** and did up to the time of issue of the prospectus believe, that the statement was true, or the inclusion or omission was necessary.
    - **(a) Immaterial-** Last name of auditor was misspelled, it was not resembling to anyone else / Last digit of firm registration number, was accidentally omitted while finalising.
    - **(b) Reasonable grounds to believe** -Auditor believed that employees working with company were on full time basis and not part time on contract basis
- **Sec 448**
  - **Punishment for false statement**- According to Section 448 of the Companies Act, 2013if in **any return, report, certificate, financial statement, prospectus, statement or other document** required by, or for, the purposes of any of the provisions of this Act or the rules made there under, any person makes a statement —
    - (a) **which** is **false in any material particulars**, knowing it to be false; or
    - (b) which **omits any material fact, knowing it to be material**, he shall be liable under section 447

➢ **Sec 447**



➢ **Punishment for fraud.**

Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud [*involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower*], shall be punishable with imprisonment for a term which shall

- not be less than six months but which may extend to ten years and
- shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years:

[Provided further *that where the fraud involves an amount less than ten lakh rupees or one per cent of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to* [48c] [*fifty lakh rupees*] *or with both.*]

Explanation.—For the purposes of this section—

(i) "fraud" in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

➢ **Sec 140 (5)**

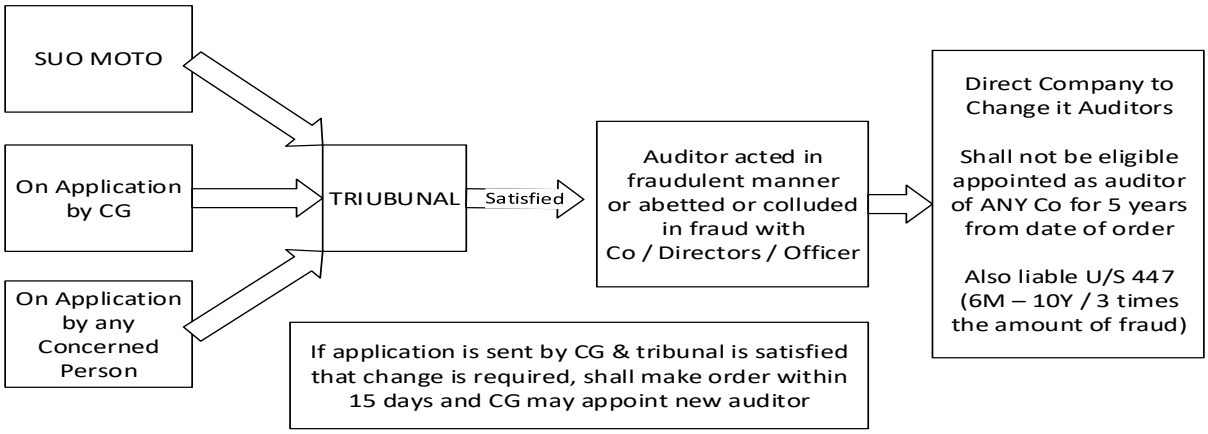
Direction by Tribunal in case auditor acted in a fraudulent manner: As per sub-section (5) of the section 140, the Tribunal either Suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, 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 370.020	**Criminal Liabilities(Sec 448)** **Bhaskar CNO – LOA.060**	**Old Course – (N18E)** **New Course – (S21M)**
	State the nature of liability as provided in the Companies Act, 2013 of an auditor for not appropriately dealing with a misstatement appearing in audited financial statements or a false statement in Audit Report.	

Answer

Part I -- Relevant Standards & Laws

- Section 448 of the Companies Act, 2013

Part II -- Requirements of Relevant Standards & Laws

➢ **Requirement of Section 448**

An auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material.

➢ **Punishment as per Section 447**

If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act.

➢ **Conclusion**

Thus, in view of above, an auditor will be held liable for criminal prosecution for not appropriately dealing with a misstatement appearing in audited financial statements or a false statement in Audit Report assuming that it was known to auditor.

QNO 374.000	**Prospectus Sec 35** **Bhaskar CNO – LOA.020**	**Old Course – (N09R,M10E,N11R,M12R,N12R,M13M,N13R, N15R, P17M)** **New Course – (S17M, N18M, S21M)**
	Explain the liability of the auditor under section 35 of the Companies Act, 2013, for making an untrue statement in the report (as an expert forming a part of the prospectus). **Or** **You are the auditor of a company, which raised finance from the capital market on the basis of a**	

prospectus issued a few years back The main object for raising the finance was specified to be setting up a project on information technology. The company advanced monies so raised to various parties 'related' to directors These parties had no standing whatsoever with information technology In the Balance Sheet, these advances appeared as a current asset under the head "loans unsecured – considered good" There was no mention in the notes to accounts about nature and purpose of such advances You have given routine audit report without any qualifications One fine morning the directors and these 'related' parties disappear The company has just vanished. Can you be hauled up for professional misconduct? Do you have any liability under any law?

OR

Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if any:

(i) A misstatement had occurred in the prospectus issued by the company.

Answer

Part I -- Relevant Standards & Laws

- Section 35 of the Companies Act, 2013

Part II -- Requirements of Relevant Standards & Laws

A civil action against the auditor may either take the form of **claim for damages on account of negligence or that of misfeasance proceeding for breach of trust or duty:**

➢ **Damages for negligence:**

Sec 35 of Companies Act 2013 *(Damages due to misleading content in Prospectus).*

Civil liability for misstatement in prospectus under **Section 35** of the Companies Act, 2013, are:

- **Condition for Civil Liability**

  Where a **person has subscribed for securities** of a company acting on **any statement included, or the inclusion or omission of any matter, in the prospectus** which is **misleading** and has **sustained any loss or damage**s a consequence thereof, **the company** and every person who-

  Examples

  - *Any statement: - Company has 50 acres of land near Delhi.*
  - *Inclusion: - Graph showing false growth of sales in past 12 months.*
  - *Omission: - Schedule of cases against company was missing.*

- **Apart from company who will be responsible?**
  - **(Promoter)**

    is a **promoter of the company**;
  - **(Director)**

    is a **director** of the company **at the time of the issue of the prospectus**
  - **(To be director)**

    has authorized himself to be named and is named in the prospectus as a director of the company or has **agreed to become such director either immediately or after an interval of time**;
  - **(Authoriser)**

    has **authorised the issue of the prospectus**; and
  - **(Expert)**
    - is an **expert** referred to in sub-section (5) of section 26 *(Who is engaged & given consent to issue prospectus),* shall, without prejudice to any punishment to which any person may be liable under section 36, **be liable to pay compensation to every person who has sustained such loss or damage**.

      (Amendment)
    - *No person above shall be liable , if he proves*

      *That, as regards every **misleading statement purported to be made by an expert** or contained in what purports to be a **copy of or an extract from a report or valuation** of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and **he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent** required by sub-section (5) of section 26 to the issue of the*

prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment there under.

- **Punishment**
  Notwithstanding anything contained in this section, where it **is proved that a prospectus has been issued with intent to defraud the applicants** for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be **personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.**

- **Relief from punishment**
  (a) No person shall be liable under sub-section (1), if he proves—
    - ***(Withdrawal of consent and issue without consent)***
      that, having consented to become a director of the company, **he withdrew his consent before the issue of the prospectus**, and that **it was issued without his authority or consent** or
    - ***(Issue without consent and reasonable public notice given about the same)***
      That the prospectus was **issued without his knowledge or consent**, and that on becoming aware of its issue, he forthwith **gave a reasonable public notice that it was issued without his knowledge or consent**.
    - ***(Any of above people prove that misleading statement / report / extract of report is made by expert and he has reason to believe that such expert was competent and given consent to prospectus and has not withdrawn it or informed to such defendant, then he will not be responsible and punishable)***
      - No person shall be liable under sub-section (1), if he proves (Promoter / Director / To be Director / Authorizer / Other Expert)
      - That, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment there under.

- **Expert**
  It may be noted that the term "expert" as defined in Section 2(38) of the Companies Act, 2013 includes an **engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force**. Also, that under Section 26 of the Act a statement may be considered to be untrue, not only because it is so but also if it is misleading in the form and context in which it is included. *(5 years old profits figures were highlighted as annual profits at many places)*

  The liability would arise if the written consent of the auditor to the issue of the prospectus, including the report purporting to have been made by him as an "expert" has been obtained.

➢ **Liability for misfeasance**:
The term "misfeasance" implies a breach of trust or duty. The auditor of a company would be

	guilty of misfeasance if he has been guilty of any breach of trust or negligence in the performance of his duties which has **resulted in some loss or damage to the company or its property.** *(Auditor disclosed confidential information about company / made public draft audit report before discussing it with management etc)*
	Author's Note  **"Headings in Comics font "are included by author to help the students in remembering the points.**

QNO 374.500	**Prospectus Sec 35 (Case Study on becoming Director after some interval of time)** **Bhaskar CNO – LOA.020**	**New Course – (N21M)**
	As a part of the listing process, M/s FRAD Limited had prepared and issued its prospectus to the public. The top executives thought that a pending litigation against the company (which would cause a cash outflow of ` 1 crore) may affect the demand for share application. Due to this, they had omitted the fact, for the well-being of the company. Mr. K, who was well aware of this matter,had authorized himself to be named in the prospectus as a director. However, Mr. K was little reluctant, so he informed and agreed that he shall become such director after an interval of some time. Unfortunately, after few days, this matter got leaked and several subscribers sustained huge loss. Mr. K is now defending himself stating that he is currently not holding the director post hence no action can be taken against him. Analyse.	
Answer	**Damages for negligence**: Civil liability for mis-statement in prospectus under section 35 of the Companies Act, 2013, includes where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who has authorized himself to be named and is named in the prospectus as a director of the company or has agreed to become such director either immediately or after an interval of time; shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage. Further As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud [involving an amount of at least ten lakh rupees or one percent of the turnover of the company, whichever is lower] shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. Hence, in this case, Mr. K is liable for punishment even though he is currently not a director in the company as per section 35 of the Companies Act, 2013. He shall be liable to punishment as per section 447 discussed above as he was aware of the litigation against the company which may cause outflow of Rs. 1 crore which may affect the demand for share application and had also authorized himself to be named in the prospectus as director.	

QNO 376.000	**Two Set of Books** **Bhaskar CNO – LOA.140**	**Old Course – (M14E, M16R, P17M)** **New Course – (S17M, M18R, S21M,N22M)**
	In assessment procedure of M/s Cloud Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of Books of Accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through books he found that M/s Cloud Ltd. used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. Old had negligently performed his duties. Comment	
Answer	➢ "It is the auditor's responsibility to **audit the statement of accounts** and **prepare tax returns** on the basis of books of accounts produced before him. Also, if he is satisfied with the books and	

documents produced to him, he can **give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.**

Case Discussion

- In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Conclusion

- Mr. Old, the auditor was not under a duty to prepare books of accounts of assesses and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only. In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assesses.

QNO 377.000	**Unlawful Acts by Client** **Bhaskar CNO – LOA.120**	**Old Course – (M11R, M13E, P17M)** **New Course – (S17M, S21M)**

Write a short note on - Auditor's liability in case of unlawful acts or defaults by clients.

OR

Mr C, a practicing Chartered Accountant, in the course of the audit of a listed company discovered serious violations of the provisions of the Companies Act 2013, informed the Registrar of Companies out of public interest

Answer

- **Basic Responsibility is to give Opinion**
  The auditor's basic responsibility is to report whether in his opinion the accounts show a true and fair view and in discharging his responsibility he has to see as to how the particular situations affected his position.

- **No Legal Obligation to Report**
  The general thinking with regard to unlawful acts or defaults by clients appears to be that the auditor should not 'aid or abet' but he is apparently not under any legal obligation to disclose the offence.

- **Auditor cannot Help**
  A professional accountant would himself be guilty of a criminal offence if he advises his client to commit any criminal offence or helps or encourages in planning or execution of the same or conceals or destroys evidence to obstruct the course of public justice or positively assists his client in evading prosecution.

- **Duty of Auditor**
  A professional accountant in his capacity as auditor, accountant, or tax representative has access to a variety of information concerning his clients. On some occasions, he may acquire knowledge that his client has been guilty of some unlawful act, default, fraud, or other criminal offence. The duty of the professional accountant in such a case would depend upon the actual circumstances of the situation. Due consideration should be given to the exact nature of services that a professional accountant is rendering to his client, i.e. is he representing the client in income-tax proceedings or is he acting in the capacity of an auditor or an accountant or a consultant.

- **ICAI Clarification**
  The Institute of Chartered Accountants of India has considered the role of chartered accountants in relation to taxation frauds by an assessee and has made the following major recommendations:
  - **Sec 126**
    A professional accountant should keep in mind the provisions of Section 126 of the Evidence Act whereby a barrister, an attorney, a pleader or a Vakil is barred from disclosing any communication made to him in the course of and for the purpose of his employment.

- **Past Fraud, someone else did Audit**
  If the fraud relates to past years when the accountant did not represent the client, the client should be advised to make a disclosure. The accountant should also be careful that the past fraud does not in any way affect the current tax matters.

- **Past Fraud, Auditor himself did audit**
  In case of fraud relating to accounts examined and reported upon by the professional accountant himself, he should advise the client to make a complete disclosure. In case the client refuses to do so, the accountant should inform him that he is entitled to dissociate himself from the case and that he would make a report to the authorities that the accounts prepared or examined by him are unreliable on account of certain information obtained later. In making such a report, the contents of the information as such should not be communicated unless the client consents in writing.

- **Fraud in current year**
  In case of suppression in current accounts, the client should be asked to make a full disclosure. If he refuses to do so, the accountant should make a complete reservation in his report and should not associate himself with the return. However, it can be argued that the auditor has a professional obligation to ensure that the client is fully aware of the seriousness of the offence and to seriously consider full disclosure of the matter.

It has been clearly established in various case laws that the auditor is expected to know the contents of documents and records and ascertain whether the affairs of the client are being conducted in an unlawful manner. It is in the course of the work, he comes across any unlawful acts, and it is his duty to bring it to the notice of the client as also to make a disclosure in his report in appropriate cases. In this regard, one has to bear in mind the consequence of the act in relation to the professional code to which an auditor is subjected.

Under the code, an auditor cannot disclose confidential information unless permitted by the client or unless required by law. Each case has to be judged on its circumstances. However, in every case he has to assess the implications of the unlawful act or default on the true and fair character of the accounting statements.

Conclusion

➢ The question of liability of an auditor for unlawful acts or defaults by clients should be considered in the light of the broad parameters given above. However, it appears that if an auditor was aware of any unlawful act having been committed by client in respect of accounts audited by him and the unlawfulness was not rectified by proper disclosure or any other appropriate means, the auditor owes a duty to make a suitable report. If he does not, he may be held liable, if the true and fair character of the accounts has been vitiated.

Author's Note

This answer is based on guidelines issued by ICAI on illegal acts you have to give answer as explained. This question is not exactly on frauds in financial statements. Mentioning about 143(12), CARO 2020, and SA 240 won't get you marks.

QNO 378.000	Weakness in ICS lead to Fraud Bhaskar CNO – LOA.120	Old Course – (N09R, N11R, N13R,N14R, N16R, P17M,M19R) New Course – (S17M, M19R, S21M)

Certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor who in turn brought the same to the knowledge of the Managing Director of the company. In the subsequent year huge defalcation came to the notice of the management. The origin of the same was traced to the earlier year. The management wants to sue the auditor for negligence and also plans to file a complaint with the Institute.

Answer

➢ **Internal Control Deficiency Identified by Auditor**
In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company desires to sue the statutory auditor for negligence.

➢ **Is Auditor Responsible?**

The precise nature of auditor's liability in the case can be ascertained on the basis of the under noted considerations:

- ***(Communication of Weakness)***
  Whether the defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and

- ***(Change in Audit Procedures)***
  Whether the statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed.

➢ **Requirements of SA 265**

SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" clearly mentions that,

- ***(Auditor should determine is there a deficiency?)***
  "The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.

- ***(Is it significant deficiency?)***
  If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

- ***(Communicate in Writing)***
  The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis".

- ***(Additional Audit Procedures?)***
  The fact, however, remains that, weaknesses in the design of the internal control system and non-compliance with identified control procedures increase the risk of fraud or error. If circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate.

Conclusion

➢ Thus, normally speaking, as long as the auditor took due care in performing the audit work, he cannot be held liable. The fact that the matter was brought to the notice of the managing director may be a good defence for the auditor as well. According to the judgement of the classic case in re Kingston Cotton Mills Ltd., (1896) it is the duty of the auditor to probe into the depth only when his suspicion is aroused. The statutory auditor, by bringing the weakness to the notice of the managing director had alerted the management which is judicially held to be primarily responsible for protection of the assets of the company and can put forth this as defence against any claim arising subsequent to passing of the information to the management. In a similar case S.P. Catterson & Sons Ltd. (81 Acct. L. R.68), the auditor was acquitted of the charge.

Author's Note

"Headings in Comics font "are included by author to help the students in remembering the points.

QNO 378.100	**False information to Tax Authorities** **Bhaskar CNO – LOA.080**	**Old Course – (M17E, N18M,)** **New Course – (N18M, N18E, S21M, M23M)**
	A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted on behalf of his client's certain information and explanations to the authorities, which were	

	found to be false and misleading. Discuss briefly the liabilities of Mr. Ram under Income Tax Act, 1961. **OR** **CA Prince, a Chartered Accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivers to the Income Tax Authorities a false declaration. What are the liabilities of CA. Prince under Income Tax Act, 1961?**
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 277 of the Income Tax Act 1961 ▪ Section 278 of the Income Tax Act 1961 **Part II -- Requirements of Relevant Standards & Laws** ➢ **False Declaration as Authorized Representative:** In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorised representative of his clients and attends before an Income Tax Authority or the appellate tribunal. ➢ **Under Section 277 & 278:** Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true. he shall be punishable, • in a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true, or which is wilfully attempted to be evaded, exceeds Rs 25,00,000, with rigorous imprisonment for a term which shall not be less than 6 months, but which may extend to 7 years and with fine; • In any other case, with rigorous imprisonment for a term which shall not be less than 3 months, but which may extend to 2 years and with fine. **Part III – Case Discussion** ➢ In the instant case, Mr. Ram, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration. **Part IV – Conclusion** ➢ He would be liable under section 277 &278 of the Income Tax Act, 1961.art
	Author's Note **Here it is assumed CA was aware that facts were incorrect and misleading.** **This question has been answered specifically as per Income Tax Act as the question asked for it. Look for similar question in Professional Ethics under QNO 753.000**

QNO 378.200	**False information to Tax Authorities before National E-Assessment Centre** **Bhaskar CNO – LOA.080**	**New Course – (M22E)**
	"CA K, a Practising Chartered Accountant, was appointed as Authorized Representative by GKR Limited to appear before National e-assessment centre in the matter of its Faceless Income-tax proceedings for the Assessment year 2020-21. While preparing a reply in response to the notice for the Scrutiny Assessment, CA K observed that there were certain trade payables and loan creditors which were not in existence but was fabricated by the management of GKR Limited. Though CA K knew these accounts were fabricated, he still submitted those false accounts to the National faceless e-assessment centre. What are the liabilities of CA K under the Income-tax Act, 1961?"	
Answer	**False Declaration as Authorized Representative:** In connection with proceedings under the Income-tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients and attends before an Income-tax Authority or the appellate tribunal. Any person who acts or induces, in any manner another person to make and deliver to the Income-tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income-tax Act 1961. Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.	

	In the instant case, Mr. K, a chartered accountant was appointed as authorize representative by GKR Limited to appear before National E-Assessment Centre in the matter of its faceless Income-tax proceeding. While preparing a reply in response to the notice for the scrutiny assessment, CA. K, submitted false accounts to the National Faceless E-Assessment Centre, knowingly that certain trade payables and loan creditors accounts were not in existence and were fabricated by Management. In view of above, CA. K would be liable under section 278 of the Income-tax Act, 1961.

15 Internal Audit, Management and Operational Audit

PART - 1 INTERNAL AUDIT

QNO 621.005	Responsibility of Internal Auditor- Unique	New Course-- (N18M)
	XYZ Yarns Ltd. is a manufacturing company engaged in manufacturing of different types of yarns. Its annual turnover is Rs. 100 Crores and net profit Rs. 10 crores. It has two manufacturing units. Company is facing difficulties in maintaining adequate system of internal control. Company wants to appoint Internal Auditor who would help in the above task and also various other functions including compliance. In view of above, you are required to explain the main responsibility of Internal Auditors.	
Answer	**Shortcut - Internal Auditor should say NO to FA2KE** ➢ Main responsibility of internal auditor must be: ⩔ to observe facts and situations and bring them to notice of authorities who would otherwise never know them. ⩔ to operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him. ⩔ In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit ⩔ to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safeguards against misappropriation of assets.	

QNO 614.010	Appraisal of Organisational Structure Bhaskar CNO – IA.030	New Course-- (N18M, N18E)
	Internal auditor makes an appraisal of organization structure to ensure that it is in harmony with the objectives of the entity, besides checking of financial transactions and operational activities of the entity- Elaborate. **OR** **ABC Ltd. is engaged in manufacturing of Yarns and Towels. It sells its product in both domestic as well as in International Market. It has achieved turnover of 200 crores in the F.Y. 2016-17. Directors of the company realized that they are not managing the company professionally and thereby request your firm of Internal Auditors for appraisal of its organizational structure to ascertain whether it is in harmony with the objectives of ABC (P) Ltd. Comment.**	
Answer	➢ **Review of the Organisation Structure –** ⩔ **Introduction, Harmony between Structure & Objectives** The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith. ⩔ **What to evaluate?** For this purpose: • He should review the **manner in which the activities of the enterprise are grouped for managerial control**. It is also important to review whether responsibility and authority are in harmony with the grouping pattern. • The internal auditor should **examine the organization chart** to find out whether the structure is **simple and economical and that no function enjoys an undue dominance over the others.** • He should particularly see that the **responsibilities of managerial staff at**	

		headquarters do not overlap with those of chief executives at operating units. He should examine whether there is a **satisfactory balance** between authority and responsibility of important executives. • The internal auditor should examine the **reasonableness of the span of control of each executive** (the number of sub-ordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior. • Where **dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed**. This must be made known to all concerned. • Finally, he should evaluate the **process of managerial development** in the enterprise. This is a vital aspect in a fast-growing enterprise.

QNO 609.000	MAQ- Bhaskar CNO – MA.060	Old Course-- (N08R, P17M, N18M, N18E) New Course-- (N22R)
	What are the Management Audit Questionnaires? Give a sample questionnaire for Audit of Inventory.	
Answer	➢ **Introduction: -** • A management audit questionnaire is an important tool for conducting the management audit. • Through these questionnaires' auditors make an inquiry into important facts by measuring current performance. ➢ **Objectives: -** • Comprehensive and Constructive **examination of an organization's** management and its assigned tasks. • **Appraisals of management actions** in accomplishing the organizations objectives. • Highlights **Weakness and Deficiencies** of the organization. • Review of management functions of planning, organizing, directing, and controlling. • Evolution of effectiveness of decision-making process in accomplishing the organization objectives. ➢ **Working: -** • There are three possible answer in management audit questions "YES, NO and N.A.". • "YES" answer indicates that the specific area or function under study is functioning in an acceptable manner, no written explanation needed in that case. • 'NO' answer indicates unacceptable performance and requires explanation in writing. • Those questions which are unacceptable and shall be ignored in the audit are checked in the N.A. column. ➢ **Importance:-** • It not only serves as a management tool to analyze the current situation; but also, it enables the management auditors to identify the elements that are causing organizational difficulties and deficiencies.	

QNO 609.500	**Steps to Prepare Management Audit Report** Bhaskar CNO – MA.030	**(M22M)**
	Moksh Ltd. is a manufacturing company and started its business in the year 2000. The net profit after tax of the company was 15% up to the financial year 2019-20, but for the financial year 2020- 21 and 2021-22 the company's profit declined even when there was increase in the sales and production of goods by the company. So, the management of AS Ltd. felt a need to get the management audit conducted with the objective of detecting and overcoming current managerial deficiencies. Briefly discuss the steps to prepare the management audit report.	
Answer	**Steps to Prepare the Management Audit Report:** **Planning the Audit Report** - Before starting the report, the auditor should ask himself, "What do I want to tell the reader about this audit?" The answer will enable him to communicate effectively. **Supporting information** - The management auditor should supplement his report with appropriate audit evidence which sufficiently and convincingly supports the conclusions. **Preparing draft report** - Before writing the final report, the auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his report. It would also indicate whether there is any superfluous information or a gap in reasoning. **Writing and issuing the final report** - The final report should be written only when the auditor is completely satisfied with the draft report. The head of the management auditing department may review and approve the final report. Before issuing the final report, the auditor should discuss conclusions and recommendations at appropriate levels of management. The report should be duly signed and dated. **Follow-up of the audit report** - The management auditor should review whether follow-up action is taken	

	by management on the basis of his report. If no action is taken within a reasonable time, he should draw management's attention to it. **Action / Response of Management on Audit Report**: Where management has not acted upon his suggestions or not implemented his recommendations, the auditor should ascertain the reasons thereof. In cases where he finds that non-implementation is due to a gap in communication, he should initiate further discussions to bridge such gaps. The actions and responses to the Management Audit Report reflect management's attitude to the audit. In any case, the auditor to retain the usefulness of the audit function should ascertain from the management, preferably in writing, the reasons for non- implementation. It is possible that because of change in circumstances, the audit observation did not require any action on the part of the management. The auditor should satisfy himself on the appropriateness of such reasons as well to close the issue.

QNO 610.000	**Summary Written Report-** **Bhaskar CNO – MA.030**	**Old Course-- (M13R, P17M, N21R)** **New Course-- (S17M, S21M, N21R)**
	Write a short note on - Summary Written Report.	
Answer	➢ These are known as flash reports. They are significant highlights for immediate attention of top management. Generally suspected defalcations are reported briefly to the appropriate management official on the 'flash' basis, often ending up in referral for criminal investigation and legal action. It is common practice in number of companies of issuing a report quite frequently summarising the various individual reports issued and describing the range of their contents in a very brief and comprehensive manner where only important points are highlighted. Such reports are primarily issued for audit committees of Board of Directors and for other top-level managers who do not have sufficient time to go through the elaborate reports and matters which are required to be brought to their notice for immediate action.	

QNO 611.000	**Behavioural Aspects(Causes & Solution in short)** **Bhaskar CNO – MA.040**	**Old Course-- (M04E, N11R, N16R, N16M, P17M, M19R, N21M)** **New Course-- (M18E, M19R, S21M, N21M)**
	The "management audit" concern with the whole field of activities of the concern, from top to bottom, starting, as always where management control is concerned because we are primarily concerned with whether the general management is functioning smoothly and satisfactorily. **Briefly explain the behavioural aspects encountered in the management audit and state the ways to solve them.** **OR** **Explain in brief the behavioural aspects encountered in the management audit and state the ways to solve them.** **OR**	
Answer	➢ **Causes: -** • **Staff/Line conflict: -** ○ Management auditors are staff people, while the members of other departments are line people. ○ Management auditors has superiority complex and they may think that their approach and solutions are the only answers. ○ Staff do not consider the line before advising, as a result Line may not use advise of staff properly. ○ Line does not co-operate with staff and do not provide sufficient information to staff. • **Control: -** The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is fear that his actions based on the management audit report will affect the line people. The causes are as under; ○ Fear of criticism stemming from adverse audit findings. ○ Fear of changes in day-today working habits because of changes resulting from audit recommendations.	

- Punitive action by superiors prompted by reported deficiencies.
- Hostile audit style.

➢ **Solution to behavioural problems: -**

- Demonstrate that audit is part of an overall programme of review for **protective and constructive benefit.**
- Demonstrate the objective of the review is to provide **maximum service in all feasible managerial dimensions.**
- Perform the review to ensure with **minimum interference with regular operations** of the operating personnel.
- **Involve the responsible officers** will be kept fully informed and have an opportunity to review findings and recommendations before any audit report is formally released.
- Create an atmosphere of **trust and friendliness.**

QNO 611.500	**Behavioural Aspects (Detailed discussion on solution of behavioural problems)** **Bhaskar CNO – MA.040**	**New Course—(N20E)**
	The management auditor has to analyze the nature and causes of behavioural problems in the discharge of the review function and to arrive at possible solutions to overcome these problems. As a management auditor of Real Limited, how will you demonstrate in arriving at a solution to behavioural problems and create an atmosphere of trust and friendliness, so that audit reports will be understood in their proper perspective?	

Answer

The auditors, if they were to adopt the role of accuser or secret agency of the management to try upon the happenings of the auditee division, they would be unwelcome. Relations between the auditor and the auditee may improve if the auditor acts and is perceived as a professional advisor and consultant.

Management auditor of Real Limited shall demonstrate, in arriving at a solution, Behavioural problems in the discharge of the review function.

In this case, there is a need to demonstrate to the extent possible that:

1. The audit is part of an overall programme mandated by higher- level authority to meet higher-level organizational needs for both protection and maximum constructive benefit.
2. The objective of the review is to provide maximum service in al l feasible managerial dimensions.
3. The review will be conducted with minimum interference with regular operations of the operating personnel.
4. The responsible officers will be kept fully informed and have an opportunity to review findings and recommendations before any audit report is formally released.

It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.

1. **Constructive criticism** - It is essential that the auditor should concentrate only on constructive criticism. He should also make obvious in his report the value of his comments in tangible terms. Only then would suggestions carry weight with the auditees and they will feel convinced that the auditor has been objective in his remarks in the report
2. **Reporting methods** - To achieve this objective, the auditor has to make a concerted effort to convey effectively his role by adopting a friendly but firm tone in his report. It is always possible to disagree without being disagreeable, to criticize without being critical. The reports should concentrate on areas which need improvement rather than listing inefficiencies and deficiencies in performance of the auditee.
3. **Participative approach** - It is well established that auditor's reports have better acceptability if the improvements suggested are discussed with those who have to implement them and made to feel that they have participated in the recommendations made for improvements. On the other hand, it has been observed that either oral or written appreciation of the auditee's achievements not only encourages the auditees to develop a friendly attitude towards the auditors but look forward to their guidance in a more receptive fashion.

	The participative approach to the internal audit process has proved to be success. Feelings of hostility disappear giving room to feelings of mutual trust. Team spirit is developed. Proposed recommendations are discussed with the auditee and such modifications as may be mutually agreed upon are incorporated.

QNO 611.600	Behavioural Aspects (Causes of Antagonism) Bhaskar CNO – MA.040	New Course—(M22E)
	XYZ Limited is manufacturer of soaps and cosmetics having business operations in Delhi. XYZ Limited is planning to expand its operations across India. Before expansion, the top management of XYZ Limited is willing to appoint CA T for conducting Management Audit of XYZ Limited. However, the top management of XYZ Limited is afraid that Management Audit may lead to the breeding of antagonism on the part of the Company. The top management of XYZ Limited approached CA T and requested to explain them the causes of antagonism. Help CA T.	
Answer	CA. T as the management auditor, is expected to evaluate the effectiveness of controls, the auditees might fear that the management audit report may create their incompetent impression on the top management of XYZ Limited. Therefore, the management audit may lead to the breeding of antagonism on the part of the auditees. Causes of antagonism are as under: **i.** Fear of criticism stemming from adverse audit findings. **ii.** Fear of changes in day-today working habits because of changes resulting from audit recommendations. **iii.** Punitive action by superiors prompted by reported deficiencies. **iv.** Insensitive audit practices - reports which are overly critical, reports which focus on deficiencies only, the air of mystery cloaking some audits, and the perception that auditors gain personally from reporting deficiencies. **v.** Hostile audit style - a cold and distant aspect is a lack of understanding of the auditee's problems, an absence of empathy, an air of smugness or superiority, an excessive concentration on insignificant errors, a prosecutional tone when asking questions, and a greater concern with parading defects than helping constructively to improve conditions.	

QNO 612.000	Hostile Management Bhaskar CNO – MA.040	Old Course-- (N07E, N09R, N10E, N12R, N13R, M16R, P17M, N20M, M21M) New Course-- (M18R, N20M, S21M, M21M, M23M)
	The Marketing Department of XYZ Ltd. has been consistently showing a lower performance whereas the cost of the department is increasing in spurts over the years. The management believes that since the marketing department is under a regular radar of the CFO, an audit might result in the employee hostility. Also, an operational audit of Marketing Department was done two years back however, the recommendations of the previous audit were not followed by the concerned employees. Please advise the management if another audit is the solution and whether only one-time operational audit is enough? Further, advise on the ways to deal with the employee hostility. **OR** **DLF Ltd., a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management** **OR** **The management of Amazon, a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management.**	
Answer	The Operational Audit is not one-time activity. It should be viewed as a continuous improvement cycle. All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario. Ways to tackle the hostile management: ➢ **Audit Findings** While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.	

➢ **Cold war**

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

➢ **Participative Approach**

They come to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co-operative enterprise.

➢ **Benefit of Participative Approach**

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of DLF manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of DLF.

QNO 614.000	**Operational Audit (Objectives)** **Bhaskar CNO – OA.080**	**Old Course-- (N05E, N06E, M09R, M11E, P17M, M18E)**
	Briefly explain the objectives and scope of Operational Audit.	

Answer

➢ **Appraisal of organizational structure: -**

In evaluating organizational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority.

(Packing Department / Dispatch Department / Delivery Department)

➢ **Appraisal of controls: -**

Operational auditing deals with the administration controls and its purpose is to determine whether the controls are adequate.

(System to track delivery of goods ordered online)

➢ **Appraisal of objectives and plans: -**

In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but accumulating information and evidence to measure the **effectiveness, efficiency and economy** with which the operations are being carried on.

(Comparison with what others do, what we promised, cost involved)

➢ **Evaluation of performance: -**

- In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards.
- The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise.

(How many parcels returned, average delivery time to various regions)

QNO 615.000	Operational Audit (Types) Bhaskar CNO – OA.020	Old Course-- (N17E)
	What are the types of Operational Audits?	
Answer	➢ **Type of Operational Audits: There are three broad categories of operational auditors:** Functional, organizational, and special assignments. In case, part of the audit is likely to concern evaluating internal controls for efficiency and effectiveness. • **Functional Audits -** Functions are a means of categorizing the activities of a business, such as the billing function or production function. There are many different ways to categorize and subdivide functions. For example, there is an accounting function, but there are also cash disbursements, cash receipt, and payroll disbursement functions. There is a payroll function, but there are also hiring, time keeping, and payroll disbursement functions. As the name implies, a functional audit deals with one or more functions in an organization. It could concern, for example, the payroll function for a division or for the company as a whole. A functional audit has the advantage of permitting specialization by auditors. Certain auditors within an internal audit staff can develop considerable expertise in an area, such as production engineering. They can more efficiently spend all their time auditing in that area. A disadvantage of functional auditing is the failure to evaluate interrelated functions. The production engineering function interacts with manufacturing and other functions in an organization. • **Organizational Audits -**An operational audit of an organization deals with an entire organizational unit, such as a department, branch, or subsidiary. An organizational audit emphasizes how efficiently and effectively functions interact. The plan of organization and the methods to coordinate activities are especially important in this type of audit. • **Special Assignments -** In operational auditing, special assignments arise at the request of management. There are a wide variety of such audits. Examples include determining the cause of an ineffective IT system, investigating the possibility of fraud in a division, and making recommendations for reducing the cost of a manufactured product.	

QNO 615.030	Operational Audit -- One Time Activity & Employee Hostility #Unique	New Course-- (M22M)
	"The Marketing Department of Charitra Ltd. has been consistently showing a lower performance whereas the cost of the department is increasing in spurts over the years. The management believes that since the marketing department is under a regular radar of the CFO, an audit might result in the employee hostility. Also, an operational audit of Marketing Department was done two years back however, the recommendations of the previous audit were not followed by the concerned employees. Please advise the management if another audit is the solution and whether only one-time operational audit is enough? Further, advise on the ways to deal with the employee hostility."	
Answer	➢ **The Operational Audit is not one-time activity.** It should be viewed as a continuous improvement cycle: All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario. However, to deal with the employee hostility the participative approach of the audit should be adopted: In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes a co-operative enterprise. This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When the participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report.	

	With this attitude of the auditor, it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor does not have to force any change on the auditee.

QNO 615.050	Shortcomings of traditional sources Bhaskar CNO – OA.040	Old Course-- (N19R) New Course-- (N19R, S21M)
	Perfect Steel Ltd. has reported a higher turnover of ` 560 crores in the year 2018-19 as compared to earlier years but its sales return has also increased to 10% from only 4% up to the last year. The management is concerned about the high sales returns and feels a need to get the operational audit done for sales and production department of the company. The company is also having an internal audit system in the company. Elaborate the possible reason/s, why management is getting operational audit done when internal audit has already been done for both the departments by stating the shortcomings of conventional information sources.	

Answer

➢ **Why Operational Audit:**

- **Inadequacy of Traditional Sources**
  - Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey.
  - These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers.
  - The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company.

- **Management is at distance & there are many layers of Delegation**
  - Where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation.
  - Specifically, operational auditing arose from the need of managers responsible for areas beyond their direct observation to be fully, objectively and currently informed about conditions in the units under control.

- **Specialised Management Information Tool**
  Operational audit is considered as a specialized management information tool to fill the void that conventional information sources fail to fill.

- **The shortcomings of these sources can be stated as under:**
  - P- Executives and managers are too **preoccupied** with implementation of plans and achieving of targets. They are left with very little time to collect information and locate problems. They may come across problems that have come to surface but they are hardly aware of problems that are brewing and potential.
  - T- Managers or their aides are generally relied upon for **transmitting** information than for booking for information or for analyzing situations.
  - B - The information that is transmitted by managers is not necessarily objective - often it may be **biased** for various reasons.
  - M-Conventional internal audit reports are often **routine and mechanical** in character and have a definite leaning towards accounting and financial information. They are also historical in nature
  - A-Other performance reports contained in the **annual audited accounts** and the routine reports prepared by the operating departments have their own limitations. The annual audited accounts are good as far as an overall evaluation is concerned in monetary terms.
    - **Example:-**
      Sales may be shown at a higher monetary value compared to the previous year and this may apparently suggest that the functioning of the sales department is satisfactory. But this may have been caused by a number of factors in spite of a really bad performance on the sales front. This fact may not be readily known unless one cares to analyse the sales data by

reference to notes and explanations to the accounts and other related accounting data. Even a study of this nature may not fully reveal the weakness. It is quite possible that the established market for sales has been lost partly while some fortuitous sales have compensated the loss.

- **Example:-**
  The routine weekly production report may include production 'that is subsequently rejected by the quality control staff, or to avoid showing a bad production performance; even the partly produced goods may also be included. Remember, all this can happen inspite of specific management instructions about the basis on which the production report is to be made out.

- **P**-Another important point may be noticed in the matter of routine departmental reports. The busy management people, who can afford time only to **glance over the performance reports**, cannot be expected to make an integrated reading of several reports or to undertake an analysis of such reports. What they need is reliable, un manipulated and objective report which they would like to look into to understand the situation.
- **R**-Operations of controls in a satisfactory manner **cannot be relied** upon to bring to light the environmental conditions. Controls are specific and their satisfactory operation is related to the specific situation under control. Also monitoring of the breakdown or non-operation of controls is a periodic phenomenon.
- **O**-Surveys and special investigations, no doubt, are very useful but these are at the best **occasional** in character. Also, they are costly, time consuming and keep the departmental key personnel busy during the period they are on. These are basically an attempt to carry out a post-mortem rather than to enlighten the management about the ways on improvement or for better performance or to give a signal for dangers and disasters to come.

Author's Note
A-bhishek **B**-Bacchan is not **PROMPT**
A-**Annual audited accounts/B-Biased** for various reasons. /**P**-**Preoccupied/R**-cannot be **relied / O** - **Occasional** in character/**M**-routine and M**echanical/ P**- Glance over the **performance reports/T**-**Transmitting** information

QNO 617.010	Types of Audit & Differences Bhaskar CNO – OA.140	Old Course-- (N08R, M08E, M11R, M12E, P17M, M17M, N17E, N18R, N19R, M21E) New Course-- (N18R, N19R, S21M, N21M)

Many modern enterprises have become huge and sophisticated. This has resulted in decentralisation of their activities and different type of audits. You are required to explain the difference to the management:
(a) Internal & Operational Audit.
(b) Management Audit & Operational Audit.
(c) Financial Audit & Operational Audit.

OR

Financial vs. Operational Audit

OR

The main objective of operational auditing is to verify the fulfilment of plans, and sound business requirements while in financial auditing, the concentration is more in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are minimized or removed. Analyze and Explain stating clearly major differences between Financial and Operational Auditing.

OR

Operational auditing is not different from internal auditing" Discuss

OR

You are also required to discuss the difference in the approach of both these audits (Operational Vs Internal Audit)

Answer

(a)Difference between Internal & Operational Audit: There probably may not be much of difference in viewing operational audit as a review and appraisal of operations of an organization carried on by a competent independent person. Auditing whether carried on by an internal staff or by an external person, should necessarily be an independent activity to maintain its objectivity and usefulness.

The difference in the approach of both these audits is illustrated below:

- **Perception -**Traditionally, internal auditors have been engaged in a sort of protective function, deriving their authority from the management. They view and examine internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they check the accounting books and records to see, whether the internal checks are properly working, and the resulting accounting data are reliable.

  For example - when the auditor looks into the vouchers to see whether they corroborate the entries in the cash book or physically examines the cash in hand he is doing his traditional protective function. The moment be concerns himself to see whether customers' complaints are duly attended to or whether cash balance is excessive to the need, he comes to the operational field.

  Also, he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would be interested in such matters as reorder policy, obsolescence policy and the overall inventory management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

- **Issues** - The basic difference that exists in Conceptualization of the technique of operational auditing is in the auditor's role in recommending corrections or in installing systems and controls. According to Lindberg and Cohn, such a situation would be in conflict with the role of operational auditor. In this connection, the views of the Institute of Internal Auditors, in the context of internal audit are relevant. According to that Institute, "the internal auditor should be free to review and appraise policies, plans, procedures and records; but his review and appraisal does not in any way relieve other persons in the organisation of the responsibilities assigned to them. However, a further distinction should be observed between traditional internal auditing and operational auditing - this lies in the attitude and approach to the whole auditing proposition. Every aspect of operational auditing programme should be geared to management policies, management objectives and management goals.

- **Objectives**- The main objective of operational auditing is to verify the fulfillment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects and grasp technical matters. In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. The norms and standards should be such as are generally acceptable or developed by the company itself. Performance yardsticks can be found in the management objectives, goals and plans, budgets, records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, association and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments.

  For Example: *The standards relating to objectives for a government company are quite different from those of a private sector company. Similarly, standards of performance of a well-equipped company which also adequately looks after the well-being of employees may be significantly different from a company which offers scanty welfare facilities or is ill-equipped.*

  Today, however, the QNO of modern internal auditing suggests that there is no difference in internal and operational auditing. In fact, the scope of internal auditing is broad enough to embrace the areas covered by operational auditing as well. The modern internal auditing performs both protective as well as constructive functions.

(b) Difference between Management Audit & Operational Audit

- Management audit is concerned with the "Quality of managing", whereas operational audit focuses on the "Quality of operations".
- Management audit is the **"Audit of management"** while operational audit is the **"Audit for the management".**
- The basic difference between the two audits, then, is not in method, but in the level of appraisal. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies.

(c) Differences between Financial and Operational Auditing -The major differences between financial and operational auditing can be described as follows:

- **Purpose -**The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.
- **Area -**Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.
- **Reporting -**The financial audit report is sent to all stockholders, bankers another persons having stake in the Organisation. However, the operational audit report is primarily for the management.
- **End Task -** The financial audit has reporting the findings to the persons getting the report as its end objective; however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

Author's Note
More precise and point wise difference between internal audit and operational audit

This answer itself is little vague, there are 3 headings, these headings don't mean these 3 points of differentiation. First 2 points explain traditional internal audit and last point focuses on operational audit.
Traditional Internal Auditors focuses more on whether internal financial and accounting controls are properly designed, are they properly implemented, installed are they working properly are they able to prevent or detect problem.
For example, they will focus more on whether cash receipts and payments are as processed and recorded as per company's internal financial and accounting controls, then perform cash count and ensure cash balance is appropriate.

But operation auditors think can we change our approach of doing business, can we change technology, system, what new developments can be done in organisation.
For Example, they will think whether maintaining so much cash balance is required, how cash balance requirement can reduce how overall cash transactions can come down. How we can have more payments and receipts through banking and online medium.
Final conclusion Internal Auditor is more concerned with system installation, implementation and correction. Operational auditor is more concerned with improving business by changing company's approach, systems etc, bringing new developments to improve business activity.

For answer Explain these differences and give examples of cash etc
Focus: - For IA = Systems for OA = Business

Approach: - For IA = Protective Function for OA = Development Functions

Compliance: - For IA = Examining compliance of systems. For OA = Changes required in systems

QNO 617.050	**Management Audit or the Operational Audit -penal interest payments and the delays in shipping- #Unique**	**New Course-- (S21M)**

M/s ABC & Co., Chartered Accountants have been approached by PQR Ltd., a company engaged in iron and steel manufacturing industry. The company has been facing following operational issues:
(a) Penal interest for delayed payments to the overseas vendors despite having enough cash flows; and
(b) Despite having regular production and enough inventory, delays in shipping the final goods to the

	customers leading to its deteriorating vendor rating. **As a partner of M/s ABC & Co., through detailed discussion with the Senior Manager of PQR Ltd., you have concluded that all these delays are because of long decision-making cycles in the company. As a consultant to the Company, would you recommend Management Audit or Operational Audit?**
	➢ A comparison between the Management Audit & the Operational Audit is as follows: ➢ Management audit is concerned with the "Quality of managing", whereas operational audit focuses on the "Quality of operations". ➢ Management audit is the "Audit of management" while the operational audit is the "Audit for the management". The focus of Management Audit is on "Quality of Decision Making" rather than the effectiveness or efficiency of operations. ➢ The basic difference between the two audits, then, is not in method, but in the level of appraisal. ➢ In a management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies. ➢ Since the delays in payments and consequent penal interest payments and the delays in shipping and the consequent deteriorating vendor ratings are happening because of the delays in decision-making process of the management. Therefore, it appears that this is not just an internal control or operational issue but an issue of management process. ➢ Therefore, management audit would be recommended in this case.

QNO 619.000	**Attrition Rate** **Bhaskar CNO – OA.120**	**Old Course-- (M13E, M16M, N16R, P17M, N17R, N17M, N18M, M20M)** **New Course-- (M20M)**
	The Managing Director of Beta Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyse the causes for the same. What factors would you consider in such analysis? **OR** **You have been appointed as an internal auditor of a company RSM Ltd. The Managing Director Rakesh is worried about employee attrition in large number. Rakesh requests you to analyse the causes for high employee attrition rate in his company. What factors would you consider in such analysis?**	
Answer	➢ The factors responsible for high employee attrition rate are as under: ***(Trainings & Work Culture)*** • Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices? *(Outdated work culture, Using Type Writer)* ***(Timings)*** • Job Stress & work life imbalance *(12 hours of work&3 hours of travel, 6 hours of sleep, 2 hours of routine work, 1 hour for family)* ***(Seniors)*** • Whether the organization has properly qualified and experienced personnel for the various levels of works? *(Inexperienced seniors & HRs)* • Unbearable behaviour of Senior Staff *(Shouting & Abusing)* ***(Colleagues)*** • Is the number of people employed at various work centre's excessive or inadequate? *(Excess Staffing or Understaffing leading to strain on few)* ***(Salary & Schemes)*** • Low monetary benefits *(Salary 30-40% lower than market)* • Lack of labour welfare schemes *(No Development & Encouragement)* ***(Safety)*** • Safety factors *(Office is at remote location, prone to thefts)*	

	Author's Note **Answer has been rearranged to create a flow,"Headings in Comics font "are included by author for helping the students to understand and remember the answer**

QNO 619.010	Decreasing Operating Efficiency- #Unique	New Course--(N18E)
	The Board of Directors of XYZ Ltd. is concerned with decreasing operating efficiency in material consumption. As an Auditor entrusted with investigating the causes for this poor state, what may be the areas of your focus in this respect.	
Answer	➢ **Decreasing Operating Efficiency in Material Consumption:** It is the **input-output ratio**. In the case of public spending, efficiency is achieved when the output is maximized at the minimum of inputs, or input is minimized for any given quantity and quality of output. • The auditor should make an **analytical procedure** to compare the material consumption without put for the **current year as well as previous years.** • The **production process, scheduling, machine usage, material mix** should be studied. • The **internal control system** should be studied. • The **budget, standard costing and other MIS reports** should be called for and studied. • A **reconciliation of variation** as to various causes – Price, quantity efficiency is to be analysed • The auditor should have **discussions/ inquiry** with different personnel of the company including production personnel. • **Internal audit report** should be thoroughly studied and whether any pilferage, fraud etc. were noticed. These are to be looked into. • The **key material** should be picked up for detailed study of their ordering, receipts, issue, normal loss yield percentage etc.	

QNO 620.000	Error of 1000 Bhaskar CNO – OA.020/CNO – OA.140	Old Course-- (M14E, M15R, P17M) New Course-- (M18M)
	Mr. 'P' has been appointed as operational auditor of M/s Books & Magazine Ltd. And observed a totalling error in invoice of ` 1,000. He has not taken care of the same saying that this is out of scope of his work. Comment.	
Answer	➢ **Future Oriented and Recommendatory** Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future. ➢ **Definition of Operational Audit** The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters. ➢ **Judgement** In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues; he will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.	

	➢ **Approach -Internal Audit vs Operational Audit** To a traditional internal auditor, a loss of ` 1,000 caused by a wrong totalling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In both the cases, the auditor's objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls. ➢ **Conclusion** Hence, contention of operational auditor that totalling error in invoice of ` 1,000 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.
	Author's Note **Explanation to the above answer** • The answer first explain that operational auditor focuses on improvement in business activity so as to achieve business goals & objectives, it involves using business sense, practical approach etc but internal audit is more about compliance to internal control system and how to stop frauds & errors so approach is little different . • Error of 1000 is relevant and important for both as it is error it is important for internal audit and it is a financial loss so relevant for operational auditor also

QNO 621.005	**Responsibility of Internal Auditor- #Unique**	**New Course-- (N18M)**
	XYZ Yarns Ltd. is a manufacturing company engaged in manufacturing of different types of yarns. Its annual turnover is Rs. 100 Crores and net profit Rs. 10 crores. It has two manufacturing units. Company is facing difficulties in maintaining adequate system of internal control. Company wants to appoint Internal Auditor who would help in the above task and also various other functions including compliance. In view of above, you are required to explain the main responsibility of Internal Auditors.	
Answer	**Shortcut - Internal Auditor should say NO to FA2KE** ➢ Main responsibility of internal auditor must be: • to observe facts and situations and bring them to notice of authorities who would otherwise never know them. • to operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him. • In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit • to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safeguards against misappropriation of assets.	

QNO 621.300	**Review of Systems & Procedures (How to Review?) #UNIQUE**	**Old Course-- (N20E)**
	"In reviewing any System or Procedure, the management auditor must concern himself with its purpose as well as its design." Elucidate how you as a management auditor will study system and procedural functions?	
Answer	In reviewing any system or procedure, the management auditor must concern himself with its purpose as well as its design and then he must decide on its merits as the best serving the interests of the enterprise. A poor system or procedure may prevent the carrying out of the policy for which it was intended. A system may have outgrown its usefulness. The end result of a system or a procedure	

	may be loose and may require improvement. In the study of the systems and procedural functions, the auditor should ask himself: 1. Is the function properly located in the organisation? 2. Do the staff personnel have the necessary training and experience to perform the work? 3. Has a definite programme been established and has been taken for its attentive accomplishment ? 4. Is productivity satisfactory?

QNO 621.350	Review of Systems & Procedures (Whether it fulfils current requirements ?) #UNIQUE	New Course-- (M21E)
	CA Gudia has been appointed as Management Auditor of XYZ Ltd. The principal reason for her appointment is that current managerial decisions are not up to the mark, especially in relation to investments made by the Company. The Company is going to make huge investments in one of the that ventures identified. Management Auditor was required to ensure that systems and procedures of Company are working effectively and meeting the requirements. ` by CA Gudia to determine that the systems and procedures are meeting current requirements?	
Answer	Aspects to be considered by Management auditor to determine that the systems and procedures are meeting current requirements - CA Gudia should proceed as under : The evaluation of a system or a procedure actually includes three separate considerations. **First**, is the system or procedure meeting all of the **current requirements**? **Second**, is it **operating effectively**? And **third**, what is the **degree of effectiveness**? **To determine whether the system or procedure is meeting current requirements, the following among other things should be considered:** 1. Is the system or procedure **designed** to promote the **achievement of the company's objectives**, and is it **accomplished effectively**? 2. Does the system or procedure **operate within the framework of the organisational structure**? 3. Does the system or procedure adequately **provide methods of control** in order to obtain maximum performance with the least expenditure of time and effort? 4. Do the routines designated in the system or procedures **indicate performance in a logical sequence**? 5. Does the system or procedure provide the means for **effective coordination between one department and another**? 6. Have all required **functions been established**? 7. Has the **necessary authority been designated** to carry out responsibilities? 8. Can **any changes** be made to improve effectiveness? The important thing is to make sure that the system or procedure is designed to meet the desired results

QNO 621.400	Personal Qualities Of Operational Auditor #UNIQUE	New Course—(N22M/M23R)
	Employees of MIG Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Chinmay Travels Ltd. for managing booking, cancellation and other services required by their employees. As per contract terms, Chinmay travels has to raise its monthly bills for the tickets booked or cancelled during the period and the same are paid by MIG Ltd. within 15 days of the bill date. The bills raised by Chinmay travels were of huge amount, so the management of MIG Ltd. decided to get	

	an audit conducted of the process followed for booking/ cancellation of tickets and verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for? Also briefly discuss the qualities the auditor should possess for such audit. **OR** **Qualities of Operational Auditor.**
Answer	**Operational audit,** (functional audit) as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Chinmay travels for the organisation. The operational auditor should possess some very essential personal qualities to be effective in his work: 1. In areas beyond accounting and finance, his knowledge ordinarily would be rather scanty, and this is a reason which should make him even more inquisitive. 2. He should ask the who, why, how of everything. He should try to visualise whether simpler alternative means are available to do a particular work. 3. He should try to see everything as to whether that properly fits in the business frame and organisational policy. He should be persistent and should possess an attitude of skepticism. 4. He should not give up or feel satisfied easily. He should imbibe a constructive approach rather than a fault-finding approach and should give a feeling that his efforts are to help attaining an improved operation and not merely fault finding. 5. If the auditor succeeds in giving a feeling of help and assistance through constructive criticism, he will be able to obtain co-operation of the persons who are involved in the operations. This will itself be a tremendous achievement of the operational auditor. He should try to develop a team comprised of people of different backgrounds. Involvement of technical people in operational auditing is generally helpful.

16 Due Diligence, Investigation and Forensic Audit

PART - 1 DUE DILIGENCE

QNO 621.500	Due diligence v/s Audit Bhaskar CNO – DD.020	New Course-- (S21M)
	"Due diligence is different from audit" – Explain the difference between due diligence and audit.	
	➢ It needs be underlined that due diligence is different from audit. ➢ **Audit** Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon. ➢ **Due Diligence** Whereas due diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.	

QNO 622.000	DD (Areas) Bhaskar CNO – DD.040	Old Course-- (M08E, M13M, M15E, P17M)
	Areas in which due diligence can take place.	
Answer	➢ **Areas in which Due Diligence can take place-** ⩔ **Legal due diligence:** This may be required where legal aspects of functioning of the entity are reviewed. For example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws. ⩔ **Commercial/operational due diligence:** It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example, whether proposed merger would create operational synergies. ⩔ **Environmental due diligence:** It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity. ⩔ **Personnel due diligence:** It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring. ⩔ **Financial Due Diligence:** It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence. ⩔ **Tax Due diligence:** It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition. ⩔ **Information systems due diligence:** It pertains to all computer systems and related matter of the entity.	

QNO 623.000	Financial Due Diligence Bhaskar CNO – DD.060	Old Course-- (M11R, N12R, N12M,N14R,M16R, P17M,N17E,M21M) New Course-- (S17M, S21M, M21M)

Mr. Q is the proprietor of a very profitable business dealing in speciality chemicals. Due to his old age, Mr. Q wants to sell his business and has approached XYZ Pvt. Ltd., a competitor, for the same. As an advisor to XYZ Pvt. Ltd., you are appointed to do a 'Due Diligence' of the business. Enumerate the points which you would look into as part of the Due diligence exercise.

OR

Sri Rajan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. Ceta Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business. What procedures you would adopt before you could render any advice to Ceta Ltd.?

OR

PB Ltd. entered into a deal with SV Ltd. for buying its business of manufacturing wooden products/ goods. PB Ltd. has appointed your firm for conducting due diligence review and they want to know the cash generating abilities of SV Ltd. What points will you check in order to ensure that the manufacturing unit of SV Ltd. will be able to meet the cash requirements internally?

Answer

Some of the significant key areas which shall be covered under the review are as under:

- **Historical Background:** The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. **An eye into the history of the company may reveal its turning points, survival strategies adopted from time to time, the market share enjoyed by and changes therein, product life cycle and adequacy of resources.** It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the said company. This could, inter alia, include the nature of business(es), location of production facilities, warehouses, offices, products or services and markets.

- **Financial Projections:** The projections for the **next five years with detailed assumptions and workings and the appropriateness of assumption** used in the preparation and presentation of financial projections. If the accountant is of the opinion that as assumption used by the company are unrealistic, the accountant should consider its impact on the overall valuation of the company.

- **Significant Accounting Policies:** The accounting policies being followed by the company and the appropriateness thereof is another key area. **The impact of the recent changes in the accounting policies in the recent past keeping in view its intention of offering itself for sale.** The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is also quite important to ascertain significant accounting policies used by the company, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the company are different from those adopted by the acquiring enterprise and the effect of such differences. **Finally, examine whether the financial statements of the company have been prepared in accordance with the governing statutory requirements.**

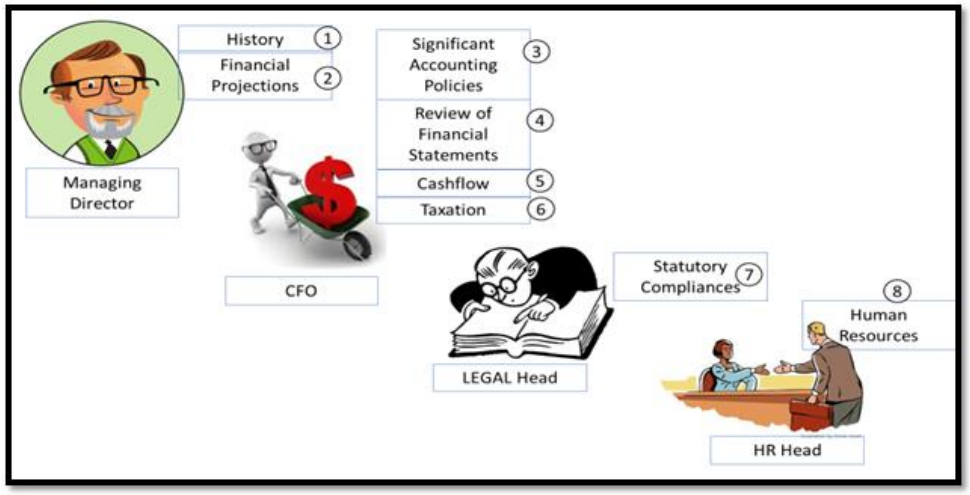
- **Review of Financial Statements:** An evaluation of the profit reported by the company would be largely based upon its operating results**. Any extraordinary item of income or expense that might have affected the operating results would require close examination.**

  It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. It is important that the trading results for the **past four to five years are compared and the trend** of normal operating profit arrived at. The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business. The exercise to evaluate the balance sheet of the company has to take into consideration the basis upon which assets have been valued and liabilities have been recognized. **The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.**

- **Cash Flow:** A review of historical cash flows and their pattern would reflect the cash generating abilities of the company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. It is necessary to check:
  - Whether the company **is able to honour its commitments** to its trade payables, to the banks, to government and other stakeholders;
  - How well is the **company able to turn its trade receivables and inventories;**
  - How well does it **deploy its funds;** and
  - Whether any funds are **lying idle or is the company able to reap maximum benefits out of the available** funds.

- **Statutory Compliance:** This is one area that has to be examined in detail. It is important to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance, it could lead to punitive charges under the law. The impact on such violations be quantified and assessed in respect of entity; financial status and even on its governing concern status.

- **Human Resources:** In the Indian context, the status of work force, staff and employees is a complex problem. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these matches the requirements of the new incumbents. The aspects whether all employee benefits like PF, Gratuity, ESI and superannuation have been properly paid/funded. The pay packages of the key employees will be thoroughly reviewed since this can be a crucial factor in future employee costs.



Author's Note

- **If the question asks about due diligence but it is silent on which type of due diligence, then we have to assume and write answer considering financial due diligence.**
- **Question may also ask about any specific requirement such as the 3rd question which specifically asks for "What points will you check in order to ensure that company will be able to meet the cash requirements internally?", in such case such write the 5th para of the answer that deals with cash flow.**
- **If question is on due diligence on proprietary business then give answer for financial due diligence i.e QNO 623.000 and if it is on investigation of proprietary business answer as per QNO 643.050.**

QNO 627.000	DD (Under / Over Valuation) Bhaskar CNO – DD.100	Old Course-(N05E, N10E, M12E, N13E, M15R, P17M, M17R, N17M, N19R, N20R, N20E) New Course-- (M18E, N19R, N20R, N20E, S21M,N22M)

M Limited is going to acquire S Limited The purchase consideration has been decided at Rs 4000 Crores M Limited is worried about hidden liabilities or overvalued assets of S Limited and approached you to examine the same List out eight important transactions/items which you would like to investigate in the Due Diligence exercise.

OR

Zeta Ltd is anticipating taking over a manufacturing concern and appoints you for due diligence review While reviewing, it requests you to look specifically for any hidden liabilities and overvalued assets State in brief the major areas you would examine for hidden liabilities and overvalued assets.

OR

Vita Ltd. is anticipating taking over a manufacturing concern and appoints you for due diligence review. While reviewing, it requests you to look specifically for any hidden liabilities. State in brief the major areas you would examine for hidden liabilities.

OR

K.DK Bank Ltd., received an application from a pharmaceutical company for takeover of their outstanding term loans secured on its assets, availed from and outstanding with a nationalized bank. KDK Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts.

Answer

Different Types

Due diligence is an all-pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter.

Review of Financial Statements

As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the viewpoint of extraordinary items, analysis of significant deviations, etc.

Hidden Liabilities

However, in order to investigate hidden liabilities, the auditor should pay his attention to the following areas

Government

- The company may not show any **show cause notices** which have not matured into demands, as contingent liabilities. These may be material and important.
- **Tax liabilities under direct and indirect taxes**.
- **Long pending sales tax assessments**.
- Pending final assessments of customs duty where **provisional assessment** only has been completed.

Share Holders

- Agreement to buy back shares sold at a stated price.

Financers

- The company may have given **"Letters of Comfort"** to banks and Financial Institutions.
- Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.

Subsidiaries

- The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.

Employees

- **Unfunded** gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
- Huge **labour claims under negotiation** when the labour wage agreement has already expired.

- **Customer**
  - Product and other **liability claims; warranty liabilities;** product returns/ discounts; liquidated damages for late deliveries etc. and all litigation.
- **Other Third-Party Liabilities**
  - Environmental problems/claims/third party claims.
  - Future lease liabilities.
  - Contingent liabilities not shown in books.

➢ **Regularly Overvalued Assets**

The auditor shall have to specifically examine the following areas:

- **Fixed Assets**
  - **Underused or obsolete** Plant and Machinery and their spares;
  - Asset values which have been **impaired due to sudden fall in market value etc**.
  - Litigated assets and property.
- **Investments**
  - Investments **carried at cost** though realizable value is much lower.
  - Investments carrying **a very low rate of income / return.**
- **Inventory**
  - **Obsolete,** slow non-moving inventories or inventories valued above NRV; **huge** inventories of packing materials etc. with name of company.
- **Trade Receivables**
  - Uncollected / uncollectable receivables.
  - Group Company balances under reconciliation etc.

Authors Note

Students are advices to see in the question what is asked, whether hidden liabilities or overvalued assets or both and then shall answer accordingly.

QNO 628.000	Due Diligence Report Bhaskar CNO – DD.120/ CNO – DD.060	Old Course-- (M07E, N08R, N15E, N16R, P17M, N17R, M19M, N21R) New Course-- (N18M, M19M, S21M, N21R)

A Japanese Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India, request you to conduct a "Due Diligence" of this Indian Company and submit your report.

As a due diligence auditor:

(a) indicate the key areas you will cover in your review.

(b) list out the contents of your Due Diligence Review Report that you will submit to your Japan based Client.

Answer

(a)Some of the significant key areas which shall be covered under the review are as under:

➢ **Historical Background:** The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. **An eye into the history of the company may reveal its turning points, survival strategies adopted from time to time, the market share enjoyed by and changes therein, product life cycle and adequacy of resources.** It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the said company. This could, inter alia, include the nature of business (es), location of production facilities, warehouses, offices, products or services and markets.

➢ **Financial Projections:** The projections for **the next five years with detailed assumptions and workings and the appropriateness of assumption** used in the preparation and presentation of financial projections. If the accountant is of the opinion that as assumption used by the company are unrealistic, the accountant should consider its impact on the overall valuation of the company.

- **Significant Accounting Policies:** The accounting policies being followed by the company and the appropriateness thereof is another key area. **The impact of the recent changes in the accounting policies in the recent past keeping in view its intention of offering itself for sale.** The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is also quite important to ascertain significant accounting policies used by the company, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the company are different from those adopted by the acquiring enterprise and the effect of such differences. **Finally, examine whether the financial statements of the company have been prepared in accordance with the governing statutory requirements.**

- **Review of Financial Statements**: An evaluation of the profit reported by the company would be largely based upon its operating results. **Any extraordinary item of income or expense that might have affected the operating results would require close examination.**

  It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. It is important that the trading results for the **past four to five years are compared and the trend** of normal operating profit arrived at. The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business. The exercise to evaluate the balance sheet of the company has to take into consideration the basis upon which assets have been valued and liabilities have been recognized. **The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.**

- **Cash Flow:** A review of historical cash flows and their pattern would reflect the cash generating abilities of the company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. It is necessary to check:
  - Whether the company **is able to honour its commitments** to its trade payables, to the banks, to government and other stakeholders;
  - How well is the **company able to turn its trade receivables and inventories;**
  - How well does it **deploy its funds**; and
  - Whether any funds **are lying idle or is the company able to reap maximum benefits out of the available** funds.

- **Statutory Compliance:** This is one area that has to be examined in detail. It is important to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance, it could lead to punitive charges under the law. The impact on such violations be quantified and assessed in respect of entity; financial status and even on its governing concern status.

- **Human Resources:** In the Indian context, the status of work force, staff and employees is a complex problem. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these matches the requirements of the new incumbents. The aspects whether all employee benefits like PF, Gratuity, ESI and superannuation have been properly paid/funded. The pay packages of the key employees will be thoroughly reviewed since this can be a crucial factor in future employee costs.

(b)The contents of a due diligence report can be discussed under:

(Start of the Report)

- Terms of reference and scope of verification.
- Objective of due diligence.
- Brief history of the company including shareholding pattern.

(Legal DD Related)

- Assessment of possible liabilities on account of litigation and legal proceedings against the company and suggestion on ways and means including affidavits, indemnities, to be executed to cover unforeseen and undetected contingent liabilities.
- Status of franchises, license and patents.

	(Operational / Commercial DD Related) ➢ Assessment of operating results. ***(Environment DD Related)*** ➢ Assessment on Environment Related Policies ***(Personnel DD Related)*** ➢ Assessment of Management Structure. ***(Financial DD Related)*** ➢ Assessment of valuation of assets including comments on properties, terms of leases, lien and encumbrances including status of charges, liens, mortgages, assets and properties of the company. ➢ Assessment of financial liabilities with special emphasis on Interlocking investments and financial obligations with group/associates' companies, amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account. ➢ Assessment of net worth. ***(TAX DD Related)*** ➢ Assessment of taxation and statutory liabilities. ***(IT DD Related)*** ➢ Assessment of Information Technology ***(Conclusion Related)*** ➢ Suggestions on various aspects to be taken care of before and after the proposed merger / acquisition. ➢ Finally, an executive summary may be prepared highlighting the significant areas.

QNO 625.000	Investigation (Incoming Partner) Bhaskar CNO – INTG.100	Old Course-- (N10R, M14R,P17M, M20M) New Course-- (S17M, M18M, M20M, S21M, M23M)

What are the important steps involved while conducting Investigation on behalf of an Incoming Partner?

OR

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. The partners have agreed to take Mr. Mistri as a partner with effect from 1st April 2018 as 1/4th partner.
What are the important steps involved while conducting investigation on behalf of Mr. Mistri, the incoming partner?

Answer

➢ **Purpose: -**

- To know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc.
- To ascertain whether the capital to be contributed by him would be safe and applied usefully.

➢ **Areas to be covered: -**

- **Reasons & History**
  - Ascertain **reasons** for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
  - Ascertainment of the **history of the firm**, since inception and growth of the firm.

- **Present Situation & Partnership Deed**
  - Study the composition and **quality of key personnel employed** by the firm and any likelihood of their leaving the organization.
  - Assess **position of orders** at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
  - Studies of the provisions of the **Deed of partnership**, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
  - Examine whether any **special clause** exists in the deed of partnership to allow admission in future of a new partner, who may be specified, on concessional terms.

- **Financial Statement Analysis**
  - Appraisal of the record of **capital employed** and the rate of return. It is necessary to have a comparison with alternative business avenues for investments.
  - Ascertain manner of computation of **goodwill** on admission as also on retirement, if any
  - Scrutinize **terms of loan finance** to assess its usefulness and implication for the overall financial position.
  - Examine whether the **incomplete contracts** which will be transferred to the reconstituted firm will be a liability or a loss.
  - Scrutiny of the record of **profitability** of the firm's business over a suitable number of years.
  - Examination of the **asset and liability position** to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment.

QNO 632.000	Audit Vs Investigation Bhaskar CNO – INTG.020	Old Course- (N04E, N10R, N12M, P17M, M17R, N18E, N19R) New Course-- (N19R, S21M)

General objective of an audit is to find out whether the financial statements show true and fair view. On the other hand, investigation implies systematic, critical and special examination of the records of a business for a specific purpose. In view of the above, you are required to brief out the difference between Audit and Investigation.

Answer

➢ ***Auditing***

It involves examination of financial information contained in financial statements to **express an opinion** whether or not the same have been prepared properly. In essence, auditing involves independent examination of financial information prepared by the management of an entity.

➢ ***Investigation*: -**

- It implies systematic, critical and special examination of the records of a business for a **specific purpose.**
- The examination conducted under investigation is **intensive as well as exhaustive** so far as the activities or areas of accounting is concerned. Investigation requires a concentrated focus on the subject matter of inquiry and related matters.

Basis	INVESTIGATION	AUDIT
➢ **Objective**	It aims at **establishing a fact or a happening or at assessing a particular situation**	To verify whether the financial statements **display a true and fair view** of the state of affairs and the working results of an entity.
➢ **Legal Requirement**	Voluntary, in some companies it may be ordered as per LAW	Mandatory for Companies. For others, it is voluntary
➢ **Who performs / Conducted by**	Any person, who may not be a Chartered Accountant.	**A Chartered Accountant** within the meaning of the Chartered Accountants Act 1949.
➢ **Scope**	The scope of investigation may be governed by statute **OR** it may be non-statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
➢ **Time Frame (Period Covered)**	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain	The audit is carried on either quarterly, half-yearly or yearly.
➢ **Nature of activities performed**	Requires a detailed study and examination of facts and figures	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion
➢ **Application of accounting principles**	It is analytical in nature and requires a thorough mind, capable of observing, collecting and evaluating facts. There may not be any focus on accounting principles and disclosures.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
➢ **Evidence**	It seeks conclusive evidence	Audit is mainly concerned with prima- facie evidence (Persuasive Evidence).
➢ **Reporting**	The outcome is reported to the person(s) on whose behalf investigation is carried out. (No particular format)	The outcome is reported to the owners of the business Entity. (Format is generally fixed)
➢ **Inherent Limitations**	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent Limitation.
➢ **Pre-Condition**	Its essence lies in going into the matter with some pre-conceived notion suited to the objective	Audit is not based on suspicion unless circumstances exist to arouse suspicion

QNO 633.000	Embezzlement of Cash- Areas Bhaskar CNO – INTG.140	Old Course- (N07E, M09R, M12M,M16M, P17M, N17M, N18M) New Course-- (S17M, S21M)
	In a company, it is suspected that there has been embezzlement in cash receipts. The company appoints you as an investigator. What are the areas you would verify?	
Answer	➢ **Cash Receipts: -** • Showing a **larger cash discount** than actually allowed. • Issuing a receipt to the payee for the full amount collected and **entering only a part of the amount on the counterfoil.** • Adjusting a **fictitious credit in the account of a customer** for the value of goods returned. • Adjusting **a cash sale as a credit sale and raising a debit in the account of the customer.** • Writing off **a good debt as bad and irrecoverable** to cover up the amount collected. • **Short debiting the customer's account** in the ledger with an intention to withdraw the difference when the full amount payable. • **Under-casting the receipts** side of the Cash Book. • **Over-casting the payment side** Cash Book.	

QNO 635.000	Fraud (Supplier Ledger) Bhaskar CNO – INTG.140	Old Course- (N08E, M11E, N16M, P17M, N19E) New Course-- (S21M)
	Write a short note on Frauds through supplier ledger. **OR** **In a Public Limited Company, it is suspected by the Management that there has been embezzlement in supplier's ledger. As an auditor of the Company, you have been asked to investigate the matter. What are the major areas that you would verify in this regard?**	
Answer	➢ **Supplier Ledger: -** • **Suppressing the Credit Notes** issued by suppliers and withdrawing the corresponding amounts not claimed by them. • **Accepting purchase invoices at prices considerably higher** than their market prices and collecting the excess amount, paid in cash, from the suppliers. • Adjusting **fictitious or duplicate invoices** as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices. • **Withdrawing amounts unclaimed by suppliers**, for one reason or another by showing that the same have been paid to them. • The auditor should **verify the bought journal with reference to entries in the Goods Inward Book and the suppliers' invoices** to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received, and the suppliers' accounts had been credited correctly. • The auditor **should request all the suppliers to furnish statements of their accounts** to see whether or not any **balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted**.	

QNO 637.010	Investigate Frauds of Inventory defalcation Bhaskar CNO – INTG.140	Old Course- (M19R, N19M) New Course-- (N19E, N19M,M19R, S21M)
	Mr Sharma is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers. **Mr. Sharma is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert, you are required to brief Mr. Sharma about the inventory fraud and verification procedure with respect to defalcation of inventory?**	
Answer	➢ **Inventory frauds**- Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.	

- Employees may simply remove goods from the premises.
- Theft of goods may be concealed by writing them off as damaged goods, etc.
- Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

➢ **Verification Procedure for Defalcation of inventory**- It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.
The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- a system of inventory control, and existence of detailed record of the movement of inventory, or
- availability of sufficient data from which such a record can be constructed.

The step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.
Defalcations of inventory, sometimes, also are committed by the management, by **diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production**; similar defalcations of inventories and stores are covered up by **inflating quantities issued for production.** For detecting such shortages, the investigating accountant should take **assistance of an engineer**. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the **shortage in production has been inflated.**

In this regard, guidance can also be taken from **past records showing the extent of wastage in production in the past.** Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

QNO 639.000	**Investigation (Future Maintainable Turnover)-** **Unique**	**Old Course- (M13E, M16M, P17M, M18M, M19M)** **New Course-- (S17M, M19M, S21M,N22E)**
	H Ltd. is interested in acquiring S Ltd. The valuation of S Ltd. is dependent on future maintainable sales. As the person entrusted to value S Ltd., what factors would you consider in assessing the future maintainable sales?	

Answer

➢ **Factors to be considered in Assessing Future Maintainable Sales:**
In assessing the sales which the business would be able to maintain in the future, the following factors should be taken into account-

(Past)

- **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.

(Present)

- **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

- **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

	(Future) • **Marketability**: Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.

QNO 640.000	Investigation (Ownership)- Bhaskar CNO – INTG.160	Old Course- (N16E, M18M)
	The Central Government is of the view that there are certain interested members and companies who are financially interested in the success or failure of the company or who have been able to control or to materially influence the policy of the company. Hence the Central Government wants to investigate the ownership of the company. Describe the scope and extent of investigation by an Investigator/ Chartered Accountant on behalf of Central Government under Companies Act, 2013.	

Answer

➢ Scope and extent of investigation under Companies Act,2013 –

(Extend of Enquiry & Objective of the investigation)

- When a chartered accountant is appointed to carry out an investigation, the extent of enquiry, the objective of the investigation and the various matters referred to for investigation are specified in the order of investigation issued by the appointing authority.

(Determination of Area of Accounts)

- On a consideration thereof, the investigating accountant should determine the areas of accounts which require investigation and the extent to which the enquiry is to be made as well as his general approach to the enquiry. For example, if the allegation is that certain transactions have been entered into in contravention of the provisions of the Companies Act, the nature of transactions, the persons who were parties thereto, the amount or amounts involved and the circumstances under which these were entered into must be examined. If the loss suffered by the company has given rise to a gain by director and other managerial personnel or its associates, the manner in which the benefit has accrued, and the amount thereof shall have to be investigated.

(Subsidiaries & Directors)

- In case of a company having subsidiaries or where one or more directors are interested in one or more concerns, all the dealings with these concerns should be examined for these may have been entered into with the intention of transferring profit. Generally, all sales and purchases of goods and assets from directors and their associated concerns should be scrutinised since these also can be a vehicle of illicit transferring of profits.

(Materiality)

- Any breach of duty or abdication of responsibility for purposes of investigation would be material only if it has resulted in a loss to the company. In such a case, the factors responsible for the loss or losses, besides the amount thereof, shall have to be investigated. Negligence would be culpable only if it was in relation to a duty cast by the Act, Articles of Association or by a resolution of the shareholders or that of the Board of Directors.

(Negligence)

- Any negligence in the discharge of duty of a director or any other managerial personnel must be construed very broadly, for apart from being the agents of the company, they are trustees of its property.

(Interrogation)

- It may be necessary for an investigator to interrogate directors, officers, agents, and others concerned with matters under his enquiry. Before drawing up his brief in this regard as well as for framing his conclusions, he should, if necessary, take legal assistance.

(Reporting)

- If the Investigating accountant is required to report on the efficiency of the management, he should be discreet in expressing his opinion. Usually, it is sufficient if he merely indicates the general limitations of the management.

	(Opportunity to explain) • The inspector must ensure that the persons who figure in the investigation get the fullest opportunity to explain their action and conduct.

QNO 641.000	Investigation (Sec 210) Bhaskar CNO – INTG.160	Old Course- (M15R, P17M, N18R, N18M)
	What will be your approach in investigation under Section 210 and 213 into the affairs of the company registered under Companies Act, 2013?	
Answer	➢ Approach in investigation under section 210 and 213 into the affairs of the Companies: The general approach for investigation under Sections 210 and 213 of the Companies Act, 2013 is conditioned by the legal requirements in these regards. The affairs of the company may include everything such as goodwill, profit and loss, contracts, investments, assets, shareholding in subsidiaries, decision making, etc. Also, the specific circumstances mentioned in these sections like fraud, mismanagement, oppression of any shareholder etc. come within the term "affairs of the company." Investigation under Sections 210 and 213 do not call for any special approach. Approach/Steps for pursuing the investigation are: • **Clarity of Terms of Reference:** The approach to any investigation is determined on a consideration of the nature of the investigation and the terms of reference. However, the inspector should ensure that the terms of reference are clear, unambiguous and in writing. If he has any doubt about any item in the terms, he should obtain clarification in writing. It should also be, seen that the terms of reference are not too general, because that may frustrate the whole objective of the investigation; the scope of the investigation will become unwieldy and ill defined. An investigation order to investigate into the affairs of the company would be an instance at point. Therefore, the inspector should ask for reframing of the order specifying the exact matters to be investigated. He should also take into consideration the possible effect of limitations, if any, put in the terms of reference and should keep the Central Government informed in writing about their effect on the investigation. • **Scope of Investigation:** The next point for consideration of the inspector would be the determination of the scope of the investigation on the basis of the terms of reference. At this stage, it may be useful for the inspector to go into the history of the company and its affiliates or associates. He should evaluate the terms of reference in sketching the scope of investigation; this will enable him to locate the limitation, if any, in the terms of reference, not clearly mentioned. For a purposeful investigation, he may need to stretch his inquiry into the books and records of allied and associated persons and concerns and may require to arm himself with the powers given under the Companies Act. • **Period for investigation:** He should also have regard to the period over which the investigation should stretch. The evaluation of terms of reference and the consequential determination of the scope of investigation are the twin props on which the entire investigation would rest and, therefore, the inspector appointed under Sections 210 and 213 should devote careful attention to these. • **Framing of Programme:** The next step is the investigator/inspector should frame his programme for investigation in a systematic manner. He should keep adequate working notes and papers with references and cross references in a proper and methodical way to aid him in the preparation of the report. The actual process of investigation would be essentially an evidence gathering procedure and, at every step, he should have regard to the procedures laid down in these sections regarding production of documents and evidence, examination on oath and seizure of documents. He should also keep his mind open to the revelations he comes across in the process of evidence collection and should assess whether the programme of investigation needs amendment or modification.	

- **Using the work of Experts:**
  He should also consider whether assistance of other experts like engineers, lawyers, etc., is necessary in the interest of a comprehensive and full proof examination of the documents and information.

- **Legal requirements and investigation Report:**
  Only after he has completed the steps in the investigation programme and has marshalled all the information that he needed should he prepare his report. He, however, can also make interim report. The findings should be completed and exhaustive. Before he makes his final report he should obtain and keep on record the evidences relied upon by him. By the nature of things, such evidence should be as conclusive as possible depending on circumstances of the case. He should make his report in accordance with the provisions of the Companies Act, 2013.
  The general approach for investigations under Sections 210 and 213 should, therefore, be formulated having regard to the terms of reference, scope, the period, the programme and procedure of the investigation and the attending legal requirements specified above.

QNO 643.000	Investigation of Borrower Bhaskar CNO – INTG.120	Old Course- (M12R, M13R, N15R, P17M, M18E, M20R) New Course-- (S17M, N18R, M18M, M20R, S21M)

A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not. Decide the points you will cover in your investigation before submitting your report to the General Manager.

Answer

➢ **Purpose: -**
- Reason for obtaining the loan
- Determining of sources of repayment.
- Availability of security, if borrower fails to repay.

➢ **Collection of Information: -**
Investigator is required to collect the information with respect to;
- **The financial standing and reputation** for business integrity enjoyed by directors and officers of the company.
- **History of growth and development** of the company and its performance during the past 5 years.
- **Authorization** under Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- **The purpose** for which the loan is required.
- Manner in which the borrower **proposes to invest the amount of the loan.**
- **Schedule of repayment of loan** submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.

➢ **Examination of Financial Statements: -**
- From the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned, and taxes paid annually during each of the five years.
- The purpose is to ascertain strengths of profitability

➢ **Computation of relevant Ratios: -**
- Equity to Fixed Assets.
- Equity to Long Term Loans.
- Sales to Fixed Assets.

- Sales to Average Inventories held.
- Sales to Book Debts.
- Current Assets to Current Liabilities.
- Quick Assets (the current assets that are readily realizable) to Quick Liabilities.
- Return on Capital Employed.

➢ **Break-up of annual sales: -**
Product-wise to show their trends.

➢ **Schedule of assets and liabilities: -**

- **Assets: -**
  - To ensure their existence, ownership and proper valuation.
  - To examine whether assets have been adequately insured.
- **Liabilities: -**
  - To determine present and future obligations.
  - To ensure completeness of recording.

QNO 643.020	Investigation of borrower-Special Focus on Assets & liabilities - Unique	Old Course-- (N20M) New Course—(N20M)

A nationalized bank received an application from a Limited company seeking sanction of a term loan to expand its existing business. In this connection, the Loan Manager of the Bank approaches you to conduct a thorough investigation of the items of the Balance Sheet of this Limited company and submit a confidential report based on which he will decide whether to sanction this loan or not. List out the major steps an investigating accountant would keep in mind while verifying assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank.

➢ Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank - The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

- **Fixed assets –**
  A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

- **Inventory –**
  The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued. Details as regards the nature and composition of finished goods should be disclosed. Slow moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered. If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

- **Trade Receivables, including bills receivable -** Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.
  Further, the total amount outstanding at the close of the period should be segregated as follows:
  - debts due in respect of which the period of credit has not expired;
  - debts due within six months; and
  - debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

- **Investments**–
  The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.

- **Secured Loans**–
  Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.

- **Provision of Taxation**–
  The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears in be inadequate, the fact should be stated along with the extent of the shortfall.

- **Other Liabilities**–
  It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

- **Insurance** –
  A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance -cover appears to be adequate, having regard to the value of assets.

- **Contingent Liabilities**-
  By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

  Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

Author's Note
In QNO 643.000 and 643.020 questions are similar but QNO 643.000 asks about investigation of borrower in general and QNO 643.020 focuses on investigation of assets and liabilities of borrower.

QNO 643.030	Investigation of Borrower (Due Diligence) BHASKAR CNO—INTG.120	New Course – (M23M, M23R)

CA. Rajul is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth `10 crore for meeting usual business requirements. It is a prospective new client. She checks past history of the company, background of promoters & directors, shareholding pattern and nature of business. Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company.

Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified.

She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters, and directors.

	Based on above: **i. Identify activity being performed by CA Rajul and discuss its nature.** **ii. Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.** **iii. Name any three other areas where identified activity can be undertaken.**
Answer	**i.** The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction. Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans. Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit. **ii.** There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person. **iii.** The areas where due diligence may be undertaken are: - 1) Corporate restructuring. 2) Venture capital financing. 3) Public offerings.

QNO 643.050	**Investigation (Propriety Business) – Unique**	**Old Course- (M04E,P17M) New Course-- (S17M, S21M)**
	Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation	
Answer	➢ Following are the areas which shall be covered under investigation while proposing to buy a proprietary business- ● **Studying the overall picture:** o The first and foremost important aspect in any business investigation is to have an overall picture of the position of the business which is being investigated before the details are gone into. o Further, it is important to know whether the business is engaged in the manufacture of one or two important lines of products, is principally processing materials or is concerned only with the sale of a single product. o Also, whether it is a business which depends for its success on imported raw materials or supply of parts and components from ancillary businesses or uses indigenous materials and parts which are manufactured locally. o If the business is labour - intensive, its future profitability would be dependent on availability of skilled labour and relations of the management with the trade unions. Labour relations thus can affect the future profitability of the business. o The method of distribution of products, either through wholesalers or retailers also must be examined. o For studying the economic and financial position of the business, the following should be considered- o The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?	

- What will be the trend of the sales and profits in the future?
  The success of a business in the future would depend on the position enjoyed by it in the past in relation to its competitors. A business may be successful because it enjoys a monopoly.
  In such a case, the possibility of emergence of competition must be examined. This may be ascertained on the basis of the trend in market share of the product and the licensing policy followed by the government. Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.
- Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?

- From the accountant's view point, the following specific areas need to be looked into:
  - **Statement of Profit and Loss**:
    To study the Statement of Profit and Loss of a concern and consider each item, included therein, in relation to the corresponding items in the Statement of Profit and Loss of the previous years. It is therefore, necessary that a summary, in a columnar form, should be prepared of the balances included in the Statement of Profit and Loss of the business for a period, say of 5 to 7 years.
  - **Fixed Assets**:
    Fixed assets, usually, are shown in accounts at cost less depreciation but the accounts do not show the ages of different assets. It is desirable, therefore, to obtain age analysis of various items of fixed assets. Assets which are old or are obsolete would naturally have to be replaced. It should be seen that their values are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap.
  - **Inventories**:
    It should be seen that stocks have been valued consistently and that the basis of valuation was such that the value placed on inventories did not include any element of profit. Also, there should be due allowance for damaged, obsolete and slow-moving inventories.
  - **Other liquid assets**:
    It should be ascertained that the assets so described are readily realisable. Money with a bank in liquidation should be taken only to the extent guaranteed by Deposit Insurance Scheme.
  - **Idle assets**:
    On a scrutiny, it may appear that certain assets are remaining idle and are not being properly applied in the business. For example, certain plant and machinery may have been put to use after a considerable period of time after acquisition. Some of the fixed assets may be awaiting installation even at the valuation time.
  - **Liabilities:**
    The important matter to investigate in this regard is whether those are stated fully or understated or overstated. In other words, whether the profits of the business have been inflated by suppression of liabilities or there are any free reserves included in the liabilities. In either case, an adjustment would be necessary. Secondly, it should be ascertained that liabilities are not unduly 'large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.
  - **Taxation:**
    Orders in respect of assessments completed should be studied and it should be verified that an adequate provision has been made in respect of liabilities for taxes which have not been assessed. Also, it should be seen that in the past there has been no reopening of assessments. If so, the company may be liable for an undisclosed sum of taxes plus penalties. Any temporary tax benefit should also be disregarded.

- Apart from the above areas, the other factors relating to the management, skilled labour, etc. May also be covered in the investigation.

	Author's Note **If question is on due diligence on proprietary business, then give answer for financial due diligence i.e QNO 623.000 and if it is on investigation of prop business answer as per QNO 643.050.**

QNO 644.020	**Special issues in investigation** **Bhaskar CNO – INTG.060**	**Old Course- (N16M)** **New Course—(M21E)**
	Milk Ltd. is engaged in the business of manufacturing and distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and whether you can put reliance on already audited statement of accounts? **OR** **You have been appointed to investigate the accounts of a company and informed that the accounts have already been audited. Discuss whether you can put reliance on such already audited statement of accounts for the purpose of investigation.**	
Answer	Process used for checking and reliance on already audited statement of accounts - Following process may be carried out- **1.** If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified. **2.** However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties. **3.** Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared. Whether the investigator can put reliance on the already audited statement of account - If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require t o test everything afresh.	

QNO 644.030	**Investigator taking assistance of expert** **Bhaskar CNO – INTG.060**	**New Course-- (S21M)**
	XYZ Ltd. has bought a land in Nagpur for setting up a manufacturing unit in the year 2018 at a price of Rs. 10 crores. In the year 2019, one of the directors of company raised suspicion on the price and transactions related to purchase of land. Therefore, an investigation was ordered by the management and PV Associates were appointed to investigate the matter and submit their report accordingly. PV Associates were of the view that they need to take an expert's opinion on the price of land. Whether PV Associates is authorized to take assistance of expert? If yes, what is the process they need to follow?	
	If PV Associates feels the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation, they are allowed to do so. It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.	
	Author's Note: **ICAI has drafted big question, but relevant answer given is of 3 to 4 lines which is sufficient for 2 marks question.**	

PART- 3 FORENSIC AUDIT

QNO 628.500	Forensic Accountants Service – Areas Bhaskar CNO – FA.140	New Course-- (S21M, N22R)

What are the areas where the services of forensic accountants/ auditors are generally required?

Answer

The services rendered by the forensic accountants are in great demand in the following areas:

Criminal Investigation:	• Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence.
Professional Negligence Cases :	• Professional negligence cases are taken up by the forensic accountants. Non-conformation to Generally Accepted Accounting Standards (GAAS) or noncompliance to auditing practices or ethical codes of any profession, Forensic Auditors are needed to measure the loss due to such professional negligence or shortage in services.
Arbitration service:	• Forensic accountants render arbitration and mediation services for the business community. Their expertise in data collection and evidence presentation makes them sought after in this specialized practice area.
Fraud Investigation And Risk / Control Reviews:	• Forensic accountants render such services both when called upon to investigate specific cases as well for a review of or for implementation of Internal Controls. Another area of significance is Risk Assessment and Risk Mitigation.
Settlement of insurance claims:	• Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled. • In case of policyholders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies. A forensic accountant handles the claims relating to consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims.
Dispute settlement:	• Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trade marks cases, liability arising from breach of contracts and so on.

QNO 629.000	Forensic Accounting Vs Audit Bhaskar CNO – FA.040	New Course-- (S17M, M18R, M18E, M22R,N22E)

ABC Ltd. is a listed company having turnover of ` 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of ` 20 crore.

OR

Rupees (In crore)	Purpose
10.0 8.5 1.5 20 crore	- for Building - for Machinery - for Working Capital

Project gets implemented in 2017-18 and one of the accountants points out to Managing Director that something wrong has happened in the purchase of building material. On hearing this, the management is planning to appoint Forensic Auditor. Advise management that how is a forensic accounting analysis is different from an audit.

OR

Explain how a Forensic Audit differs from an Assurance Engagement

OR

Forensic audit is unlike other audits Explain

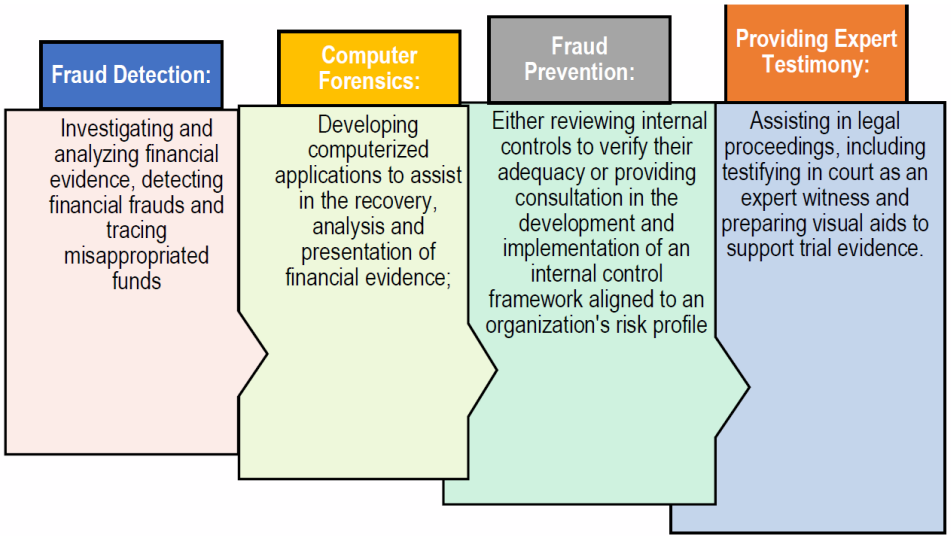
Answer **Difference between a forensic audit and financial audit**:

Sr. No.	Particulars	Financial Audit	Forensic Audit
1	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has taken place in books
2	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
3	Period	Normally for a particular accounting period.	No such limitations
4	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures	Regulatory & propriety of these transactions/contracts are examined.
6	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

QNO 629.500	**"Forensic" meaning and its need** **Bhaskar CNO – FA.040**	**New Course-- (S21M)**

What do you understand by the word "Forensic" and why the need for forensic audit arises?

- "Forensic" means "suitable for use in the court of law".
- Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence.
- As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.
- Need for forensic audit (A Forensic Auditor is often involved in



QNO 629.800	Points to keep in mind while appointing a forensic auditor Bhaskar CNO – FA.160	New Course-- (S21M, M22M)

BR Construction was into the business of building roads and other infrastructure facilities for government contracts. Mr. Tiwari, one of the senior official, was looking after the procurement of cement required at the construction sites. There was a substantial increase in the price of cement bags bought as compared to those bought prior to the appointment of Mr. Tiwari. The management of the company decides to get a forensic audit done for the transactions handled by Mr. Tiwari. What points should be kept in mind by the management while appointing a forensic auditor?

A Forensic Auditor is often retained to analyze, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported. Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation. Forensic auditor needs to have an understanding on various frauds that can be carried off and how evidence need to be collected.

While appointing a forensic auditor, the Management of BR Construction must initially consider whether the firm has the necessary skills and experience to accept the work. In view of above, Management of BR Construction should ensure that the forensic auditor should necessarily possess the following characteristics and skills:

- Crafting questions to be posed.
- Responding to questions posed.
- Identifying documents to be requested and/or subpoenaed.
- Identifying individuals to be most knowledgeable of facts.
- Conducting research relevant to facts of the case.
- Identifying and preserving key evidence.
- Evaluating produced documentation and information for completeness.
- Analysing produced records and other information for facts.
- Identifying alternative means to obtain key facts and information.
- Providing questions for deposition and cross examination of fact and expert witnesses.

QNO 630.000	Forensic Audit Steps Bhaskar CNO – FA.060	New Course-- (S17M, N18M, S21M, N21E)

Enumerate the steps to be undertaken in case of forensic audit process

OR

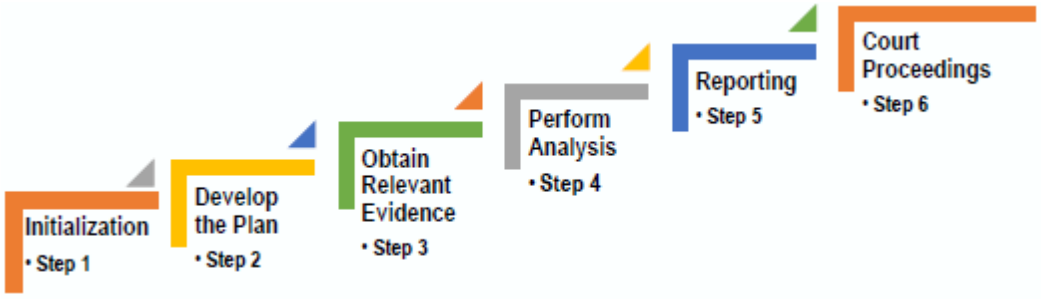
PQR Ltd. is a listed company having turnover of Rs. 50 crores & plans expansion by installation of new machines at new building-having total additional project cost of Rs. 20 crore.

Rupees (In crore)	Purpose
10.0	- for Building
8.5	- for Machinery
1.5	- for Working Capital
20 Crore	

Project gets implemented in 2017-18 and one of the accountants points out to Managing Director that something wrong has happened in the purchase of building material.
On hearing this, the management is planning to appoint Forensic Auditor. Advise the Forensic Auditor about the steps to be undertaken in case of forensic audit process.

Answer

➢ Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.



Step 1. – Initialization

- **Purpose**
  It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.
- **Meet Client**
  It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.
- **Conflict Check**
  A conflict check should be carried out as soon as the relevant parties are established. *(Whether it will affect other assignment of firm and vice versa)*
- **Preliminary Investigation**
  It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. - Develop Plan

- **Set Objectives & Methodology**
  This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

- **Economic Information / Documents / Assets / Person / Expert / Company**
  Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.
- **Depends on Nature of Fraud**
  In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed.
- **Sufficient to Prove Identity of Fraudster / Mechanics of Fraud / Amount of Fraud / Clear Chain of Custody / Usable in Court**
  The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4.- Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- summarizing a large number of transactions

- calculating economic damages;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model;
- utilizing charts and graphics to explain the analysis.
- performing a tracing of assets;

Step 5.- Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud.

- **Sections in Report**

  The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

  The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

- **Facts should be the base and not mere Opinions**

  The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

QNO 630.100	Forensic Audit Steps (Types of Analysis) Bhaskar CNO – FA.060	New Course-- (M19E)
	You have been appointed as a forensic accountant in M/s Secure Ltd .to carryout various analysis as a part of your assignment to arrive at a % particular result. Specify the various analysis which might have to be carried out by you to arrive at your result.	

➢ **Perform the analysis**

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- summarizing a large number of transactions;
- calculating economic damages;
- performing present value calculations utilizing appropriate discount rates
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model;
- utilizing charts and graphics to explain the analysis.
- performing a tracing of assets;

QNO 631.000	Forensic Audit Techniques Bhaskar CNO – FA.080	New Course-- (S17M,N20E, S21M, M22M,M22E,N22M)

Briefly mentioned the forensic audit techniques name.

OR

CA Robo has been appointed as Forensic Auditor by BMY Bank Limited for one of its borrowal accounts WRONG Ltd. CA Robo started the audit by first reviewing the transactions of the borrower in Bank statement as per Bank records to identify any hidden patterns in that information. She had to review huge volume of data, as the number of transactions per day were in hundreds and the data was to be reviewed for the last three years. So, she was stuck up as to how to proceed further to identify any hidden patterns in information, if any. Guide CA Robo, suggesting which technique to be used for identifying any hidden patterns in the information.

OR

TQR Limited is engaged in the business of garment manufacturing having registered office at Mumbai and branches across India. Mr. Shyam, one of the senior Managers was involved in creating false documents and legitimate documents were altered to support fictitious transactions. Consequently, the management appointed you to get forensic audit done based on the digital foot-print of transactions handled by Mr. Shyam. The use of sound techniques will enable to discover the defalcations on a timely basis. As a forensic auditor how will you deal and suggest Technology based/Digital forensic techniques.

Answer

(Fraud can be in any corner of financial statements)

- Detecting fraud is difficult, especially frauds involving material financial statement misstatements, which occur only in about 2 percent of all financial statements.

(Concealed – Omission or Falsification & Collusion)

- Fraud is generally concealed and often occurs through collusion. Normally, the documents supporting omitted transactions are not kept in company files. False documentation is often created, or legitimate documents are altered to support fictitious transactions.

  While fraud detection techniques will not identify all fraud, the use of sound techniques can increase the likelihood that misstatements or defalcations will be discovered on a timely basis.

- Forensic Audit Technique will be very important technique as per **GST** - **D**iscussion at **CCD**

Some of the techniques that a forensic auditor may use are listed below:

- **General Audit Techniques:**
  - **Testing defences:** A good initial forensic audit technique is to attempt to circumvent these defences yourself. The weaknesses you find within the organizations control will most probably guide you down the sea path taken by suspected perpetrators. This technique requires you to attempt to put yourself in the shoes and think like your suspect.
- **Generalized Audit Software (GAS):** Generalized Audit Software (GAS) is a class of CAATs that allows auditors to undertake data extraction, querying, manipulation, summarization and analytical tasks. GAS focuses on the fully exploiting the data available in the entity's application systems in the pursuit of audit objectives. GAS support auditors by allowing them to examine the entity's data easily, flexibly, independently and interactively in data-based auditing.

  Using GAS, an auditor can formulate a range of alternative hypotheses for a particular potential misstatement in the subject matter and then test those hypotheses immediately. "What if" scenarios can be developed with the results and the auditors can examine the generated report rapidly. Currently, the latest versions of GAS include the Audit Command Language (ACL), Interactive Data Extraction and Analysis (IDEA) and Pan audit.

- **Statistical & Mathematical Techniques:**
  - **Trend Analysis:** Businesses have cycles and seasons much akin to nature itself. An expense or event within a business that would be analogous to a snowy day in the middle of summer is worth investigating. Careful review of your subject organization's historical norms is necessary in *order* for you to be able to discern the outlier event should it arise within your investigation.

- **Ratio Analysis:** Another useful fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.

- **Technology based /Digital Forensics Techniques:** Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target hard drives is a requisite facet of any modern forensic audit. Before taking steps, such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy. Digital investigations can become quite complex and require support from trained digital investigators. However, many open-source digital forensics tools are now available to assist you in this phase of the investigation.
  ***CD** should be checked by **S²MELL** technique*

  - **C**ross Drive Analysis *(Earlier each hard disk / pen drive etc. were analysed one by one, in this approach they are analysed at the same time)*
  - **D**eleted Files
  - **S**tochastic Forensics *(Analysing change in pattern, to detect insider data theft)*
  - **S**teganography *(Understanding hidden message in electronic file, images, communication)*
  - **M**D5 *(Software used to investigate computers)*
  - **E**ncase *(Software used to extract evidence from sized hard drives etc.)*
  - **L**ive Analysis *(When cyber-attack takes place)*
  - **L**og Related
  - Tracking Log Files
  - PC System Log
  - Free Log Tools *(To extract meaningful information form logs)*

- **Data Mining Techniques:**
  It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modelling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It explains various affinities, association, trends and variations in the form of conditional logic.

- **Computer Assisted Auditing Techniques (CAATs):** Changing patterns of businesses, regulatory framework, scarcity of resources at auditors' disposal on one side and the ever-increasing mountainous data on other hand is making audit a complex process. Use of CAATTs is, thus, indispensable to the Auditors and forensic auditors. Computer-assisted audit techniques (CAATs) or computer-assisted audit tools and techniques (CAATTs) are computer programs that the auditors use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him.

- **Common Software Tool (CST):** Due to shortcomings of GASs, CSTs have become popular over a period. Spreadsheets (like MS Excel, Lotus, etc.), RDBMS (like MS Access, etc.) and Report writers (like Crystal reports, etc.) are few examples of CSTs. Their widespread acceptability is due to its instant availability and lower costs. While spreadsheets may be extremely easy to use due to its simplicity and versatility, other CSTs may need some practice.

  Whether one uses GAS or CST, it is imperative that the auditor is aware about the manner and processes that have led to the data generation, the control environment revolving around the data and the source from where the data samples are imported into the GAS/CST.

	⩔ **Laboratory Analysis of Physical and Electronic Evidences:** • **Computer Forensics** ○ Chain of Custody ○ Hard disk imaging ○ Search for erased files • **E-mail analysis** ○ Analyze use & possible misuse ○ Computer software to analyze data • **Protection/Validation of Evidence** ○ Altered & Fictitious Document ○ Physical examination ○ Document dating ○ Ink sampling ○ Fingerprint analysis ○ Forgeries ○ Federal Rules of Evidence
	Note: In Question of (CA Robo) only Points related to Data Mining Techniques should be given.

QNO 631.500	**Areas of Information (Content) of Forensic Audit Report** **Bhaskar CNO – FA.100**	**New Course-- (M21E)**
	M/s GSB Limited is into the business of construction for the past 25 years. Management of the Company came to know that building material sent to construction sites are of substandard quality whereas the payment released by the accounts department of the Company are on the higher sides. Forensic Auditor was asked to carry out detailed investigation. Forensic auditor completed his investigation and now preparing his report. What are the broad areas of information that needs to be incorporated in the report of forensic auditor?	
Answer	Broad areas of information to be incorporated in the report of Forensic auditor - Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings. The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future. The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.	

17 Peer Review & Quality Review

Part – 1 PEER REVIEW

QNO 645.000	Peer Review & Its Objectives Bhaskar CNO – PR.040	Old Course- (N07E, M08R, N08E, M11R, P17M) New Course- (N18E)
	Explain the objectives of Peer Review.	
Answer	➢ **Objectives of Peer Review** • To ensure that members while performing attestation services comply with technical standards issued by the Institute; • To ensure that such a member has in place proper system (including documentation system) for maintaining the quality of attestation services performed by him; • To ensure adherence to various statutory and regulatory requirements and • To enhance the reliance placed by the users of financial statements from economic decision making.	

QNO 646.000	Focus of Peer Review Bhaskar CNO – PR.100	Old Course- (M10E, N15R, M16M, P17M, N17M, N18M)
	Focus of a Peer Review.	
Answer	➢ **What to examine?** • Compliance with directions and / or guidelines issued by the Council in relating to **article assistants and/ or audit assistants,** including attendance register, work diaries, stipend payments, and such other related records • **Training programmes for staff** (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure. • **Systems and procedures** for carrying out assurance services. • Quality of **reporting.** • Compliance with **Technical, Professional and Ethical Standards** • Compliance with **directions and / or guidelines issued by the Council** to the Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records.	

QNO 647.000	Scope of Peer Review Bhaskar CNO – PR.080	Old Course- (N11E, N13E, M14E, N16M, N16R, P17M, N17E, N18M, N18E, N19M,M19M, M20R, N20E) New Course-- (S17M, M19M,S21M,M20R)
	Areas not to be examined in Peer Review **OR** **CA. M appointed as a Peer Reviewer for M/s, K Associates has asked for all the compilation and the Due Diligence engagements carried out by Mils. K Associates for her peer review during the period considered for peer review purposes by the board. She has also sent out a mail to Peer review Board regarding her selections. Mr. K, the managing partner of the firm seeks your advice on this matter.**	
Answer	**Selection of Assurance Service Engagements for Review:** The Statement on Peer Review defines the scope of peer review which revolves around compliance with **technical, ethical and professional standards**; quality of reporting; office systems and procedures with regard to compliance of assurance engagements; and, training programmes for staff including articled and audit assistants involved in assurance engagements. The **entire peer review process is directed at the assurance services.** Assurance Services means assurance engagements services as specified in the **"Framework for Assurance Engagements"** issued by the Institute of Chartered Accountants of India and as may be amended from time	

	to time. **Assurance engagements does not include:** • **Providing expert opinion** on points of principle, such as **Accounting Standards or the applicability of certain laws**, on the basis of facts provided by the client. • Engagements solely to assist the client in preparing, compiling or collating information other than financial statements • Engagements for the **compilation of financial statements** • Engagements to **prepare tax returns or advising clients in taxation matters** • **Representation before various Authorities** • Testifying as an **expert witness** ***(Courts take help of experts in law, tax, fraud etc)*** • **Management Consultancy** Engagements • Engagement for **Due diligence** In the given situation, CA. M is appointed as a peer reviewer for M/s K Associates, has asked for all the compilations and the due diligence engagements carried out by M/s K Associates for her peer review. In view of above, Peer Review of compilation and due diligence at the time of execution step by **CA. M is not correct as due diligence and compilation engagements are not covered** in the scope of Assurance engagement and Peer Review is directed at assurance engagement only.

QNO 647.500	**Scope of Peer Review - Case Study** **Bhaskar CNO – PR.080**	**Old Course-- (M21M)** **New Course-- (M21M,M22M)**
	CA. Sudarshan, appointed as a Peer Reviewer for M/s. Preet Associates, has asked for all the management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements carried out by M/s. Preet Associates for peer review during the period considered for peer review purposes by the board. Peer Reviewer CA. Sudarshan has also sent out a mail to Peer Review Board regarding his selection. Mr. Preet, the managing partner of the firm seeks your advise on this matter. **OR** **CA. Sita, appointed as a Peer Reviewer for M/s. Ram Associates, has asked for all the compilation and the Due Diligence engagements carried out by M/s. Ram Associates for her peer review during the period considered for peer review purposes by the board. She has also sent out a mail to Peer Review Board regarding her selection. Mr. Ram, the managing partner of the firm seeks your advice on this matter.**	
Answer	**Selection of Assurance Service Engagements for Review:** The Statement on Peer Review defines the scope of peer review which revolves around compliance with **technical, ethical and professional standards**; quality of reporting; office systems and procedures with regard to compliance of assurance engagements; and, training programmes for staff including articled and audit assistants involved in assurance engagements. The **entire peer review process is directed at the assurance services.** Assurance Services means assurance engagements services as specified in the **"Framework for Assurance Engagements"** issued by the Institute of Chartered Accountants of India and as may be amended from time to time. Assurance engagements **does not include management consultancy** engagements or engagements solely to assist the client in preparing, compiling or collating information other than financial statements. In the given situation, CA. Sudarshan is appointed as a peer reviewer for M/s Preet Associates, has asked for all management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements carried out by M/s Preet Associates for her peer review. In view of above, Peer Review of management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements at the time of execution step by **CA. Sudarshan is not correct** as management consultancy engagements and engagements solely to assist the client in preparing, compiling or collating information other than financial statements **are not covered** in the scope of Assurance engagement and Peer Review is directed at assurance engagement only	

QNO 648.000	Technical Standards Bhaskar CNO – PR.120	Old Course-- (M13E, M16M, P17M, N17M, M18M, M19R, M20M) New Course-- (S17M, M18R, M19R, M20M, S21M)
	Technical, ethical and professional standards as per statement on peer review. **OR** **"The Statement defines the scope of peer review which revolves around compliance with technical, ethical and professional standards; quality of reporting; office systems and procedures with regard to compliance of assurance engagements; and, training programmes for staff including articled and audit assistants involved in assurance engagements." You are required to explain the meaning assigned to Technical, Ethical and Professional Standards as per Peer Review Statement.**	

Answer	As per the Statement, Technical, Professional and Ethical Standards – means
	• **Accounting Standards 3**
	  • Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;
	  • Accounting Standards prescribed under section 133 of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with the National Financial Reporting Authority (NFRA) and notified as Accounting Standards Rules 2006, as amended from to time to time
	  • Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time.
	• Standards issued by the Institute of Chartered Accountants of India including
	  • **Engagement and Quality Control Standards 4**
	  • **Statements 5**
	  • **Guidance notes 7**
	  • **Standards on Internal Audit 6**
	  • Notifications / Directions / Announcements / Guidelines / Pronouncements /Professional standards **issued from time to time by the Council** or any of its committees. **8**
	• **Framework** for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements;**2**
	• Provisions of the relevant **statutes and / or rules or regulations** which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements**1**	

QNO 649.000	Collection of Evidence Bhaskar CNO – PR.140	Old Course-- (N09E, N11R, N13R, N14R, M16R, N16M, P17M, M17M)
	Collection of Evidence by Peer Reviewer.	

Answer	➢ **Collection of Evidence by Peer Reviewer:**
	A Peer Reviewer collects evidence by applying the following methods:
	  • ***Inspection***- Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practice unit.
	  • ***Observation***- Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.
	  • ***Inquiry***-Inquiry consists of seeking appropriate information from the partner (designated by the practice unit for the purpose)/sole proprietor or other knowledgeable persons within the practice unit. The inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of	

		documentation maintained by the practice unit. While observation and inquiry may be considered as external independent sources of review evidence, inspection remains the most significant method for confirming the effective observance of control procedures in the practice unit. Observation and inquiry may also corroborate the evidence provided by inspection. The reviewer, in order to carry out the review effectively, should have an understanding of the documentation maintained by the practice unit.

QNO 650.000	**Independence- Unique**	**Old Course-- (M12E, M16E, P17M, N17R,N20E,N21R) New Course—(S17M, N18M, N19M,S21M,N21R)**
	A, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas A should review in the assessment of independence of the practicing unit?	
Answer	➢ **Review in the Assessment of Independence of the Practicing Unit –** The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed. A, a practicing Chartered Accountant should review following controls in respect of assessment of independence of the practicing unit: • Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy? • Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff? • Does the practice unit monitor compliance with policies and procedures relating to independence? • Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?	

QNO 650.500	**Selection of Sample – Timing & Intimation Bhaskar CNO – PR.180**	**Old Course-- (N20R) New Course--(N20R)**
	Selection of sample by the reviewer in case of peer review.	
	• **Selection of Sample by the Reviewer:** • On receiving the Application cum Questionnaire in Form 1 from the Practice Unit, the Peer Reviewer shall initiate the Peer Review by intimating the Practice Unit of proposed visit and the proposed samples selected to be kept ready by the Practice Unit. The proposed samples selected are to be intimated by the Peer Reviewer in **Form 5** prescribed by the Board. • The Reviewer may seek further/ additional clarification in **Form 6** from the Practice Unit on the information furnished/ not furnished by the Practice Unit in the Questionnaire. The Practice Unit shall provide this additional information to the Reviewer within one working day. • The Reviewer shall, within two working days of receiving the information from the Practice Unit, select assurance service engagements that he would like to review and intimate the same to the Practice Unit and the Peer Review Board in Form 5. • The Reviewer shall plan for an "on–site review" visit for initial meeting in consultation with the Practice Unit. The Reviewer shall give the Practice Unit at least two working days to keep ready necessary records of the selected assurance services in Form 5. • The Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within twenty working days from the date of receipt of application from the Practice Unit for being Peer Reviewed or from the date of notifying the Practice Unit about its selection for Review as the case may be. • In case of Peer Review of a **New Unit**, the Reviewer and Practice Unit shall mutually co-operate and ensure that the entire review process is completed within seven working days	

	from the date of receipt of application cum questionnaire from the Practice Unit for being Peer Reviewed

QNO 650.600	Matters Considered While Selecting Number of Assignments in Peer Review Bhaskar CNO – PR.180	New Course – (N20E)
	CA S has been appointed as peer reviewer of Shivam & Co. LLP. Shivam & Co. LLP submitted a list of its assurance and due diligence services for the peer review. CA S is in the process of deciding as to how many assurance services should be reviewed. Guide CA S in deciding the number of assurance services engagement to be reviewed.	

Answer	In the given case, CA S appointed as peer reviewer of Shivam & Co. LLP, is in the process of deciding as to how many assurance services need to be reviewed.
	
	The number of assurance service engagements to be reviewed shall depend upon:
	• (**Selection of Assurance Service Engagements for Review**
	  • The number of assurance service engagements to be Reviewed shall depend upon:
	  o Its size and nature **1**(Big→ Bigger Sample & More Banks → More Bank Audits)
	  o Generally prevailing standards of quality control**4**(Poor Standards → Bigger Sample)
	  o Methodology adopted by PU **5** (Manual Vs Computer Based)
	  o Number of partners/members involved **2**(More Partners→ Bigger Sample)
	  o Number of locations/ branch offices **3** (Ensure selection from all locations / branches)
	  o Fees charged / received / gst paid**6** (All range of assignments	

QNO 651.000	Reporting (Areas of Control) Bhaskar CNO – PR.180	Old Course-- (M05E, M09E, N12M, M15R, M17R, P17M ,M18M, N20M) New Course-- (N20M,N22E)
	AB & Co., Chartered Accountants, is a large firm based in Mumbai. AB & Co. is subject to peer review. For the peer review of the financial year ended March 31, 2021 the firm got an intimation on June 30, 2021. X & Co., Chartered Accountants, were appointed to undertake the peer review process. Upon completion of the peer review, X & Co., observed certain non-compliance with auditing standards. X & Co., did not share any of observations with AB & Co. and submitted its final report to the Peer Review Board of the Institute of Chartered Accountants. Comment **OR** **ABC & Co LLP is a large firm of Chartered Accountants based out of Chennai. ABC & Co. LLP is subject to peer review which was last conducted 3 years back. For the peer review of the financial year ended 31 March 2020, the firm got an intimation on 31 May 2020. The process of peer review got started and was completed on 29 September 2020. In view of peer reviewer, the systems and procedures of ABC & Co. LLP are deficient / non-compliant. The peer reviewer did not share any of his observations with ABC & Co LLP as draft and final report was submitted tithe Board. Comment.** **OR** **Areas of Control for Reporting Stage of Peer Review.** **OR** **Preliminary Report under Peer Review.**	
Answer	After completing the on-site review, the Reviewer, shall submit the Peer Review Report to the Board along with Form 9 if in his opinion, the Practice Unit has adequate systems and procedures in compliance with the Technical, Professional and Ethical Standards. A copy of the report shall also be forwarded to the Practice Unit. **1)** In case, in the opinion of the Peer Reviewer, the systems and procedures of the Practice Unit are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification, he shall communicate his findings to the Practice Unit, in a Preliminary Report issued by him. **2)** The Practice Unit shall, within two working days of the date of receipt of the findings, make its submissions or representations, in writing to the Reviewer. **3)** If the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit an	

	unqualified Peer Review Report to the Board along with Form 9. A copy of the report shall also be forwarded to the Practice Unit. **4)** In case the Reviewer is of the opinion that the response submitted by the Practice Unit under clause 9(4) above is not satisfactory, the Reviewer shall submit a Qualified Report to the Board incorporating his reasons for the same along with Form 9. A copy of the report shall also be forwarded to the Practice Unit. **5)** The Peer Review Report should state that the system of quality control for the assurance services of the Practice Unit for the period under Review has been designed so as to carry out the assurance services in a manner that ensures compliance with Technical, Professional and Ethical Standards. The Peer Review Report shall address his report of compliance or otherwise on the following areas of controls: • Staff recruitment, Supervision and Development • Independence • Maintenance of Professional skills and standards. • Outside Consultation • Office Administration. **6)** The Peer Reviewer shall ensure to submit the following documents along with the Peer Review Report: (i) Annexures to the Report as prescribed by the Board (ii) Copy of Questionnaire as received from the Practice Unit (iii) List of samples selected by him in accordance with the criteria prescribed by the Board (iv) Preliminary Report, if issued, along with Practice Unit's submissions on the same. **7)** The Practice Unit as well as the Reviewer shall ensure that all documents submitted to the Board are duly dated, signed and complete in all aspects.
	Author's Note ICAI gave Alternative answer for X & Co Que where they first explained Eligibility Criteria & then gave Conclusion that only individual can become Reviewer & not CA Firm.

QNO 651.500	**Preliminary Report Not Shared with PU** **Bhaskar CNO – PR.800**	**New Course-- (N22R)**
	Prabhu & Co LLP is a large firm of Chartered Accountants based out of Mumbai. Prabhu & Co. LLP is subject to peer review which was last conducted 3 years back. For the peer review of the financial year ended 31st March 2021, the firm got an intimation on 29th May 2021. The process of peer review got started and was completed on 27th September 2021. In view of peer reviewer, the systems and procedures of Prabhu & Co. LLP are deficient / non-compliant. The peer reviewer did not share any of his observations with Prabhu & Co LLP as draft and final report was submitted to the Board. Comment.	
Answer	**Peer Review Report of Reviewer:** After completing the on-site Review, the Peer Reviewer, before making his Report to the Board, **shall communicate his findings in the Preliminary Report to the Practice Unit** if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification. The Practice Unit shall within 5 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (i.e. Response to the Preliminary Report). At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.	

	In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit. In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report. In the instant case, in view of Peer Reviewer systems and procedures in Prabhu & Co. LLP are deficient, therefore, Peer Reviewer should not submit the report directly to the Board. Thus, contention of Prabhu & Co. LLP is correct.

QNO 653.000	**Stepwise Approach / Approach of Reviewer** **Bhaskar CNO – PR.300**	**Old Course-- (N18R, M15E, P17M)** **New Course-- (N18R)**
	Explain the stepwise approach adopted by the Peer reviewer.	
Answer	The stepwise approach which may be adopted by the reviewer is discussed in the following paragraphs: ➢ The reviewer may follow a **combination of compliance procedures and substantive procedures throughout the peer review process.** The mix of compliance and substantive procedures depends upon the professional judgement of the reviewer. The reviewer may consider the following: • In carrying out the **compliance tests,** the reviewer may evaluate whether the policies and procedures of the practice unit are sufficient to ensure compliance of technical standards and whether these policies and procedures are adequately communicated to all staff who are involved in carrying out the assurance work. • In performing substantive tests, the reviewer should evaluate whether the practice unit's **working papers relating to the client** adequately document the findings and conclusions and whether the report of practice unit is in consonance with the findings and conclusions drawn. ➢ The **number of assurance engagements** to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the **questionnaire and the size of the practice unit.** The objective is to obtain a reasonable cross-section of the practice unit's clients although greater weight may be given to large clients. ➢ The practice unit may have **policies and procedures for accepting a particular engagement.** These policies and procedures may not exist in the form of records in each practice unit. In such a case the reviewer should consider enquiring from the concerned persons about such policies and procedures. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists. ➢ The reviewer should gain an **understanding of the engagement letter** since an assurance engagement or for that matter any other kind of engagement should begin with an engagement letter. Engagement letter is an important document as it defines the nature and scope of the assurance engagement, practice unit's responsibilities with regard to the engagement. This understanding would help him in **planning the review of documentation**. The reviewer should focus the review primarily on the key engagement matters. The reviewer should also consider the materiality of the matter while planning the review. ➢ Finally, the reviewer while evaluating records may consider the following: • determine that any **significant issues, matters, problems** that arose during the course of the engagement have been appropriately considered, resolved and documented; • determine that **adequate audit evidence or other relevant evidence** in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and	

	• determine that **significant decisions relating to the engagement, use of professional judgement, resolution of significant matters** have been properly documented.

QNO 653.010	Eligibility criteria Bhaskar CNO – PR.280	Old Course-- (M18E, M19E) New Course-- (M18E, S21M,N21M, M22R)
	Eligibility criteria to be a Peer Reviewer. **OR** **The elements of skill, experience and independence of reviewers are ensured before initiating them in Peer Review process. In the above light, state few eligibility criteria fixed for a person to be empanelled and also for being appointed as a Peer Reviewer.**	

Answer	**A Peer Reviewer shall:**
	• Experience**2**
	  • Shall be a member in practice with at least 7 years of audit experience.
	  • In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice.
	  • Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board. Is **in Practice** as per the Chartered Accountants Act, 1949. **1**
	• Should have undergone the **requisite training as prescribed by the Board.3**
	• **Declaration4**
	  • a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer.
	  • a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.
	• For being a Reviewer, a member should not have: -**5**
	  • Disciplinary action / proceedings pending against him
	  • been found guilty by the Council or the Disciplinary Board or Committee at any time.
	  • been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
	  • any Obligation or **conflict of interest** in the Practice Unit or its Partners / Personnel.
	  • He has undergone training/articleship under any of the partner of Practice Unit.
	➢ A Reviewer shall **not accept any professional assignment** from the Practice Unit**for a period two years from the date of appointment**. Further, he **should not have accepted any professional assignment** from the Practice Unit for a period of **two years before the date of appointment** as reviewer of that Practice Unit.**6**	

QNO 653.020	Eligibility Criteria Case Study Bhaskar CNO – PR.280	New Course- (N22M)
	CA. Vimal wants to apply in the empanelment of peer reviewer. He was into employment till 2012 since then he shifted from industry and started his own practice. Below is his experience and employment record from 1995 to 2012. Name of Company Designation From Date To Date Parshav Ltd Project Implementation Manager 1-4-1995 31-3-1998 Suparshava Ltd Financial Reporting Senior Manager (Assisting in Audits) 1-4-1998 31-3-2007 Parasnath Ltd Project & Improvement Director 1-4-2007 31-3-2012 Own Practice – Sole Prop Audit & Taxation 1-4-2012 31-3-2022 Kindly assess whether CA. Vimal can apply and is qualified to get admitted in the empanelment of Peer Reviewer.	
Answer	As per Peer Review Statement, **1.** A Peer Reviewer shall: - (a) Shall be a member in practice with at least 7 years of audit experience.	

	(b) In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice. (c) Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board. **2.** A member on being appointed as a Reviewer shall be required to furnish- (a) a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer. (b) a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer. **3.** A member shall not be eligible for being appointed as a Reviewer of a Practice Unit, if – (i) any disciplinary action / proceeding is pending against him; (ii) he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time (iii) he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment, (iv) he or his partners have any obligation or conflict of interest in the Practice Unit. (v) He has undergone training/articleship under any of the partner of Practice Unit. **4.** A Reviewer shall not accept any professional assignment from the Practice Unit for a period of next two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as reviewer of that Practice Unit. In the current scenario, CA. Vimal was in employment for a period from 1-4-95 to 31-3-12 i.e., 17 years. Out of which, he was having audit experience for 9 years. However, he is in practice since 10 years i.e. 2012 to 2022. Hence, he will be eligible for Peer Reviewer by virtue of the condition stipulating that a Peer Reviewer shall be a member in practice with at least 7 years of audit experience.

QNO 653.025	**Obligation Practicing Unit** **Bhaskar CNO – PR.200**	**(N21E)**
	CA Manoj has been appointed as Peer Reviewer of M/s UV Associates, a Chartered Accountant firm consisting of 18 partners. As a Practicing unit what are the obligations that are to be complied by M/s UV associates in addition to furnishing the questionnaire, statements and such other particulars as the Board may deem fit?	
Answer	**M/s UV Associates-Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements and such other particulars as the Board may deem fit, shall comply with the following:** • **Produce to the Reviewer or allow access** to, any record, document or prescribed register maintained by the Practice Unit or any other record or document which is of a class or description so specified, and which is in the possession or under the control of the Practice Unit. • **Provide to the Reviewer such explanation** or further particulars/ information in respect of anything produced in compliance with a requirement under sub clause (1)above, as the Reviewer shall specify. • **Provide to the Reviewer all assistance** in connection with Peer Review; • Where any information or matter relevant to a Practice Unit is recorded **otherwise than in a legible form,** the Practice Unit shall provide and present to the Reviewer are production of any such information or matter, or of the relevant part of it in a legible form, with a translation in English or Hindi, if the matter is in any other language, and if such translation is requested for by the Reviewer. The Practice Unit shall be responsible and accountable for the accuracy and truthfulness of the translation so provided.	

QNO 653.030	Inherent limitations of Peer Review – Unique	New Course-- (N18E, S21M)
	What are the inherent limitations of Peer Review?	
Answer	➢ **Inherent Limitations of Peer Review:** • **Not expected to show all deficiencies.** The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of quality of assurance services since it would be based on selective tests. • **System of quality control has its own deficiencies.** As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject matter of review, departure from the system may occur and may not be detected.	

QNO 653.035	Difference Between Peer Review & Quality Review Bhaskar CNO – PR.320	Old Course-- (M21M) New Course--(M21M)
	Briefly explain the difference between Peer Review and Quality Review.	
Answer	**Difference Between Peer Review and Quality Review:** Peer review is a review of the systems and procedures of an audit firm. Although sample audit files are inspected by the peer reviewer, it is done for the purpose of testing the effectiveness of the systems and procedures. The intention is to not to find faults but to help the firm develop effective systems. It is a kind of mentoring process. Peer review is a part of the activities of ICAI aimed at improving the quality of service. In contrast, a quality review is supposed to act as a deterrent. Quality Review Board (QRB) is constituted by the Central Government and is independent of ICAI. As per Section 28A of the Chartered Accountant's Act, the Central Government has the authority to constitute a Quality Review Board. QRB carries out supervisory and disciplinary functions. A quality review normally pertains to one particular audit conducted by an audit firm. The main objective quality review is to find errors or inadequacies, if any, committed by the auditor while conducting the audit. Serious errors detected in quality review lead to disciplinary action against the member.	

Part -2 QUALITY REVIEW

QNO 653.040	Objectives of QR Bhaskar CNO – QR.020	New Course-- (S17M, N18R, S21M)
	What are the objectives of the Quality review?	
Answer	➢ **Evaluate Audit Quality** Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements. ➢ **Identify & Address Weaknesses & Identify Deficiency & Failures** They are designed to identify, and address weaknesses and deficiencies related to how the audits were performed by the audit firms. In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards. ➢ **Review Aspects of Selected Statutory Audits & Firms Quality Control System** To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system. ➢ **Not the Purpose to Review all Audits** It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient. Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.	

QNO 653.042	Scope of the Quality Review- Unique	New Course-- (N19R)
	Scope of the Quality review.	
Answer	➢ **Audit Firm has system as per SQC 1 and it is implemented.** • Examining whether the Audit firm has implemented a system of quality control as envisaged in line with the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements. ➢ **EP has ensured compliance with LAW / Regulations / Professional / Ethical / Technical Standards** • Examining whether the Engagement Partner has ensured compliance with the relevant laws and regulations. • Examining whether the Engagement Partner has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and requirements.	

QNO 653.045	Functions of QRB V/s NFRA (Case Study) BHASKAR CNO— QR.080	New Course – (M23M, M23R)
	Secretarial staff of the Quality Review Board (QRB) is in the process of preparing a panel for submission to Board to enable it to initiate reviews of the quality of audit services provided by members of ICAI. The draft panel has been prepared by Mr. P, a junior staff in QRB secretariat and it has moved up in hierarchy for vetting by a senior staff, Mr. R, before being put up in the upcoming meeting of Quality review board for its consideration. **The draft panel contains details of following entities audited by different audit firms: -**	

Name of entity	Listing status	Sector	Paid up capital*	Annual turnover*	Outstanding loans & deposits	Name of audit firm
XYZ Ltd.	Unlisted Public	Education technology	450	1200	450	BB & Co
PQR Ltd	Listed in BSE, NSE & NYSE	Manufacturing	1000	5000	750	GPR & Co
X Insurance Ltd	Unlisted	Health insurance	250	1500	400	DS & Co.
AAZ Ltd	Unlisted	Manufacturing	200	800	200	CT & Co

*** Figures are of immediately preceding year and are in Crore.**

Is the inclusion of names of audit firms of corresponding entities in the draft panel to be put up before QRB appropriate? Guide Mr. R

Answer

Rule 3 (1) of National Financial Reporting Authority Rules, 2018 inter alia, provides that the Authority (NFRA) 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, namely: -

a) companies whose securities are listed on any stock exchange in India or outside India;
b) 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;
c) 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 subsection (4) of section 1 of the Act;
d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and
e) 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), if the income or net-worth of such subsidiary or associate company exceeds twenty percent 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).

The Ministry of Corporate Affairs has vide their letter dated 30th January, 2019, has clarified to the Quality Review Board that in view of Sec.132 (2) of the Companies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, the issue of QRB reviewing audits of the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will only arise in case a reference is so made to QRB by NFRA, and not otherwise.

Considering the above, in the case of auditors of PQR Ltd., X insurance Ltd. and AB banking Company, NFRA has power to oversee quality of services of these audit firms. However, QRB can undertake review of the quality of services of auditors of AAZ Ltd.

Therefore, inclusion of names of auditors of PQR Ltd., X insurance Ltd. and AB banking Company in the draft panel for consideration by QRB is not proper.

Only the inclusion of the name of the auditor of AAZ Ltd in the draft panel is proper.

QNO 653.050	Qualifications by QR Bhaskar CNO – QR.220	New Course-- (S17M, N18M, S21M)
	Give examples of areas on which the reviewer may qualify the report	
Answer	➢ *A reviewer may qualify the report due to one or more of the following:* • quality control system design deficiency; • non-compliance with quality control policies and procedures; or • non-existence of adequate training programmes for staff. • non-compliance with relevant laws and regulations; • non-compliance with technical standards;	

QNO 653.060	General Reporting Responsibilities of QR- Unique	New Course-- (S17M, S21M)
	What are the reporting responsibilities of the technical reviewer while carrying out a Quality review assignment?	
Answer	➢ The Technical Reviewers expresses an opinion on whether the system of quality control for the attestation services of the firm under review has been designed so as to carry out professional attestation services assignments in a manner that ensures compliance with the applicable Technical standards and maintenance of the quality of attestation service work they perform. The Technical Reviewer's review would not necessarily disclose all weaknesses in the quality of attestation work or all instances of lack of compliance with applicable Technical Standards. As there are inherent limitations in the effectiveness of any system of quality control, departure from the system may occur and not be detected. Also, projection of any evaluation of system of quality control to future periods is subject to the risk that the system of quality controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. In the process, the Technical Reviewers also identified what they considered to be deficiencies and any defects in, or criticisms of the firm's quality control system.	

QNO 653.065	Eligibility of Technical Reviewer for Quality Review Bhaskar CNO – QR.160	(M22M)
	While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, certain eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment. In view of above, briefly discuss those eligibility conditions prescribed for Technical Reviewer.	
Answer	While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment. **For being a technical reviewer (TR):** • He should not have disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him/her or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against him during last three financial years and/or thereafter. • He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have been the statutory auditor of the company, as specified, or have rendered any other services to the said entity during last three financial years and /or thereafter. • He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have had any association with the specified AFUR, during the last three financial years and /or thereafter. • He should comply with all the eligibility conditions laid down for appointment as an auditor of a company u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis in respect of the review of	

	the quality of statutory audit of the entity, as specified, so far as applicable. • He does not belong to the city/region of head office of the AFUR.

QNO 653.070	Stages of Quality Review Bhaskar CNO – QR.200	New Course-- (M18R, S21M)
	Various Stages involved in the Conduct of the Quality Review Assignments	

Answer

➢ **Stages of Quality Review**

Various Stages involved in the Conduct of the Quality Review Assignments: The following table describes the various stages involved in the conduct of the quality review assignments:

(Selection of Audit Firm & TR – Offer Letter to TR – TR Acceptance – Confidentiality Statement – Intimation to Audit Firm – TR to send Quality Review Programme General Questionnaire – Call for Additional Firm – Carry out Quality Review , Visit Audit Firm – TR will send Preliminary Report – Audit Firm to submit Representation – TR to submit Final Report – Within 45 days from Acceptance – Audit Firm to send Submission to QRB – TR to submit final findings on reply of Audit Firm— Quality Review Group will consider Report , Reply of audit firm and TR's final findings and send recommendations to Quality Review Board – QRB to consider final course of action)

- Selection of Audit Firm and Technical Reviewer to conduct Quality Review and
- Sending Offer Letter of Engagement to the Technical Reviewer.
- Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
- Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
- Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.
- Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
- Technical Reviewer to send the preliminary report to Audit firm.
- Audit firm to submit representation on the preliminary report to the Technical Reviewer.
- Technical Reviewer to submit final report along with a copy of Annual report of the company/entity for the year, to the Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.
- Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions thereon to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon along with their final comments in the specified format.
- Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
- Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

QNO 653.080	Actions by QRB Bhaskar CNO – QR.260	New Course-- (S17M, M18M, S21M, M23M)
	List out the consequences if the Quality review board notices major non-compliances with the requirements of the Standards on quality control or standards on auditing or accounting standards?	
Answer	➢ The actions that may be recommended by the Board include one or more of the following: • Consider the matter complete and inform the audit firm/auditor accordingly. • Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949; • Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise; • Intimating the concerned auditor as to the findings of the Report as well as action initiated under(b) and/or (c) above;	

QNO 653.090	Basic elements of quality review report Bhaskar CNO – QR.220	New Course-- (M18M)
	Reviewers, based on the conclusions drawn from the quality review, shall issue a preliminary report and subsequently the final report. As a quality reviewer briefly discuss the basic elements of Quality Review Report. ?	
Answer	➢ **Basic Elements of the Reviewer's Report in case of Quality Review:** The quality review report should contain elements relating to audit quality of companies and elements relating to quality control framework adopted by the audit firm in conducting audit which are given below: • **Elements relating to audit quality of companies:** ◦ A reference to the description of the scope of the review and the period of review of audit firm conducted along with existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged. ◦ A statement indicating the instances of lack of compliance with technical standards and other professional and ethical standards. ◦ A statement indicating the instances of lack of compliance with relevant laws and regulations. • **Elements relating to quality control framework adopted by the audit firm in conducting audit:** ◦ An indication of whether the firm has implemented a system of quality control with reference to the quality control standards. ◦ A statement indicating that the system of quality control is the responsibility of the reviewed firm. ◦ An opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for attestation services and whether it was complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards in all material respects. ◦ Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions ◦ A reference to the preliminary report ◦ An attachment which describes the quality review conducted including an overview and information on planning and performing the review. Further, the Quality Review Report should be issued on the reviewer's (individual) letterhead and signed by the reviewer. The report should be addressed to the Board and should be dated as of the date of the conclusion of the review.	

QNO 653.095	Important areas as per Quality Review Report-SQC 1 Bhaskar CNO – QR.040	New Course-- (S21M)
	What are the important areas for evaluation while conducting quality reviews in terms of SQC -1 Standard on Quality Control?	
Answer	➢ Example of important areas as per Quality Review Report 2018-19 in accordance with Standard on Quality Control -1 are • Whether the audit firm establishes and implements policies and procedure on all the element of system of quality control • Whether the engagement quality control reviewer review at an appropriate time for the planning of an audit, significant audit judgement, and expressions of an audit opinion. • Whether the audit firm assigns as the person responsible for the monitoring of the system of quality control a person with appropriate experience for the role, vest the assigned person with sufficient and appropriate authority. • Whether the audit firm obtain, at least annually, a confirmation letter concerning compliance with policies and procedure for the maintenance of independence from all person required to maintain independence. • Whether the audit firm perform the independence confirmation procedure set forth in its internal rules before acceptance and continuance of an audit engagement, and when issuing the auditor's report appropriately confirms that there was no change in the status of independence. • Whether the audit firm develop and provides education/ training program that fully take into account the knowledge, experience, competence and capabilities of the professional staff.	

QNO 653.098	Professional judgment exercised by the auditor is one of the important aspects under Quality review- Unique	Old Course—(N21R) New Course--(S21M, N21R, N22M,N22R)
	Evaluating the professional judgment exercised by the auditor is one of the important aspects under Quality review, please explain the situation with reference to applicable SA.	
	Evaluating the professional judgment exercised by the auditor: It is also important for the Technical Reviewer (hereinafter referred as TR) to understand that "professional judgment", as defined in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" is an integral concept in the context of an audit and application of SAs in real life audit scenarios. SA 200 defines professional judgment as "the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the course of action that is appropriate in the circumstances of the audit engagement." The concept of "professional judgment" underscores the fact that Standards, particularly, Standards on Auditing are written to lay down the fundamental principles that would apply to an audit situation. Hence, no Standard can have straight jacketed application/solutions for all audit scenarios. Above all, the Standards on Auditing issued by the Institute of Chartered Accountants of India are principle based rather than rule based. Hence, almost all the SAs envisage exercise of professional judgment by the auditor in their application in real life audit scenarios. The TR would need to appreciate that the exercise of professional judgment in any particular case is based on the facts and circumstances that are known to the auditor as at the time of exercising that professional judgment. Normally, exercise of professional judgement by an auditor is preceded by consultation on the relevant matters both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm. **In evaluating the professional judgment exercised by the auditor, the TR should consider the following factors:** • whether the judgment reached reflects a due consideration and application of the relevant auditing and accounting principles; and • whether the judgment is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report. Hence, the TR	

	and the QR Team should not, under any circumstance, use "hindsight" (i.e. perception or retrospection) in their evaluation of exercise of professional judgment by the auditor. Since the auditor needs to exercise professional judgment throughout the audit, the latter also needs to be appropriately documented. Hence, the TR can expect to find such audit documentation as a part of the audit engagement file. It is important to note that professional judgment cannot be used by an auditor as a justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

QNO 653.099	Powers of Quality Review Board #Unique	New Course--(M22E)
	"In exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. Elucidate the powers of Quality Review Board in discharging its functions. How the Quality Review Board would proceed in case it does not receive the information called for by it from any Company? "	
	Powers of Quality Review Board : The Government of India has, in exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006'. To facilitate the discharge of its functions, Rule 6 of aforesaid rules provides: i. on its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide; ii. lay down the procedure of evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms rendering such services for review; iii. call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations, in such form and manner as it may decide, and may also give a hearing to them; iv. invite experts to provide expert/technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute; v. make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto. In case, the Board does not receive the information called for by it from any company registered under the Companies Act, 2013, the Board may request the Central Government in the Ministry of Corporate Affairs for assistance in obtaining the information.	

18 Professional Ethics

Part 1 - Introduction & CA Act

QNO 654.000	Sec 2 --MCS (Portfolio Management Services) Bhaskar CNO – PE.400	Old Course – (M06E, N08R, M12R, M12M, M13R, N15E, S17M, P17M, M18M, N18R) New Course – (S20M)
	P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2015, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients. **OR** **Mr. Sam, a Chartered Accountant in practice, provides guidance on post -issue activities to his clients e.g., follow up steps which include listing of instruments, dispatch of certificates and refunds etc. with the various agencies connected with the work. During the year 2017-18, looking to the growing needs of his clients to invest in the stock markets, he also started advising them on Portfolio Management Services whereby he managed portfolios of some of his clients.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 2(2)(iv) of the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients. **Part III – Case Discussion** ➢ A Chartered Accountant in practice provides management consultancy and other services to his clients. He also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients **Part IV – Conclusion** ➢ In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949.	

QNO 655.000	Sec 2 --MCS (Recruitment Services) Bhaskar CNO - PE.400	Old Course – (N07E, M11R, M15E, P17M)
	Mr. A, a practicing Chartered Accountant agreed to select and recruit personnel, conduct training programmes for and on behalf of a client.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 2(2)(iv) of the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.	

	Pursuant to Section 2(2)(iv) above, the Council has passed a resolution permitting a Chartered Accountant in practice to render entire range of "Management Consultancy and other Services". The definition of the expression "Management Consultancy and other Services" includes Personnel recruitment and selection. Personnel Recruitment and selection includes, development of human resources including designing and conduct of training programmes, work study, job description, job evaluation and evaluations of workloads. **Part III – Case Discussion** ➢ Mr. A, a practicing Chartered Accountant has agreed to select and recruit personnel, conduct training programmes for and on behalf of a client. **Part IV – Conclusion** ➢ So, Mr. A is not guilty of professional misconduct.

QNO 655.050	**Sec 2 --MCS (Advisor to issue and underwriting)** **Bhaskar CNO – PE.400**	**New Course – (M19E)**
	CA Natraj, in practice, accepted an assignment as advisor and consultant to the public issue of shares **by his client M/s Super Ltd.** **Besides helping the company as an advisor, he** also underwrote the public issue **of the company to the extent of 25% at a commission of 1%. Remaining shares were underwritten by banks and other financial institutions at the same rate of commission. He contends** that above assignments are part of management consultancy work permitted by the council of the Institute**. Do you agree with the view of CA Natraj ? Decide in the light of applicable code of conduct.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 2(2)(iv) of the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients. **Part III – Case Discussion** ➢ A Chartered Accountant in practice provides management consultancy (advisor to the issue) and Underwriting Services to the client. **Part IV – Conclusion** ➢ In view of this, **CA Natraj** would be guilty of misconduct under the Chartered Accountants Act, 1949 since providing Underwriting Services to the client is not permitted.	

QNO 655.100	**Sec 6 --Certificate Issued Without COP by CA** **Bhaskar CNO – PE.420/ Bhaskar CNO – PE.1080**	**Old Course – (N16M, P17M, M18R, M19R)** **New Course – (M18R)**
	The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. **Without having certificate of practice (CoP), CA. Vineet issued the certificate to the manager of the company,** acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute.	
Answer	**Part I -- Relevant Standards & Laws** ▪ As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949	

Part II -- Requirements of Relevant Standards & Laws

- As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.
  This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

Part III – Case Discussion

- In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Part IV – Conclusion

- Therefore, CA. Vineet will be held guilty of professional misconduct in terms of clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act by issuing certificate in respect of a consumption statement of raw material.

Author's Note

Following has not been included in detail by the institute in answer, however as per author it is advisable that it shall be included. Students are free to take their stand.

Section 6 -Certificate of Practice tells about the significance of COP.

- No member of the Institute shall be entitled to practise whether in India or elsewhere unless he has obtained from the Council a certificate of practice.
- A member who is not in practice is precluded from accepting engagement to render services of any of the types normally prescribed for a Chartered Accountant, even though for doing so, he does not require special qualifications

So, CA Vineet has contravened with of the provisions of section 6 of the CA Act ,1949 by issuing the raw material consumption certificate to the manager of the company.

CA deemed to be in practice

In any case where CA is practicing without COP, concept of deemed to be in practice will be applicable, apart from non-compliance of Sec 6. ICAI thought from point of view of Sec 6, you can very well mention Sec 2(2) at the end.

If he does any unethical activity while doing such practice first schedule & second schedule will get applicable and he will be further punished for wrong deeds,

- **Consequence**
  Consequence is applicability of all points of CA in practice and getting punished for any unethical act.

QNO 655.200	Sec 6 --Practice during Suspension Bhaskar CNO – PE.420	Old Course – (N11E, P17M)

A Chartered Accountant in practice has been suspended from practice for a period of 6 months **and he had surrendered his Certificate of Practice for the said period. During the said period of suspension, though the member did not undertake any audit assignments,** he undertook representation assignments for income tax whereby he would appear before the tax authorities in his capacity as a Chartered Accountant.

Answer

Part I -- Relevant Standards & Laws

- Chapter II - Section 6 of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

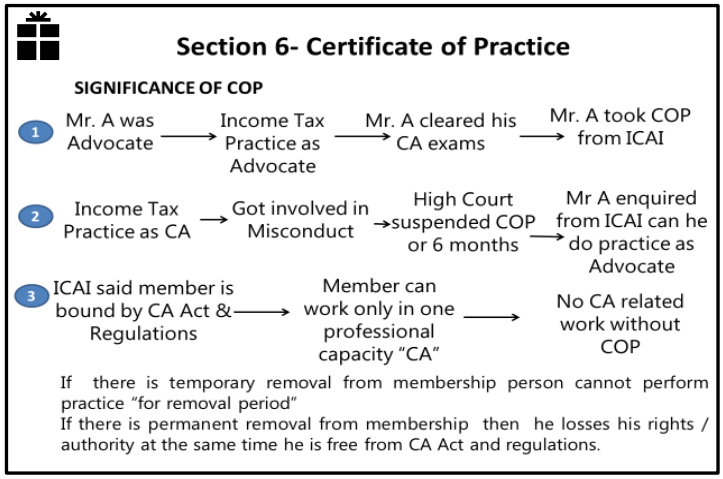
In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practises as a member of the Institute. This is because once a

member becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

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Part III – Case Discussion

- In the instant case, a chartered accountant not holding certificate of practice cannot take up any other work because it would amount to violation of the relevant provisions of the Chartered Accountants Act, 1949. If he appears before the income tax authorities, he is only doing so in his capacity as a chartered accountant and a member of the Institute. Having bound himself by the said Act and its Regulations made thereunder, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity.



Part IV – Conclusion

- Thus, in the instant case, a chartered accountant would not be allowed to represent before the income tax authorities for the period he remains suspended.

Author's Note:

Once person becomes member of ICAI, he is bound by CA Act and corresponding ICAI regulation. In such case he can do any work related to CA practice like accounting, auditing, tax costing, finance etc only in capacity as CA not in capacity of any other professional like CS, Lawyer etc.

QNO 655.300	**Sec 6 --Practice during Suspension** **Bhaskar CNO – PE.420**	**New Course – (M18E)**

Mr. Dice, a practising Chartered Accountant was ordered to surrender his Certificate of Practice and he was suspended for one year on certain professional misconduct against him. During the period of suspension, Mr. Dice, designating himself as GST Consultant, did the work of filing GST returns and made appearance as a consultant before various related authorities. He contended that there is nothing wrong in it as he, like any other GST consultant, could take such work and his engagement as such in no way violate the order of suspension inflicted on him. Is he right in his contention?

Answer

Part I -- Relevant Standards & Laws

- Chapter II Section 6 of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- A chartered accountant not holding certificate of practice cannot take up any other work in the capacity of Chartered Accountant in practice because it would amount to violation of the relevant provisions of the Chartered Accountants Act, 1949.

  In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practices as a member of the Institute. This is because once a member becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations.

	➢ In case he files GST returns and appears as a consultant before various related authorities in his capacity as a chartered accountant and a member of the Institute, having bound himself by the said Act and its Regulations made thereunder, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity. ~~But if he is doing so in any other capacity such as GST Consultant wherein his capacity is not chartered accountant in practice, he will not be held guilty for misconduct.~~
	Part III – Case Discussion
	➢ In the instant case, Mr. Dice was a practicing-chartered accountant and he was ordered to surrender his certificate of practice and was suspended for one year. As per Mr. Dice he is doing the work of filing GST returns and has appeared as a consultant before various related authorities as GST Consultant which is not in capacity of a practicing-chartered accountant rather in capacity of authorized representative. ~~Any person who has been authorized to act as a GST Practitioner on behalf of the concerned registered person can become authorized representative.~~ Mr. Dice would not be allowed to represent as a Chartered Accountant before various related authorities for the period he remains suspended.
	Part IV – Conclusion
	➢ Accordingly, in the present case he is guilty of professional misconduct.
	Author's Note **#controversy** The institute has changed this answer. Earlier it was "not guilty" and accordingly the answer was drafted. However later on the answer was changed to "guilty "only in conclusion, but the overall drafting is still the same which creates a lot of confusion and contradiction. **Removing the contradictory part will bring the required consistency in the answer.**

QNO 655.400	**Sec 8-- Effect of Insolvency on CA Membership** **BHASKAR CNO-- PE.420**	**New Course –(M23M)**
	Mr. Sheetal is a practicing chartered accountant. Due to natural calamities and misfortune during the year 2021, he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 2023, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without an y misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).	
Answer	Mr. Sheetal was discharged insolvent: Disabilities for the Purpose of Membership : Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period. In addition, failure on the part of a person to disclose the fact that he suffers from any one of the disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council. In the given case, it is clearly stated that Mr. Sheetal was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. Sheetal has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.	

QNO 656.000	**Sec 21 --Examples of Other Misconduct** **Bhaskar CNO – PE.480/ CNO – PE.920/CNO- PE.1160**	**Old Course – (N04E, M08R, N16E, P17M)** **New Course – (S17M,S21M)**
	Write a short note on Other Misconduct. **OR**	

A Chartered Accountant is liable for disciplinary action under section 21 of CA Act, 1949, if he is found guilty of any professional or other misconduct Explain the meaning of other misconduct with the help of two illustrative examples.

Answer

Part I -- Relevant Standards & Laws

- Section 21 of the Chartered Accountant Act
- Part IV of First Schedule the CA (Amendment Act) 2006.
- Part III of Second Schedule in the CA (Amendment Act) 2006.

Part II -- Requirements of Relevant Standards & Laws

➢ **Section 21 of the Chartered Accountant Act**

- A member is liable to disciplinary action under Section 21 of the Chartered Accountant Act if he is found guilty of any professional or 'other misconduct

Other Misconduct has been defined under :

➢ **Part IV of First Schedule in the CA (Amendment Act) 2006.**

- As per Part IV of First Schedule of the CA Act, a member of the Institute whether in practice or not, shall be deemed to be guilty of other misconduct if he
  - Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months
  - In the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action, whether or not related to his professional work.

(Other Misconduct as per past decided cases)

A	Anger	Objectionable / Derogatory / Abusive language / Insane Comments
	Anger	Publishing advertisement with malafied intention to malign any person
	Article	Used service of article for running other occupation or business (Eg Agriculture)
B	Bank	Submission of bogus bills & receipts to claim expenses during bank audit
C	Client	Coercion for payment of fees
	Client	Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.
	Client	Retained books & failed to return without reasonable clause. Further as ESB announcement :- A chartered accountant cannot exercise lien over the client documents/records for non-payment of his fees.
	Client	Conviction by a competent court of law for any offence under Section 8(v) of the Chartered Accountants Act 1949.
D	Deceive	Manipulating minute book of Company
	Deceive	Giving fake documents to client, calming that they are issued by ROC
	Deceive	Issue of fake experience certificate to other person
	Deceive	Forged will of relative
	Deceive	chartered accountant makes a material misrepresentation
E	Employer	Gross negligent as employee
	Employer	Fake experience while applying for job
F	Fraud	Misappropriation of ICAI funds for personal purpose
	Fraud	Cheques given by NBFC bounced because of lack of funds, where CA was managing director
G	Govt	Not replying to authorities (Export Authorities)
	Govt	Unauthorised possession of government records
	Govt	Authored book on tax for secret income (black money)
	Govt	CA filed 2 returns of income to evade tax
	Govt	Fabricated challans of advance tax of client, encashed it by opening fake account of client

➢ **Part III of Second Schedule in the CA (Amendment Act) 2006.**

(i) As per Part III of Second Schedule to the CA Act, a member of the Institute whether in practice or not shall be deemed to be guilty of other misconduct if he Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

This provision empowers the Council to enquire any misconduct of a member even if it does not arise of professional misconduct.

➢ **Some illustrative examples, where a member may be found guilty of "Other Misconduct", under the aforesaid provisions rendering, himself unfit to be member are:**

- Where a chartered accountant retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

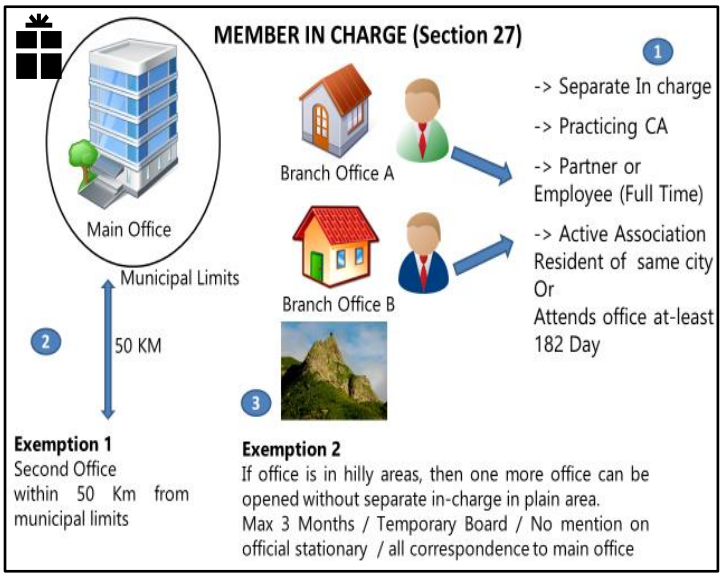
	• Where a chartered accountant makes a material misrepresentation. • Where a chartered accountant uses the services of his articled or audit clerk for purposes other than professional practice • Conviction by a competent court of law for any offence under Section 8(v) of the Chartered Accountants Act 1949. • Misappropriation by office-bearer of a Regional Council of the Institute, of a large amount and utilisation thereof for his personal use. • Non-replying within a reasonable time and without a good cause to the letter of the public authorities. • Where certain assessment records of income tax department belonging to the client of Chartered Accountant were found in the almirah of the bed-room of the chartered accountant. • Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.

QNO 656.500	**Sec 21 -- Other Misconduct (Not Replying to Public Authority)** **Bhaskar CNO – PE.480**	**New Course-- (N20E)**
	Mr. P, a practicing Chartered Accountant did not reply within a reasonable time and without any cause to the letter received from the local Police Station, a public authority**, soliciting his suggestions as regards some non-professional work. Comment with reference to Chartered Accountant Act, 1949.**	
Answer	Section 21 of the Chartered Accountants Act, 1949 provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct." Though the term "Other Misconduct" has not been defined in the said Act, this provision enables the Council to enquire into any misconduct of a member even if it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards even in his non-professional work, would expose him to disciplinary action. The Council has also laid down that among other things "non-replying within a reasonable time and without a good cause to the letter of the public authorities." would amount to "other misconduct". In the given scenario, CA. P did not reply within a reasonable time and without any cause to the letter received from the local police station, a public authority regarding soliciting his suggestion as regards some non-professional work. Thus, in the instant case, CA. P would be liable for disciplinary action.	

QNO 657.000	**Sec 27 --Sec 27 (Separate branch In charge)** **Bhaskar CNO – PE.520**	**Old Course – (N12M, P17M)**
	Write a short note on - Maintenance of branch offices by Chartered Accountants in practice.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Section 27 of the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws**	

➢ Section 27 of the Chartered Accountants Act, 1949 requires that if a chartered accountant in practice or a firm of chartered accountants has more than one office in India, i.e., a branch, each of such offices should be in the separate charge of a member of the Institute.

Failure on the part of a member or a firm, to have a member in charge of its branch office and a separate member in case of the branches, if more than one, would constitute professional misconduct.



However, exemption from the above has been given to members practising in the hilly areas subject to the certain conditions.

It is necessary to mention that the Chartered Accountant in charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him.

The above rule applies in case additional office is situated at a place beyond 50 Kms. from the municipal limits in which the office is situated.

The exemption may be granted under proviso to section 27(1) of the Chartered Accountants Act, 1949 to a member or a firm of Chartered Accountants in practice to have a second office without such second office being under the separate charge of a member of the Institute provided

- the second office is located in the same premises, in which the first office is located or
- the second office is located in the same city, in which the first office is located or
- the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located. A member having two offices of the type referred to above shall have to declare, which of the two offices is his main office which would constitute his professional address.

QNO 658.000	Sec 27 --Sec 27 (Separate branch In charge) / ITO Bhaskar CNO – PE.520	Old Course –(N12E, N15E, P17M, M17M, M19E) New Course – (S17M,S21M)

Mr. G, a Chartered Accountant in practice as a sole proprietor has an office in Mumbai near Church Gate. Due to increase in professional work, he opens another office in a suburb of Mumbai which is approximately 80 kilometres away from his existing office. For running the new office, he employs three retired Income-tax Officers

OR

K, Chartered Accountant in practice as a sole proprietor at Chennai has an office in the suburbs of Chennai. Due to increase in the income tax assessment work, he opens another office near the income tax office. For running the new office, he has employed a retired income Tax Commissioner.

Answer

Part I -- Relevant Standards & Laws

- Section 27 of Chapter VII of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

➢ In terms of section 27 of the Chartered Accountants Act, 1949, if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute.

There is however an exemption for the above if

- the second office is located in the same premises, in which the first office is located; or
- the second office is located in the same city, in which the first office is located; or
- the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located.

Part III – Case Discussion

- Since the second office is situated beyond 50 kms of municipal limits of Mumbai city which is approximately 80 kilometres away from his existing office. For running the new office, he employed three retired Income-tax Officers whereas he should have created a separate charge of a member of the Institute.

Part IV – Conclusion

- Thus, he would be liable for committing a professional misconduct.

Author's Note

⚠ **# Mistake point**

- Here it is written that another office is opened in a suburb of Mumbai which is approximately 80 kilometres away from his "existing office".
  As per section 27 of the CA Act ,1949 - Distance from existing office is of no importance. What is important is distance from "Municipal Limits" in which existing office is situated.
  Here institute has assumed the distance from existing office is same as distance from Municipal limits. (Also refer chart in previous question)

- In second question of "Chennai city" kms are not specified. Further word suburbs is not defined in law. It simply means residential area either on outskirts of city or after city limit. So in this question we don't know exact distance between city limits and office.
  So in this question we should give conditional answer after explaining requirements of Sec 27 and exemptions.
  If its within 50 km then no need of separate CA in charge, so not violating sec 27
  if it's beyond 50km then separate CA in charge required, so violating sec 27

QNO 659.000	Sec 27 --Sec 27 (Separate branch In charge) No Intimation Bhaskar CNO – PE.520	New Course – (M18E)

M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirt which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there is any professional misconduct in this respect

Answer

Part I -- Relevant Standards & Laws

- Section 27 of Chapter VII of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located.

Part III – Case Discussion

- In the given case, M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city and had great difficulty in regularly attending to the consultancy needs of his clients. Therefore, a facilitation centre was opened in the industrial cluster and the proprietor is managing both the office and facilitation centre.

Part IV – Conclusion

- Though distance between his office and facilitation center i.e. sort of second office is within prescribed range i.e. 50 kilometers but M& Co., will be liable for misconduct as prescribed intimation about facilitation centre and main office should be sent to the Institute of Chartered Accountants of India.

Author's Note

⚠ **# Mistake point**

Here it is written that another office is opened in a suburb of Mumbai which is approximately 26 kilometres away from his "existing office".

As per section 27 of the CA Act ,1949 –

1. **Distance from existing office is of no importance. What is important is distance from "Municipal Limits" in which existing office is situated.**
   Here institute has assumed the distance from existing office is same as distance from Municipal limits. For this point is not guilty.
2. **Opening and closing of branch are required to be informed to the institute as per section 27(2) of the CA Act ,1949 and it should be informed within 1 month as per regulation 189. But for this point he is guilty. Further many students may miss this point, so be careful.**
   (Also refer chart in previous question)

QNO 660.000	**Sec 27 (Separate branch In charge) Same Board at Residence Bhaskar CNO – PE.520/ CNO – PE.600**	**Old Course – (N07E, P17M) New Course – (N21M,N22M)**

XY & Co., a firm of Chartered Accountant having 2 partners X & Y, one in charge of Head Office and another in charge of Branch at a distance of 80 kms, puts up a name-board of the firm in both premises and also in their respective residences.

Answer

Part I -- Relevant Standards & Laws

- Section 27 of Chapter VII of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- The council of the Institute has decided that with regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of chartered accountant, provided, it is a name-plate or board of an individual member and not of the firm.

Part III – Case Discussion

- In the given case, partners of XY & Co., put up a name board of the firm in both offices and also in their respective residences. Distance given in the question is not relevant.

Part IV– Conclusion

- Thus, the chartered accountants are guilty of misconduct as name board of the firm cannot be used in place of residence.

QNO 660.500	**Sec 27 --Sec 27 (Separate branch In charge) Hilly Region Branch Bhaskar CNO – PE.520**	**Old Course—(M21M) New Course—(M21M)**

Mr. Z, a newly qualified chartered accountant started his practice in February 2018 by setting up an office in the hill station Kodaikanal. Initially, since he was getting very less assignments, he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed and Mr. Z was in-charge for both the offices. Mrs. A, another newly qualified chartered accountant who is also in practice in Marudai came to know about the new office of Mr. Z. Thinking that he could be a potential competitor, she informed the institute stating that Mr. Z had violated the provisions of the Chartered Accountant Act. As a member of the Board of Discipline of ICAI, you are requested to analyse this complaint.

Answer

As per section 27 of Chartered Accountants Act 1949, if a Chartered Accountant in practice or a Firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct. This condition applies to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

	However, exemption has been given to members in practicing in hill areas subject to certain conditions such as: – Such member/ firm be allowed to open temporary offices in a city in the plains for a limited period not exceeding 3 months in a year. – The regular office need not be closed during this period and all correspondence can continue to be made at the regular office. – The name board of the firm in temporary office should not be displayed at times other than the period such office is permitted to function. – The temporary office should not be mentioned in letter head, visiting card, any other documents as a place of business of the member/ firm. – Before commencement of every winter, it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post. In the given case, Mr. Z has set up his regular office in the hill area of Kodaikanal, he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed. Further he was in-charge for both the offices. In view of abovementioned criteria's, he is eligible to avail the benefits of the above exemptions. Also, it is given that the temporary office was open in Madurai for only 3 months and not beyond that. The fact that Mr. Z is in-charge for both the offices, the temporary office being set-up in the plains which is 100 kms away and the regular office kept open during the 3 months does not constitute any violation of the provisions of the Chartered Accountant Act. Assuming Mr. Z has informed the Institute regarding such temporary office in the prescribed manner. Therefore, in the given case, no penal action needs to be taken on the basis of complaint registered by Mrs. A, as Mr. Z is not guilty of professional misconduct.

QNO 660.100	First Schedule, Part I,Cl,1-Working on behalf of CA or CA firm Bhaskar CNO – PE.580	New Course – (M19E,M22M, M23M)
	CA Sant, a newly qualified professional with certificate of practice, approached CA Pant, the auditor of his father's company M/s Max Ltd., to allow him to have some practical and professional knowledge and experience in his firm before he can set up his own professional practice. CA Pant allowed him to sit in his office for 6 month and allotted a small chamber with other office infrastructure facility. In the course of his association with CA Pants office, he used to provide tax consultancy independently to the client of the firm and also filed few IT and GST return and represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Pants office he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of 3,00,000 by CA Pant for his association out of gratitude. Examine the case in the light of code of professional misconduct.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ It states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him. ➢ The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision. **Part III – Case Discussion** ➢ In the instant case, CA Pant allowed CA Sant (who is a newly qualified CA professional with COP) to sit in his office for 6 months, and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. ➢ He also allowed him to appear before various tax authorities on behalf of his firm. CA Sant was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. ➢ However, after the end of agreed period he was given a lump-sums of rupees 3,00,000 for his association out of gratitude. **Part IV– Conclusion** ➢ Thus, in the present case CA. Pant will be held guilty of professional misconduct as per Clause (1) of Part I of First Schedule to the Chartered Accountants Act, 1949 as he allowed CA Sant to practice in his name as Chartered accountant and CA Sant is neither in partnership nor in employment with CA. Pant.	
	Author's Note **Here it is clearly written that he "did not" get any share in salary or commission. So, no question of Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949**	

QNO 661.000	First Schedule, Part I,Cl,2 --Sale of Goodwill Bhaskar CNO – PE.600	Old Course – (N04E, N08R, N12E,P17M, N17R) New Course – (S17M,M22E)
	A Chartered Accountant who was in practice since last 18 years died in a road accident. His widow sold the practice to another Chartered Accountant in practice for ` 30 lakhs. The price also included the right to use the firm name. **OR** **CA Ravi, a practising Chartered Accountant, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for 25 Lacs along with right to use the firm name i.e., M/s. Ravi & Associates and requested the Institute to consider the effect of such**	

sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and Schedules thereto:
(i) Whether Roohi can sell the practice to CA Balwan?
(ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates?

Answer

Part I -- Relevant Laws

- Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949

Part II -- Requirements of Relevant Laws

➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than

- a member of the Institute or a partner or
- a retired partner or the legal representative of a deceased partner, or
- a member of any other professional body or
- with such other persons having such qualification as may be prescribed,
- for the purpose of rendering such professional services from time to time in or outside India.

The Council of the Institute of Chartered Accountants of India had an occasion to consider whether the goodwill of a proprietary concern of chartered accountant can be sold after the death of the proprietor to another member who is otherwise eligible.

The Council has clarified that the sale/transfer of goodwill in the case of a proprietary firm of chartered accountant to another eligible member of the Institute shall be permitted. It further laid down that in cases where the death of proprietor occurs after 30.08.1998, the goodwill of the deceased member's practice can be sold to another member and permission of the Institute has to be obtained within a year of the death of the proprietor concerned. It is even laid down that in such cases the name of the proprietary firm concerned would not be removed up to a period of one year from the death of the proprietor.

In case there exist a dispute as to the legal heir of deceased proprietor, information as to the existence of dispute is received by the institute within a year of the death. In such a case name of the firm is kept in abeyance till one year from the date of settlement of dispute.

Part III – Case Discussion

➢ A Chartered Accountant who was in practice since last 18 years died in a road accident. His widow sold the practice to another Chartered Accountant in practice for ` 30 lakhs. The price also included the right to use the firm name.

Part IV – Conclusion

➢ Thus, in the instant case, when the widow of the chartered accountant sold the practice to another member, it is nothing, but goodwill sold to another member. The sale of the practice and the right to use the name is also allowed in terms of the above decision of the Council. Therefore, the above act of the widow of the Chartered Accountant is permissible.

QNO 662.000	**First Schedule, Part I,Cl,2 –Sharing with of Fees** **Bhaskar CNO – PE.600**	**Old Course – (M12E, N13E, M16E, P17M, N17M, N19M, N19E)** **New Course – (S17M, N19M, S21M,N22M)**

Mr. X who passed his CA examination of ICAI on 18th July 2015 and started his practice from August 15, 2015. On 16th August 2015, one female candidate approached him for article ship. In addition to monthly stipend, Mr. X also offered her 1 % profits of his CA firm. She agreed to take both 1 % profits of the CA firm and stipend as per the rate prescribed by the ICAI. The Institute of Chartered Accountants of India sent a letter to Mr. X objecting the payment of 1 % profits. Mr. X replies to the ICAI stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the financial position of the articled clerk is very weak. Is Mr. X Liable to professional misconduct?

OR

CA Ciya, a practicing Chartered Accountant gave 60% of the audit fees received by her to Mr. Suhas, who was not a Chartered Accountant, under the nomenclature of office allowances.

OR

CA. P is a newly qualified Chartered Accountant in practice and in order to increase his professional practice and client base, entered into an agreement with Mr. A, a qualified and experienced registered

	valuer to share 20% professional fees for all cases of valuation referred to him by CA. P. **Based on this, CA. P received? 1,20,000 during the year 2018-19 from Mr. A. Is' CA. P guilty of misconduct under the Chartered Accountants' Act, 1949?**
Answer	**Part I -- Relevant Laws** ▪ Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than • a member of the Institute or • a partner or • a retired partner or • the legal representative of a deceased partner, or • a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India. **Part III – Case Discussion** ➢ In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable. **Part IV – Conclusion** ➢ Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.

QNO 662.005	**First Schedule, Part I,Cl,2 --Sharing with Digital Marketer** **Bhaskar CNO – PE.600**	**New Course – (M22R)**
	Mr. Avi, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. Ravi gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. Avi started a website with colourful catchy designs and shared the website address on his all social media posts and stories and tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services". Besides, Mr. Avi entered into an agreement with a Digital Marketer to give him 8% commission on each service procured through him. Discuss if the actions of Mr. Avi are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.	
Answer	**(a)**As per Clause (6) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. Mr. Avi is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines. In the given situation, Mr. Avi shared the website address on his all social media posts and stories and tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on the website issued by the ICAI. Thus, CA, Avi would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.	

QNO 662.010	**First Schedule, Part I,Cl,2 & Cl 3 Sharing & Accepting (Advocate)** **Bhaskar CNO – PE.600/ CNO – PE.620**	**Old Course – (M15R, M16E, P17M, M18M)** **New Course – (M18M,N22E)**
	Mr. A is a practicing Chartered Accountant. Mr. B is a practicing Advocate representing matters in the court of law. Mr. A and Mr. B decided to help each other in the matters involving their professional expertise**.** Accordingly, Mr. A recommends Mr. B in all tax litigation matters in the court of law and	

Mr. B **consults Mr. A in all matters related to finance and other related matters, which comes to him in arguing various cases in the court of law. Consequently, they started sharing some part in the profits of their professional work.**

Answer

Part I -- Relevant Laws

- Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949
- Clause (3) of Part I of First Schedule to the Chartered Accountants Act 1949

Part II -- Requirements of Relevant Laws

➢ **Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949**

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute, for the purpose of rendering such professional services from time to time in or outside India.

➢ **Clause (3) of Part I of First Schedule to the Chartered Accountants Act 1949**

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts any part of the profits of the professional work of a person who is not a member of the Institute.

A practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988.

Part III – Case Discussion

➢ Mr. B, an advocate, a member of Bar Council, is sharing part of profits of his professional work with Mr. A, a chartered accountant.

Part IV – Conclusion

➢ Under the said regulation, the member of "Bar Council of India" is included. Hence, Mr. A, a practicing Chartered Accountant, will not be held guilty under any of the abovementioned clauses for paying and accepting part of profits from Mr. B.

QNO 664.000	**First Schedule, Part I, Cl 4 Partnership Outside India With Foreign Professional** **First Schedule, Part I, Cl 7 Designation Consultant** **Bhaskar CNO – PE.640/ CNO – PE.700**	**Old Course – (N11R, P17M)** **New Course – (N18M)**

Discuss whether the following actions by a Chartered Accountant would amount to misconduct or not:

(i) A Chartered Accountant practising in India enters into partnership with

(a) A Certified Public Accountant in New York.

(b) A Chartered Accountant from the Institute of Chartered Accountants in England and Wales in London, and in each case, the members concerned take the profits earned in their own country.

Will it make any difference, if an Indian Chartered Accountant is practicing outside India **and becomes a partner with the aforesaid accountants?**

(ii) A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as

(a) Tax Consultant

(b) Cost Accountant.

Answer

Part (i)

Part I -- Relevant Laws

- Clause (4) of Part I of First Schedule to the Chartered Accountants Act 1949

Part II -- Requirements of Relevant Laws

➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he enters into partnership, in or outside India, with any person other than a chartered accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(a) Partnership with a CPA in New York

Part III – Case Discussion

- In the given case a Chartered Accountant practising in India enters into partnership with a Certified Public Accountant in New York.

Part IV – Conclusion

- Thus, chartered accountant would be guilty of professional misconduct since certified public accountants (CPA) are not eligible to become members of the Institute.

Author's Note

A Certified Public Accountant in New York means a Certified Public Accountant practising in New York

(b) Partnership with a chartered accountant from ICAEW

Earlier, the Council had passed a resolution permitting chartered accountants from ICAEW to become members of the Institute as also fulfilment of certain conditions in respect of persons not permanently residing in India. However, the Council of the Institute at its meeting held in December 1995 decided to withdraw the resolution w.e.f. December 8, 1995. In view of this, persons qualified from any of the four Institutes in the United Kingdom including England and Wales are not entitled to have their names entered in the Register of Members maintained by the Institute effective from December 8, 1995. Based on this development, partnership between members of the Institute and members of above foreign professional bodies will not be permissible from the above date.

Part III – Case Discussion

- In the given case a Chartered Accountant practising in India enters into partnership with a chartered accountant from ICAEW

Part IV – Conclusion

- Even a chartered accountant from ICAEW who was eligible to become member of the Institute, the profit sharing arrangement stated in the question goes against the provisions of Clause (4). Hence, it would constitute professional misconduct.

Author's Note

Chartered Accountant from the Institute of Chartered Accountants in England and Wales in London means a practising Chartered Accountant from the Institute of Chartered Accountants in England and Wales in London

Chartered Accountants practising outside India:

A member of the Institute of Chartered Accountants of India is governed by the Code of Ethics whether practicing in India or outside India. Accordingly, the question of professional misconduct would arise if an Indian chartered accountant practising outside India becomes a partner with aforesaid accountants and enters into partnership in that country with a member of the Institute of that country.

Part III – Case Discussion

- An Indian Chartered Accountant is practising outside India and becomes a partner with the aforesaid accountants (Chartered accountant from ICAEW / CPA in New York)

Part IV – Conclusion

- There would be professional misconduct within the provisions of the Institute of Chartered Accountants Act, 1949 as the applicability of such provisions extend to members practicing outside India.

Part (ii)

Part I -- Relevant Laws

- Clause (7) of Part I of First Schedule to the Chartered Accountants Act 1949
- Section 7 of Chartered Accountants Act 1949.

Part II -- Requirements of Relevant Laws

- Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public.

Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

(a) Tax Consultant:

Part III – Case Discussion

- A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as Tax Consultant

Part IV – Conclusion

- Thus, it is improper to use designation "Tax Consultant" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. This would constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(b) Cost Accountant:

Part III – Case Discussion

- A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, as Tax Consultant

Part IV – Conclusion

- Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". However as per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant". This would also constitute misconduct under section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

QNO 665.000	First Schedule, Part I,Cl 4 Partnership (Advocate) Bhaskar CNO – PE.640	Old Course – (N05E, M09R, P17M, M19R) New Course – (S17M, N18R, N18M)

Mr. P, a Chartered Accountant in practice entered into a partnership with Mr. L, an advocate for sharing of fees for work sent by one to the other. However, due to some disputes, the partnership was dissolved after 1 month without any fees having been received.

Answer

Part I -- Relevant Laws

- Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Regulation 53B of the Chartered Accountants Regulations, 1988

Part II -- Requirements of Relevant Laws

Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949

A chartered accountant will be guilty of professional misconduct if he enters into partnership with any person other than

- a chartered accountant in practice or
- Member of any other body having prescribed qualifications
- a person resident outside India who but for his residence abroad would be entitled to be registered as a member under Clause (v) of Sub-section (1) of Section 4 or
- whose qualification are recognized by the Central Government or the Council for the purpose of permitting such partnership.

Regulation 53B of the Chartered Accountants Regulations, 1988

A Chartered Accountant in practice to enter into partnership with other prescribed Professionals which includes an Advocate, a member of Bar Council of India.

Part III – Case Discussion

- In the instant case, Mr. P, a chartered accountant, has entered into partnership with Mr. L, an advocate.

Part IV – Conclusion

- Thus, he would not be guilty of professional misconduct as per Clause (4) of Part I of First Schedule read with Regulation 53B.

QNO 666.000	First Schedule, Part I,Cl 4 Partnership with Non-CA's Bhaskar CNO – PE.640/ CNO – PE.780	Old Course – (M15E, P17M)

A Chartered Accountant having CoP entered into partnership with persons, who are not the members of the institute, for the purpose of carrying on business. The share of the chartered account in the profit and losses was 25%. He was to take part in the business and was entitled to represent the firm before Govt. authorities etc. He was operating the bank account of the firm, was receiving moneys from the customers and was also looking after the affairs of the Partnership.

Answer

Part I -- Relevant Laws

- Clause (4) of Part I of First Schedule to the Chartered Accountants Act, 1949
- Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

➢ **Practicing CA Entering into Partnership and Carrying on Business:**

As per Clause (4) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he enters into partnership, in or outside India, with any person other than Chartered Accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

It may be noted that the Council has prescribed the list of persons qualified and the professional bodies for the purpose of entering into partnership under the Chartered Accountants Regulations, 1988.

➢ **Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949**

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

It may also be noted that a member in practice is required to apply for specific and prior approval of the Council for entering into any business.

Part III – Case Discussion

➢ In the given case, a chartered accountant in practice has entered into partnership with persons who were not the members of the Institute, for the purpose of carrying on business.

The question is silent about with whom the partnership has been entered into and whether the prior permission for entering into such business has been obtained.

Part IV – Conclusion

➢ It is assumed that the persons with whom the partnership has been entered into has not been allowed under the Regulations and the prior approval of the Council has not been obtained for entering into such business. Hence, the Chartered Accountant shall be held guilty of professional misconduct under Clause (4) and Clause (11).

Author's Note

There is a old case where CA got permission to do business under clause 11, then that time ICAI said that it means he also has permission to enter in partnership with non-CA to that particular business under clause 4. So, approval under clause 11 will mean approval to enter into partnership for such business

QNO 666.050	First Schedule, Part I,Cl,6 – (Multiple Issues) Bhaskar CNO – PE.680	New Course – (N20E, S21M)

Mr. A, a newly qualified Chartered Accountant, started his practice and sought clients through telephone calls from his family and friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. X gave him an idea to start online services and give stock certifications to traders with Cash Credit Limits in Banks. Mr. A started a website with colourful catchy designs and shared the website address on his all-social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services". Besides, Mr. A entered in an agreement with a Digital Marketer to give him 5% commission on each service procured through

	him. Discuss if the actions of Mr. A are valid in the light of the Professional Ethics and various pronouncements and guidelines issued by ICAI.
	Part I -- Relevant Laws ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. **Part III – Case Discussion & Conclusion** ➢ Mr. A is wrong in seeking clients through family and friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines. ➢ In the given situation, Mr. A shared the website address on his all-social media posts and stories and tagged 30 traders of his local community with the caption "Easy Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on website issued by the ICAI. ➢ Thus, CA, A would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

QNO 667.000	**First Schedule, Part I,Cl,6 Advertisement (Opening Ceremony)** **Bhaskar CNO – PE.680**	**Old Course – (M10E, P17M)** **New Course – (S17M, S21M)**
	An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. **Part III – Case Discussion** ➢ In the given case, Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. **Part IV – Conclusion** ➢ On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties cannot be maintained. The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	
	Author's Note **Even if advertisement is given by others like relatives or friends then also guilty**	

QNO 668.000	**First Schedule, Part I,Cl,6 Clarification (Books)** **Bhaskar CNO – PE.680**	**Old Course – (N05E, M09R, M13M,P17M)** **New Course- (S17M)**
	Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience and his present association as partner with M/s RST, a firm.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949	

	Part II -- Requirements of Relevant Laws ➢ The clause refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. **Part III – Case Discussion** ➢ In this case, Mr. S a Chartered Accountant published the book and mentioned his professional experience and his association as a partner with M/s RST, a firm of chartered accountants. **Part IV – Conclusion** ➢ While elaborating forms of soliciting work, the Council has specified that a member is now permitted to indicate in a book or an article, published by him, the association with any firm of chartered accountants, but even today highlighting professional attainments is not allowed. Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning is professional experience, as it will lead to highlighting professional attainments.
	Author's Note **Clause 6 and Clause 11 both govern book authorship**. • **Clause 11** – Clears confusion regarding book authorship CA can author any book, no restrictions on that. • **Clause 6** – Clarifies whether CA Firm name can be mentioned. After writing book, name and firm name of CA is allowed. (Name of firm is allowed as on today, it was not allowed earlier. This is a recent change But highlighting professional attainments is still not allowed.

QNO 668.100	**First Schedule, Part I,Cl,11 Clarification (Books, Cooking Book Without Permission)** **Bhaskar CNO – PE.680/CNO – PE.780**	**Old Course – (M16M, M18M)**
	CA. Ritu is a leading Income Tax Practitioner in Delhi. She is very much fond of cooking. Due to this passion of her, she also wrote a cookery book "Delight your tummy" during the year. But she didn't take any permission from the Council of the Institute for engaging herself into authorship of such book. Comment.	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in Practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. Further, the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same, general permission has been granted for authorship of books and articles. **Part III – Case Discussion** ➢ In the given case, CA. Ritu has written a cookery book without obtaining specific or prior approval of the Council. **Part IV – Conclusion** ➢ On this context, it may be noted that no specific permission is required to be obtained for authorship of books and articles. Therefore, CA. Ritu would not be held guilty of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	
	Author's Note	

	• **Specific permission is required for Editorship of journals other than professional journals. CA Ritu is guilty of professional misconduct under Schedule I Part I Clause 11?** ○ **She is writing a book, you can write book on any topic without any permission, firm name should not be mentioned it's not editorship, so not guilty**

QNO 669.000	**First Schedule, Part I,Cl,6 Clarification (Greeting Cards & Invitations)/ Marriage** **Bhaskar CNO – PE.680**	**Old Course – (P17M, N17R, N18R)**
	Mr. Raj, a renowned practicing Chartered Accountant, decided to tie his knot with Ms. Anjani. While giving order for marriage invitation cards, Mr. Raj instructed to add his designation "Chartered Accountant" with his name. Later on, the cards were distributed to all his relatives, close friends and clients. **OR** **Mr. Swapnil, a renowned practicing Chartered Accountant, decided to tie his knot with Ms. Anjani. While giving order for marriage invitation cards, Mr. Swapnil instructed to add his designation "Chartered Accountant" with his name. Later, the cards were distributed to all his relatives, close friends and clients.**	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. However, the Council of the ICAI is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages and religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned. **Part III – Case Discussion** ➢ In the given case, Mr. Raj instructed to write designation "Chartered Accountant" on his marriage invitation cards and distributed the same to all his relatives, close friends and clients. **Part IV – Conclusion** ➢ On this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for marriages, provided these are sent only to clients, relatives and close friends of the members concerned. Therefore, Mr. Raj would not be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	

	Author's Note:
	Clarification regarding GREETING CARDS / INVITATIONS
	• **Cannot use "Chartered Accountant" designation, free to use prefix CA (General Rule)**
	• **Exceptions (Use of "Chartered Accountant" designation- Allowed in below cases)**
	  ○ **Greeting Cards**
	  ○ **Invitation to Religious Ceremony / Opening of office / Marriages (CA's) / Intimation of change in office, premises or telephone number.**
	PROVIDED it should be sent to CLIENTS / RELATIVES / FRIENDS.	

QNO 670.000	**First Schedule, Part I,Cl,6 Clarification (Greeting Cards & Invitations) Sonu/Monu** **Bhaskar CNO – PE.680**	**Old Course – (M16R, N16M,N20R)** **New Course – (N20R)**
	CA. Sonu and CA. Monu are two partners of the CA firm 'Sonu Monu and Associates'. Being very pious, CA. Sonu organised a religious ceremony at his home for which he instructed his printing agent to add his designation "Chartered Accountant" with his name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners. **OR** **(a) CA. Srishti and CA. Mishti are two partners of the CA firm 'Srishti Mishti & Associates'.**	

	Being very pious, CA. Srishti organised a religious ceremony at her home for which she instructed her printing agent to add her designation "Chartered Accountant" with her name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.
Answer	**Part I -- Relevant Laws** ➢ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. However, the Council of the ICAI is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned. **Part III – Case Discussion** ➢ In the given case, CA. Sonu has instructed to write designation "Chartered Accountant" on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners. **Part IV – Conclusion** ➢ In this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only. Therefore, CA. Sonu would be held guilty of professional misconduct under the said clause for sending such invitations to the relatives, close friends and clients of CA. Monu as well.
	Author's Note **Here invitations are sent to relatives, close friends and clients of CA. Monu as well. If the invitations were only sent to relatives, close friends and clients of CA Sonu then he would not have been guilty.**

QNO 672.000	**First Schedule, Part I,Cl,6 Clarification (Mass Communication to Other CA in Practice)** **Bhaskar CNO – PE.680**	**Old Course – (N14R, P17M, M20M)** **New Course – (M20M)**
	CA. N, in practice, started project consultancy work as a part of his practice and to advance the same, sent mail to all the CAs in the country informing them of his services and for securing professional work.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. However, nothing herein contained shall be construed as preventing or prohibiting, any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountants in practice. **Part III – Case Discussion** ➢ In the instant case, CA. N has written email to all the CA for securing professional work from them and has not approached any other person or professional or communicated with any client, **Part IV – Conclusion** ➢ Thus, as per exception to the Clause (6) CA. N is well within the regulation of the act and has not committed any professional misconduct.	
	Author's Note **If paper advertisement is given, it goes to everyone - "Guilty" If email sent only to CA's - "Not Guilty"**	

QNO 673.000	First Schedule, Part I,Cl,6 Clarification (Public Interview) Bhaskar CNO – PE.680/ CNO – PE.700	Old Course – (N13E, P17M, M19M, M21M) New Course – (S17M, M18E, N19M, S21M, M21M, M22E)

Mr. Nigal, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment.

Answer

Part I -- Relevant Laws

- Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949
- Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

➢ **Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

A Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

➢ **Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

It prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration.

Part III – Case Discussion

➢ Mr. Nigal, delivered a speech and while delivering the speech, he told to the audience that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience

Part IV – Conclusion

➢ It is improper to use designation "Management Expert" by Mr. Nigal since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council.

Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation “Management Expert” in his speech and also, he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

QNO 674.000	First Schedule, Part I,Cl,6 Clarification (Public Interview) [TV Interview Case]	Old Course – (N08R, P17M) New Course – (S17M, S21M)

	Bhaskar CNO – PE.680	
	A partner of a firm of chartered accountants during a T.V. interview handed over a bio-data of his firm to the chairperson. Such bio-data detailed the standing of the international firm with which the firm was associated. It also detailed the achievements of the concerned partner and his recognition as an expert in the field of taxation in the country. The chairperson read out the said bio-data during the interview. Discuss whether this action by the Chartered Accountant would amount to misconduct or not.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The clause prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means since it shall constitute professional misconduct. **Part III – Case Discussion** ➢ The bio-data was handed over to the chairperson during the T.V. interview by the Chartered Accountant which included details about the firm and the achievements of the partner as an expert in the field of taxation. The chairperson simply read out the same in detail about association with the international firm as also the achievements of the partner and his recognition as an expert in the field of taxation. Such an act would definitely lead to the promotion of the firms' name and publicity thereof as well as of the partner and as such the handing over of bio-data cannot be approved. **Part IV – Conclusion** ➢ The partner would be held guilty of professional miscount under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	
	Author's Note **Conclusion** If there is reference to word interview go for clause 6 where firm name is allowed but not highlighting and publicity. If there is appearance in programs of television / radio or films then firm name is not allowed. If question specifies TV interview apply clause 6, as we have specific clarification about "Public Interview"	

QNO 675.000	**First Schedule, Part I,Cl,6 Clarification (Representation by CA Under Company Act)** **Bhaskar CNO – PE.680**	**Old Course – (M15R, M16M, P17M, M18M, M19M)** **New Course – (M18M, M19M)**
	A special notice has been issued for a resolution at 3rd annual general meeting of Fiddle Ltd. providing expressly that CA. Smart shall not be re-appointed as an auditor of the company. Consequently, CA. Smart submitted a representation in writing to the company as provided under section 140(4)(iii) of the Companies Act, 2013. In the representation, CA. Smart incorporated his independent working as a professional throughout the term of office and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the Company	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders. Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.	

Part III – Case Discussion

- CA. Smart submitted a representation in writing to the company as provided under section 140(4)(iii) of the Companies Act, 2013. In the representation, CA. Smart incorporated his independent working as a professional throughout the term of office and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the Company.

Part IV – Conclusion

- Thus, the incorporation as an independent professional, made by CA. Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness to continue as an auditor if reappointed by shareholders, does not leads to solicitation.

  Therefore, CA. Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Author's Note

If any question is related to clarification of Clause 6, you have to apply Clause 6. Don't make word by word interpretation like we do in Tax or Companies Act. Professional Ethics cases are solved by pattern and not by interpretation. This pattern is very simple i.e. if it is related to clarification of clause 6 apply clause 6 and if it is related to clarification of clause 7 apply clause 7.

QNO 676.000	First Schedule, Part I, Cl,6 Clarification (Representation by CA Under Company Act seeking publicity) Bhaskar CNO – PE.680	New Course – (N19E)

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

A special notice has been issued for a resolution at 3rd annual general meeting of LED Ltd., providing expressly that CA. Anoop shall not be re-appointed as an auditor of the company. Consequently, CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company.

Answer

Part I -- Relevant Laws

- Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

  Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.

Part III – Case Discussion

- CA. Anoop submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Anoop included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company.

Part IV – Conclusion

- The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner so as to seek publicity.

- Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation U/S 140(4)(iii) of the Companies Act 2013, would amount to canvassing

	or soliciting for his continuance as auditor. Therefore, CA. Anoop will be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

QNO 677.000	First Schedule, Part I,Cl,6 Clarification (Roving Inquiry) Bhaskar CNO – PE.680	Old Course – (M11E, P17M, M17M, N17E)

A CA firm M/s GST & Associates, has sent a letter to the Goods and Service Tax Council stating that the firm has 2 partner who specialise in the law of Goods and Service Tax and asked the said Council to include their name in the panel, whenever formed, for providing advisory and audit services for Goods and Service Tax. Comment with reference to the Chartered Accountants Act, 1949

Answer

Part I -- Relevant Laws

- Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- A Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgement and may be able to command respect from their prospective clients.

  In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the member to make roving inquiries by applying to any such organization for having his name included in any such panel."

Part III – Case Discussion

- In the given case, a CA firm M/s GST & Associates, has sent a letter to the Goods and Service Tax Council and asked the said Council to include their name in the panel, whenever formed, for providing advisory and audit services for Goods and Service Tax

Part IV – Conclusion

- Accordingly, CA. Firm M/s GST & Associates and its partners are guilty of misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 as it has solicited professional work from the Goods and Service Tax Council, by inquiring about the maintenance of the panel and advertising about 2 partners in the firm having specialized knowledge of GST Law.

Author's Note

- **There are**
  - **12 clarifications of Clause 6 of Part I of First Schedule to the Chartered Accountants Act, 1949**
  - **10 clarifications of Clause 7 of Part I of First Schedule to the Chartered Accountants Act, 1949 and**
  - **8 common clarification for above clause 6 & 7**
  - **The above question is related to 12 clarifications of Clause 6 of Part I of First Schedule to the Chartered Accountants Act, 1949.**

    If any question relates to these clarifications, concerned clause number should be referred
    Clarifications & shortcut to remember clarifications are explained in detail in regular lectures and books.

- **"Request for empanelment- Not Solicitation " Vs "Roving inquiry – Solicitation"**
  - **Roving Inquiry means applying without verifying whether there is requirement or panel maintained by authority.**
  - **Empanelment where CA is aware about panel is not guilty.**

    These are 2 separate points, below are 2 separate points :

  - **Roving Inquiry Circular**

	- **It is not permissible for a member to address letters or circulars to persons who are likely to require services of a Chartered Accountant since it would tantamount to advertisement.** ○ **Applying for empanelment** - **CA can apply if he has information regarding existence of panel.** - **Mention fees (only if asked** - **No cyclostated (pre-printed) copies of fees**

QNO 677.500	**First Schedule, Part I,Cl,6 -- Quoting Fees in response to Query** **Bhaskar CNO – PE.680**	**New Course— (M21E)**
	M/s SR & Associates is one of the three firms shortlisted by ARG Cooperative Bank for assignment of Statutory Audit for the F.Y 2020-2021. Bank mailed the list of branches to the audit firms along with the maximum fee per branch and asked them to submit the quotations. SR & Associates responded to the bank and submitted their quotation. **Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto.**	
Answer	**Part I -- Relevant Standards & Laws** Clause 6 of Part I of First Schedule **Part II -- Requirements of Relevant Standards & Laws** As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he Solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. Provided that nothing herein contained shall be construed as preventing or prohibiting – **(i)** Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or **(ii)** A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence. However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants. **Part III – Case Discussion** In the given case of ARG Cooperative Bank, Bank mailed the list of branches to the audit firms along with maximum fees per branch, in response to which SR & Associates responded and submitted their quotation. **Part IV – Conclusion** Keeping in view the facts, clause 6 and guideline issued by the council, it can be concluded that SR & Associates is guilty of Professional misconduct.	

QNO 678.000	**First Schedule, Part I,Cl,6 Solicitation (Another CA Firm)** **Bhaskar CNO – PE.680**	**Old Course – (N13E, P17M)** **New Course- (S17M,M23M)**
	Mr. Honest, a Chartered Accountant in practice, wrote two letters to M/s XY Chartered Accountants a firm of CAs; requesting them to allot him some professional work. **As he did not have a significant**	

	practice or clients he also wrote a letter to M/s ABC, a firm of Chartered Accountants for securing professional work. Mr. Clever, another CA, informed ICAI regarding Mr. Honesty's approach to secure the professional work. Is Mr. Honest wrong in soliciting professional work?
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 Part II -- Requirements of Relevant Laws ➢ A Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients. Provided that nothing herein contained shall be construed as preventing or prohibiting any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice. **Part III – Case Discussion** ➢ In the given case, Mr. Honest wrote letters only to other Chartered Accountants, M/s XY and M/s ABC requesting them to allot some professional work to him. **Part IV – Conclusion** ➢ Thus, Mr. Honest is not wrong in soliciting professional work.

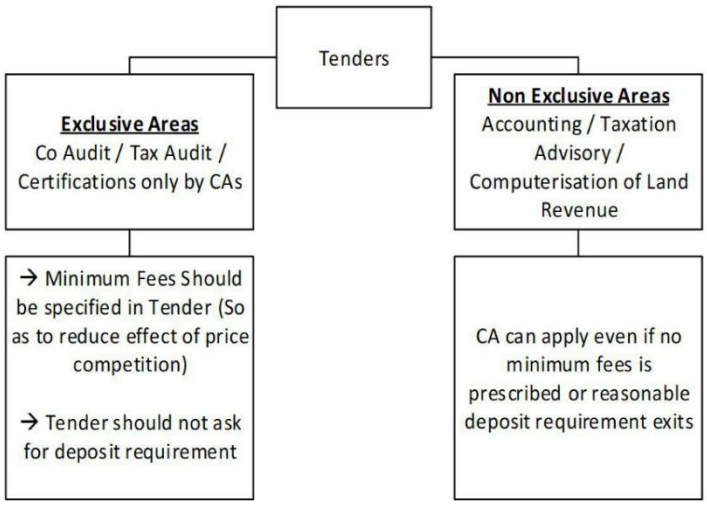
QNO 678.010	**First Schedule, Part I, Cl,6 Solicitation (Accepting work emanating from contact of Another CA)** **Bhaskar CNO – PE.680**	**New Course – (N18E)**
	During the opening ceremony of a new branch office of CA.Young, his friend CA.Old introduced to CA.Young, his friend and client Mr. Rich, the owner of an Export House whose accounts had been audited by CA.Old for more than 15 Years. After few days, Mr. Rich approached CA.Young and offered a certification work which hitherto had been done by CA.Old. CA.Young undertook the work for a fee which was not less than fee charged by CA.Old in earlier period. Comment whether CA.Young had done any professional misconduct.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 ▪ Clarification by ICAI **Part II -- Requirements of Relevant Laws** ➢ **Clause 6** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. ➢ **Clarification by ICAI** Further, some forms of the soliciting work which the Council has prohibited include that a member should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work. **Part III – Case Discussion** ➢ In the given case, CA Old introduced his friend CA. Young to his friend and client Mr. Rich, the owner of an Export House whose accounts has been audited by CA. Old for more than 15 years. After a few days Mr. Rich approached CA. Young and offered a certification work which hitherto had been done by CA. Old. Fees charged by CA. Young is also not less than fee charged by CA. Old. **Part IV – Conclusion** ➢ In view of above decision CA Young should ask the client to come through CA Old. However, CA Young undertook the work without informing CA. Old. Thus, CA. Young is held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act,1949	

QNO 679.000	First Schedule, Part I, Cl,6 Solicitation (Personal Communication) Bhaskar CNO – PE.680	Old Course – (M10E, P17M, M21M) New Course – (S17M, M21M)
	Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter. **OR** **Can a Practicing Chartered Accountant be held guilty of Professional Misconduct under the following circumstances? Give your views with reasons in brief.** **Z, a Chartered Accountant wrote several letters to Government Department, pointing out seniority of his firm, sending his life sketch and stating that he had a glorious record of service to the country as well as to the organization of accountancy profession with a view to get the audit work.**	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ **Clause 6** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. **Part III – Case Discussion** ➢ In the given case, Mr. X, a Chartered Accountant and proprietor of M/s X and Co., wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work **Part IV – Conclusion** ➢ In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work then Mr. X will be liable for professional misconduct. ➢ Consequently, Mr. X would therefore be held guilty under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	

QNO 681.000	First Schedule, Part I,Cl,6 Solicitation (Tender) Land Revenue Bhaskar CNO – PE.680	Old Course – (M06E, N10R, M12R, M12M, M13R, M14R, P17M, N18M, N20E) New Course – (S17M, N18M)
	M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid ` 50,000 as earnest deposit as part of the terms of the tender.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The Clause lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender.	

As per the guidelines issued by council a member can respond to tenders where minimum fees of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with Chartered Accountants.

Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits.



Part III – Case Discussion

- In the present case, M/s LMN, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records.

Part IV – Conclusion

- In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s LMN can respond to tender as well as deposit 50,000 as earnest deposit and shall not have committed any professional misconduct.

QNO 682.000	First Schedule, Part I,Cl,6 Solicitation (Tender) No Minimum Fees Bhaskar CNO – PE.680	Old Course – (M17R, N17R, M20R) New Course – (M20R)

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto: M/s LMN & Associates, a firm of Chartered Accountants responded to a tender issued exclusively for Chartered Accountants by an organisation in the area of tax audit. However, no minimum fee was prescribed in the tender document.

OR

PK Foundation decided to review its historical financial statements For this, it proposed a tender exclusively for Chartered Accountants to obtain assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement However, the foundation did not prescribe the minimum fee in the tender document M/s Sodhi & Co, a Chartered Accountant firm, responded to such tender

Answer

Part I -- Relevant Laws

- Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- The clause lays down guidelines for responding to tenders, etc. It states that a member may respond to tenders or enquiries issued by various users of professional services or organizations from time to time and secure professional work as a consequence.

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

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

Part III – Case Discussion

- In the instant case, M/s LMN & Associates responded to a tender of tax audit which is exclusively reserved for Chartered Accountants even though no minimum fee was prescribed in the tender document.

Part IV – Conclusion

- Therefore, M/s LMN & Associates shall be held guilty of professional conduct for responding to such tender in view of abovementioned guideline.

	Author's Note **For better understanding of tendering refer Chart in QNO 681.000**

QNO 682.500	**First Schedule, Part I,Cl,6 --Solicitation (Tender of GST Audit)** **Bhaskar CNO – PE.680**	**Old Course—(N20E)**
	M/s ABC & Co., a firm of Chartered Accountants responded to a tender from a State Government for appointment of GST Auditor wherein no minimum fee was prescribed. For this purpose, the firm also paid ` 50,000 as earnest deposit as part of the terms of the tender. Comment on the above with reference to the Chartered Accountants Act, 1949, Code of Ethics and Schedules to the Act.	
Answer	Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down Guidelines tor responding to tenders, etc. As per the Guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits. M/S ABC & Co., a firm of Chartered Accountants responded to a tender from a State Government for appoint of GST Auditor and for this purpose, the firm also paid ` 50,000 as earnest deposit as part of the terms of the tender.  In the instance case, since GST Audit does not fall within exclusive areas for chartered accountants, M/S ABC & Co can respond to tender as well as deposit ` 50,000 as earnest deposit and shall not have committed any professional misconduct.	

QNO 683.000	**First Schedule, Part I,Cl,6 -Website (Award Highlighting)** **Bhaskar CNO – PE.680**	**Old Course – (N15R, P17M, N18M)**
	CA. Intelligent, a Chartered Accountant in practice, provides part-time tutorship under the coaching organization of the Institute. On 30th June 2015, he was awarded 'Best Faculty of the year' as gratitude from the Institute. Later on, CA. Intelligent posted his framed photograph on his website wherein he was receiving the said award from the Institute.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. In this context, it may be noted that according to the guidelines approved by the Council of the Institute of Chartered Accountants of India, no photographs of any sort are permitted on website. Only display of passport style photograph is permitted. **Part III – Case Discussion** ➢ In the given case, CA. Intelligent shared his framed photograph on website wherein he was receiving 'Best Faculty of the year' award from the Institute. **Part IV – Conclusion** ➢ Therefore, CA. Intelligent is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.	
	Author's Note **In case of any question w.r.t website always apply Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949 as guidelines of website are issued under that clause .**	

QNO 684.000	First Schedule, Part I,Cl,6 -Website (Bio Data & Photographs) Bhaskar CNO – PE.680	Old Course – (M05E, P17M) New Course- (S17M)
	M/s XYZ, a firm of Chartered Accountants created a website "www.xyzindia.com". The website besides containing details of the firm and bio-data of the partners also contains the photographs of all the partners of the firm.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A chartered accountant of the firm can create its own website using any format subject to guidelines. However, the website should be so designed that it does not solicit clients or professional work and should not amount to direct or indirect advertisement. The guidelines of the ICAI to allow a firm to put up the details of the firm, bio-data of partners and display of a passport size photograph. **Part III – Case Discussion** ➢ In the given case, the website of M/s XYZ firm besides containing details of the firm and bio-data of the partners also contains the photographs of all the partners of the firm. **Part IV – Conclusion** ➢ In the case of M/s XYZ, all the guidelines seem to have been complied and there appears to be no violation of the Chartered Accountants Act, 1949 and its Regulations.	
	Author's Note **In this question it is assumed that photograph was a passport size one, which is not prohibited.**	

QNO 685.000	First Schedule, Part I,Cl,6 -Website (Link of Associations) Bhaskar CNO – PE.680	Old Course – (M08E, N08R, M12R, M12M, M13R, P17M)
	XYZ & Associates, a firm with 5 partners developed a website www.xyzassociates.com. The website also contained a link to "All India Chartered Accountants Association", a voluntary association where X, a partner of the firm is currently the Vice-president.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ In respect of websites by chartered accountants in practice, it is permitted that website may provide a link to the website of ICAI, its Regional Councils, Branches and Government Departments and other professional Bodies like AICPA, ICAEW, CICA. **Part III – Case Discussion** ➢ In this case, M/s XYZ Associates provided a link to "All India Chartered Accountants Association" which is not permitted. **Part IV – Conclusion** ➢ Hence the firm would be liable for misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949	

QNO 686.000	First Schedule, Part I, Cl,6 -Website (Multiple Issues) Bhaskar CNO – PE.680	Old Course – (M07E, M09R, N16M, P17M, M19R) New Course – (M18R, M19R, N20E)
	Mr. Brilliant, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute **OR** **Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: Mr. Vineet, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in purple colour. The website also displayed the nature of assignments handled along with the names of clients without such requirement from any of the regulator. He also circulated the information**	

	contained in the website through e-mail to acknowledge public at large about his expertise. However, he did not intimate his website address to the Institute.
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ Circulating Information Contained in Own Website: As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. 1. However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. Hence there is no misconduct as per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. 2. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request. 3. Nature of assignments handled (to be displayable only on specific "pull" request). Names of clients and fee charged cannot be given without such requirement from any of the regulator. Mr. Vineet has displayed the nature of assignments handled along with the name of clients without such requirement from the regulator. Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act. **Part III – Case Discussion** ➢ Mr. Vineet has circulated the information contained in the website through e-mail to public at large. **Part IV – Conclusion** ➢ Therefore, he is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the said Act.
	Author's Note **As on today, no need to take permission for website, no need to immediately intimate about website to ICAI**

QNO 687.000	**First Schedule, Part I,Cl,6 -Website (Push Technology)** **Bhaskar CNO – PE.680**	**Old Course – (P17M, M17R, M20R)** **New Course – (S17M, M20R, S21M)**
	M/s ABZ & Co., a firm of Chartered Accountants, develops a website "abz.com". The colour chosen for the website was a very bright green and the website was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the website without any disclosure obligation from any regulator.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s ABZ & Co. are: • No restriction on the colours used in the website • The websites are run on a "pull" technology and not a "push" technology • Names of clients and fees charged not to be given. However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that "This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].	

	Part III – Case Discussion ➢ A firm of Chartered Accountants develops a website "abz.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator. **Part IV – Conclusion** ➢ In view of the above, M/s ABZ & Co. would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

QNO 688.000	**First Schedule, Part I,Cl,6 -Website (Visit Our Website)** **Bhaskar CNO – PE.680**	**Old Course – (N10E, P17M)**
	PQR and Associates, Chartered Accountants have their website and on the letterhead of the firm it is mentioned that "Visit our website: PQR com". In the website the nature of assignments handled, names of prominent clients and fees charged is also displayed.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The Council of the Institute of Chartered Accountants has issued guidelines for posting the particulars on Website by Chartered Accountants in practice and firms of Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949. According to the guidelines the details in the website should be so designed that it does not amount to soliciting client or professional work. It is permitted to mention the website address on letterhead but soliciting people to visit website is not permitted. The nature of assignments handled is permitted to display on website but only on specific 'Pull" request. And the name of clients, the fees charged is not permitted to be displayed at all. **Part III – Case Discussion** ➢ PQR and Associates letterhead invites to people to visit their website. Similarly, the website mentions the nature of assignments, names of the prominent clients and fees charged **Part IV – Conclusion** ➢ PQR & Associates will be held guilty of Professional Misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.	

QNO 688.500	**First Schedule, Part I,Cl,6 --Online Coaching** **Bhaskar CNO – PE.680**	**New Course- (N22M)**
	CA Praful has recently qualified and has obtained certificate of practice. In the initial years, it is taking time to set up his clientele base. He is also conducting audit of few entities. Simultaneously, he plans to provide coaching to CA students online taking advantage of his fresh reservoir of knowledge. Therefore, he advertises his classes on various social media platforms. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.	
Answer	Regulation 190A of Chartered Accountants Regulations, 1988 provides that a chartered accountant in practice shall not engage in any business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. The Council has passed a resolution under Regulation 190A granting general permission for private tutorship and part time tutorship under coaching organization of the Institute. Such general permission is subject to the condition that direct teaching hours devoted to such activities taken together should not exceed 25 hours a week in order to be able to perform attest functions. However, Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means;	

	Further, an advertisement of online coaching activities through social media platforms amounts to indirect solicitation as well as solicitation by another means and is, therefore, violative of Clause 6 of Part I of the First Schedule to Chartered Accountants Act, 1949. Therefore, although a member in practice can engage in private tutorship subject to Council Guidelines but he cannot advertise by any means for coaching activities as it amounts to indirect solicitation of clients and professional work. In the given case, CA Praful is providing coaching to CA students online and also advertising his classes on various social media platforms. In view of above, CA. Praful is guilty of professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act 1949 for advertising his classes on various social media platforms.

QNO 689.000	**First Schedule, Part I,Cl,7 Designation** **Bhaskar CNO – PE.700**	**New Course – (S17M, S21M)**
	A practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant.	
Answer	**Part I -- Relevant Laws** ▪ Section 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. **Part III – Case Discussion** ➢ In the given case, a practising Chartered Accountant uses a visiting card in which he designates himself, besides as Chartered Accountant, Cost Accountant. **Part IV – Conclusion** ➢ Thus, it is improper for a chartered accountant to state in his documents that he is a "Cost Accountant". As per the Chartered Accountants Act, 1949, the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation "Cost Accountant".	

QNO 691.000	**First Schedule, Part I,Cl,7 Designation (CA & Advocate Together)** **Bhaskar CNO – PE.700**	**Old Course – (M13E, P17M)**
	Mr. B, a practicing Chartered Accountant as well as a qualified lawyer, was permitted by the bar council to practice as a lawyer also. He printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate.	
Answer	**Part I -- Relevant Laws** ▪ Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A CA in practice is deemed to be guilty of professional misconduct if he • advertises his professional attainments or services or • uses any designation or expressions other than 'Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards Unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council. This clause prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered	

Accountant in documents through which the professional attainments of the member would come to the notice of the public.

Members of the Institute in practice who are otherwise eligible may practice as advocates subject to the permission of the Bar Council but in such case, they should not use designation 'chartered accountant' in respect of the matters involving the practice as an advocate. In respect of other matters, they should use the designation 'chartered accountant' but they should not use the designation 'chartered accountant' and 'advocate' simultaneously.

Part III – Case Discussion

- In the given case, Mr. B printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate.

Part IV – Conclusion

- Since Mr. B has printed his visiting card where he mentioned his designation as Chartered Accountant and Advocate which is prohibited under the above clause and hence Mr. B is guilty of professional misconduct.

Author's Note

Dual COP of CA & Advocate is allowed by ICAI but the same has not been approved by BAR Council of India. Hence practically not possible.

QNO 692.000	First Schedule, Part I,Cl,7 Designation (Merchant Banker) Bhaskar CNO – PE.700	Old Course – (M15E, P17M)

Mr. SP, a Chartered Accountant, obtains registration as category IV Merchant Banker under the SEBI's Rules and Regulations and act as Advisor to a capital issue of MB Co. Ltd. He designates himself under the caption "Merchant Banker" in client offer documents and 'Advisor to issue' **in his own letterheads, visiting cards and professional documents**.

Answer

Part I -- Relevant Laws

- **C**lause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- This Clause restrains a Chartered Accountant in practice from:-
  - advertising his professional attainments or services.
  - It also prohibits a member from using any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognized by the Central Government or a title indicating membership of the Institute of Chartered Accountants or of any other institution that has been recognized by the Central Government or may be recognized by the Council.

    It may be noted that, in Client Companies' offer documents and advertisements regarding capital issue, name and address of the Chartered Accountant acting as Advisor or Consultant to the Issue could be indicated under the caption "Advisor/ Consultant to the Issue". Further, such members should not use the designation of either 'Merchant Banker' or 'Advisor/Consultant to Issue' in their own letterheads, visiting cards, professional documents, etc.

Part III – Case Discussion

- In the given case, Mr. SP, a Chartered Accountant, has obtained registration as category IV Merchant banker and acted as advisor to a capital issue of MB Co. Ltd. He has designated himself under the caption "Merchant Banker" in client offer documents and "advisor to issue' in his own letterheads, visiting cards and professional documents

Part IV – Conclusion

- Therefore, Mr. SP shall be held guilty of professional misconduct as per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

QNO 692.100	First Schedule, Part I,Cl,7 Designation- Insolvency Professionals Bhaskar CNO – PE.700	Old Course – (M19E) New Course – (N18R,M22M)
	Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads and other communications also. A person residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP. You are required to examine the same with reference to the Chartered Accountants Act, 1949.	
Answer	**Part I -- Relevant Laws** ▪ Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ As per the clause a CA in practice is deemed to be guilty of professional misconduct if he • advertises his professional attainments or services or • uses any designation or expressions other than 'Chartered Accountant" on ○ professional documents, ○ visiting cards, ○ letter heads or ○ sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council. **Part III – Case Discussion** ➢ In this case, A Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads and other communications also. A person residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP **Part IV – Conclusion** ➢ Here, a Chartered Accountant empanelled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads and other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbour is not enforceable/ valid.	

QNO 693.000	First Schedule, Part I,Cl,7 Professional Achievements (Liasoning) Bhaskar CNO – PE.700	Old Course – (M12E, P17M)
	M, a practicing Chartered Accountant sent a letter to another firm of Chartered Accountants, claiming himself to be a pioneer in liasoning with Central Government Ministries and its allied Departments for getting various Government clearances for which he had claimed to have expertise and had given a list of his existing clients and details of his staff etc.	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A member shall be held guilty if a Chartered Accountant in practice solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. Further, as per Central Council Guidelines for Advertisement for the members in practice, write up of the members should not claim superiority over any other Member(s)/Firm(s) and should also not include the names of the clients. **Part III – Case Discussion** ➢ In the present case, Mr. M, a practicing Chartered Accountant sent the letter to another firm of Chartered Accountants, claiming himself to be a pioneer in liasoning with Central Government Ministries and its allied Departments for getting various Government clearances for which he had claimed to have expertise and had also given a list of his existing clients and details of his staff etc.	

	Part IV – Conclusion ➢ The act of CA M seems to be indirect methods to adventure their professional practice with a view to gain publicity and thereby solicit clients or professional work. Hence, Mr. M was guilty of professional misconduct as per Clause (6) of Part I of First Schedule of the Chartered Accountants Act, 1949
	Author's Note **Normally sending letters and asking for work from other CA firms is not a misconduct but we cannot misuse this exception, like the firm did here.** **Here CA M more than asking for work was advertising himself to another firm by mentioning things that can be influential.** **Sending letters is principally covered in clause 6, clarifications and permissions are also given in clause 6. So even if professional attainments are highlighted (generally covered by Clause 7)court has applied clause 6.** **I understand that it includes highlighting professional matters. But in PE more than interpretation we have to understand pattern.**

QNO 694.000	**First Schedule, Part I,Cl,7 Visiting Card (Name of Multiple Firms)** **Bhaskar CNO – PE.700**	**Old Course – (M06E, M09E, M12R, M12M, N15E, P17M, N17M)**
	CA Naman, a Chartered Accountant in practice is a partner in 4 firms. On the personal Letter Heads, he mentioned the names and addresses of all the 4 firms in small fonts	
Answer	**Part I -- Relevant Laws** ▪ Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he • advertises his professional attainments or services or • uses any designation or expressions other than "Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council. Here there is no prohibition for printing names on the personal letter heads in which a member holding certificate of practice is a partner. **Part III – Case Discussion** ➢ In the given case, CA Naman mentioned the names and addresses of all the 4 firms in which he is a partner on the personal letter heads **Part IV – Conclusion** ➢ Therefore, CA Naman will not be held guilty of any professional misconduct in pursuant to Clause (7) of Part I of First Schedule of the Chartered Accountants Act, 1949.	

QNO 695.000	**First Schedule, Part I,Cl,7 --Visiting Card (Quick Response Code)** **Bhaskar CNO – PE.700**	**Old Course – (M17E)** **New Course – (N18M)**
	Mr. M, a Chartered Accountant in practice, has printed visiting cards which besides other details also carries a Quick Response (QR) code. The visiting card as well the QR code contains his name, office and residential address, contact details, e-mail id and name of the firm's website. **Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.**	
Answer	**Part I -- Relevant Laws** ▪ Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he advertises his professional attainments or services.	

	Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card. **Part III – Case Discussion** ➢ In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. **Part IV – Conclusion** ➢ The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice. Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

QNO 695.010	**First Schedule, Part I,Cl,6 and 7 Professional Achievements (Offer Documents)** **Bhaskar CNO – PE.680/ CNO – PE.700**	**Old Course – (M09R, P17M, N18E, M21E)** **New Course – (S17M)**
	Is there any misconduct on the part of a Chartered Accountant in the following circumstances? **The offer document of a listed company in which Mr. D, a practising Chartered Accountant is a director mentions the name of Mr. D as a director along with his various professional attainments and spheres of specialisation**	
Answer	**Part I -- Relevant Laws** ▪ Clause (6) & (7) of Part I of First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The Council of the ICAI has in a communication to members stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field, it shall constitute a violation of Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members. ➢ It is advisable for a member that as soon as he is appointed as a director on the Board of a Company, he should specifically invite the attention of the management of the Company to the aforesaid provisions and should request that before any such prospectus or public announcements or public communication mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be got approved by him. **Part III – Case Discussion** ➢ In the given situation, a company has appointed a practicing chartered accountant as independent director on its board. The said company published description about the Chartered Accountant's expertise, specialisation and knowledge in any particular field or add appellations or adjectives to his names in the prospectus or public announcements issued by this Company. **Part IV – Conclusion** ➢ Thus, in the instant case, Mr. D would be held to be guilty of professional misconduct and liable for disciplinary action.	

QNO 696.000	**First Schedule, Part I,Cl,8 --Communication (After Acceptance Before Signing)** **Bhaskar CNO – PE.720**	**Old Course – (P17M)**
	Mr. X, a Chartered Accountant accepted his appointment as tax auditor of a firm under Section 44AB, of the Income-tax Act, and commenced the tax audit within two days of his appointment since the client was in a hurry to file Return of Income before the due date. After commencing the audit, Mr. X realised his mistake of accepting this tax audit without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement. Will Mr. X be held guilty under the Chartered Accountants Act?	

Answer

Part I -- Relevant Laws

- Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

➢ Mr. X will be held guilty since he has accepted the tax audit, without first communicating with the previous auditor in writing.

The object of the incoming auditor communicating in writing with the retiring auditor is to ascertain whether there are any circumstances which warrant him not to accept the appointment, for example, whether the previous auditor has been changed on account of having qualified the report or he had expressed a wish not to continue on account of something inherently wrong with the administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. Under all circumstances, it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit. As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to communicate with such earlier auditor.

The Code of Ethics further points out that it would also be a healthy practice if a tax auditor appointed for conducting special audit under the Income-tax Act, 1961 communicates even with the member who has conducted the statutory audit. Considering the above, though.

It is further provided that if the time schedule given for assignment is such that there is no time to wait for the reply from the retiring auditor, the incoming auditor may give conditional acceptance of the appointment and can commence the work immediately after he has sent the communication to the retiring auditor.

Part III – Case Discussion

➢ In the present case, Mr. X, a Chartered Accountant accepted his appointment as tax auditor without sending any communication to the previous tax auditor. In order to rectify his mistake, before signing the tax audit report, he sent a registered post to the previous auditor and obtained the postal acknowledgement.

Part IV – Conclusion

➢ Mr. X tried to rectify his mistake, by communicating with the previous tax auditor after accepting the audit but before signing the audit report, the auditor will be held guilty of professional misconduct.
Refer: Praful R.Gandhi of M/s Padamchand Jain & Associates councils decision dated 29th Aug 2005.

Author's Note

As per Companies Act 2013, now acceptance by auditor is not required after appointment. Now in fact prior approval is required before appointment. But clause 8 is not yet amended to bring it at par with companies act.

QNO 696.100	First Schedule ,Part I,Cl,8 Communication Over Phone Bhaskar CNO – PE.720	Old Course – (M16M, M18M)

M/s CD & Co., a firm of Chartered Accountants, accepted an assignment for audit under GST Law and communicated the same over phone to the previous auditor**, M/s AB & Co., Chartered Accountants. Comment.**

Answer

Part I -- Relevant Laws

- Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

➢ A chartered accountant in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificates Rules 1932, without first communicating with him in writing.
It is provided that incoming auditor is required to send his communication by Registered post Acknowledgement Due or by hand against an acknowledgement in writing.

	Part III – Case Discussion ➢ In the instant case, M/s CD & Co. accepted the audit under GST Law, carried out by M/s AB & Co., another firm of chartered accountants, in the previous year. The current auditor communicated their appointment over phone i.e. no written communication held. **Part IV – Conclusion** ➢ A communication in writing is mandatory requirement for all types of audit, if the previous auditor is a chartered accountant. Hence, the firm would be held guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949.

QNO 698.000	**First Schedule, Part I,Cl,8 --Communication (Certificate of Posting)** **Bhaskar CNO – PE.720**	**Old Course – (N16R, P17M)**
	W, a Chartered Accountant has sent letters under certificate of posting to the previous auditor informing him his appointment as an auditor before the commencement of audit by him.	
Answer	**Part I -- Relevant Laws** ▪ Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ The clause requires communication by the incoming auditor with the previous auditor before accepting a position by him. The Council of the Institute has taken the view that a mere posting of a letter "under certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Chartered Accountant who relies solely upon a letter posted "under certificate of posting" therefore does so at his own risk. Since the letters were sent by "W" to the previous auditor informing him of his appointment as an auditor before the commencement of audit by him under Certificate of Posting is not sufficient to prove communication with the retiring auditor. In the opinion of the Council, communication by a letter sent "Registered Acknowledgement Due" or by hand against a written acknowledgement would in the normal course provide positive evidence. **Part III – Case Discussion** ➢ In the given case, W, a Chartered Accountant has sent letters under certificate of posting to the previous auditor informing him his appointment as an auditor before the commencement of audit by him. **Part IV – Conclusion** ➢ Hence "W" was guilty of professional misconduct under Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949.	
	Author's Note **Certificate of posting means simple post which is not allowed. Registered post acknowledgement due (RPAD) is allowed**	

QNO 699.000	**First Schedule, Part I,Cl,8 --Communication Of Internal Auditor to Statutory Auditor** **Bhaskar CNO – PE.720**	**Old Course – (N14R, N16M, P17M, M19M, M21E)** **New Course –(M19M)**
	CA. T, in practice, was appointed to carry out internal audit of a stock broker, listed with BSE. However, he failed to intimate his appointment to the statutory auditors of the company. The statutory auditor feels this is violation of professional ethics.	
Answer	**Part I -- Relevant Laws** ▪ Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A chartered accountant in practice is deemed to be guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.	

This clause is applicable in situation of replacing of one auditor by another auditor. Internal auditor and statutory audition are parallel positions and not replacement positions. The management generally appoints the internal auditor whereas the statutory auditor will be appointed by the shareholders in the AGM. In this situation there is no need for communication by one to other.

Part III – Case Discussion

- In the given case, CA T, Internal Auditor of stock broker failed to intimate his appointment to the statutory auditors of the company.

Part IV – Conclusion

- In view of above the contention of the statutory auditor is unacceptable and there is no question of communicating in writing by Mr. T.

QNO 700.000	First Schedule, Part I,Cl,8-Communication (Previous Audit Fees Unpaid) Bhaskar CNO – PE.720	Old Course – (M09R, N10E, N12R, P17M)

XYZ Ltd. appoints you as the auditor of the company. You observe that previous auditors A & Co., resigned. Also Balance Sheet as at 31-03-2015 shows an audit fee payable of ` 25,000. What precautions you will take before commencing the audit work?

Answer

Part I -- Relevant Laws

- Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- **Precautions before Commencing the Audit Work:**

In the instant case, before accepting the appointment as well as commencing the audit work, the auditor should see the following –

- Check whether a statement, in the prescribed form, has been filed by the resigning auditor within a period of 30 days from the date of resignation, to the company and the registrar (or the Comptroller and Auditor-General of India, as the case may be), indicating the reasons and other facts as may be relevant with regard to the resignation, for the compliance of Section 140(2) of the Companies Act, 2013 (herein after referred as the Act).
- The auditor must obtain the NOC from previous auditor. He should also refer the resignation statement file by the previous auditor and communicate with him (previous auditor) to ascertain the circumstances which led up him to retire.
- The auditor must ascertain whether there existed any circumstances on account of which he should not accept the appointment.
- As per Section 139 of the Act, the auditor must ensure that before any appointment or reappointment of auditors is made at an annual general meeting, a written certificate has been provided by him to the company that his appointment is in accordance with the limits specified in Section 141(3)(g).
- He should also satisfy himself that the notice provided for under Sections 139 and 140 has been effectively served on the outgoing auditor.
- Ascertain that the appointment of new Auditor is in compliance with Section 139(8) of the Act as mentioned above i.e. the resolution appointing the new auditor has been approved by the company in the general meeting as in the case of casual vacancy by resignation

Part III – Case Discussion

- In the given case, XYZ appoints you as the auditor and you observed that the previous auditors A & Co., resigned. Also Balance Sheet as at 31-03-2015 shows an audit fee payable of ` 25,000.

Part IV – Conclusion

- Further, 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 Section 139 and 140 of the Companies Act, 2013, in respect of such appointment have been duly complied with.

	Author's Note **Answer does not contain reference of Council Guidelines 2008.**

QNO 702.000	**First Schedule, Part I,Cl,8 --Communication Undercutting / Lower Audit Fees** **Bhaskar CNO – PE.720**	**Old Course – (N06E, P17M)**

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto: Mr. Rahul, a locally based Chartered Accountant, accepted an audit assignment at a fee lower than that charged by the previous auditor, who was stationed in another town and had to spend a lot of money on travel for which he did not charge separately.

Answer

- Since the previous auditor was stationed in another town and therefore, had to incur higher cost on account of conveyance, and the previously the fee was decided on a composite basis inclusive of travelling expenses of the auditor, it cannot be said that Mr. Rahul has accepted an audit assignment based on under cutting of fees.
  The motive of Mr. Rahul was not to get the work from previous auditor by accepting the audit assignment on lower fee i.e. undercutting of fee. Because, in considering whether variation in fees charged would constitute undercutting, the quantum of work; incidental and out of pocket expenses and other terms of appointment should be considered.

Part I – Case Discussion

- In this case, Mr. Rahul is a locally based Chartered Accountant, accepted an audit assignment at a fee lower than that charged by the previous auditor, who was outstation based Chartered Accountant and had to spend a lot of money on travel which was included in his audit fee and was not charged by him separately.

Part II – Conclusion

- Hence, Mr. Rahul will not be held guilty for misconduct.

Author's Note
CA Act was amended in 2006. Prior to amendment there were 13 clauses in Part I, Schedule I. One of the clauses specifically prohibited undercutting. But this clause was removed in amendment. So as of now undercutting is allowed. So, in this question even if there is no valid reason for undercutting it will be allowed.
However, ICAI planning to bring the clause relating to undercutting back in future.

QNO 704.000	**First Schedule, Part I,Cl,8 --Communication (With previous GST Auditor Who)** **Bhaskar CNO – PE.720**	**Old Course – (M08E, N10R, M14R, P17M)**

BC & Co., a firm of Chartered Accountants, accepted an assignment for audit under State level GST Act, without any prior communication with the previous auditor.

Answer

Part I -- Relevant Laws

- Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- A chartered accountant in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificates Rules 1932, without first communicating with him in writing.

Part III – Case Discussion

- In the instant case, BC & Co. accepted GST– audit under State Level Act, carried out by another firm of chartered accountants in the previous year, without prior communication with the previous auditor.

Part IV – Conclusion

- A communication is mandatory requirement for all types of audit, if the previous auditor is a chartered accountant. Hence, the firm is guilty of professional misconduct.

QNO 704.500	First Schedule, Part I,Cl,8 –Communication (Previous Auditor Changed Because of Qualified Report) Bhaskar CNO – PE.720	New Course—(M21E)
	Vineet & Associates have been offered Statutory Audit of TLP Ltd. As a part of ethical requirements of the Institute of Chartered Accountants, CA. V, partner of the firm, communicated with the previous auditor enquiring as to whether any professional reason exists for which he should not accept the audit assignment. Previous auditor informed that he issued a qualified report, so management is changing the auditor. **Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto as to whether Vineet & Associates can accept the audit.**	
Answer	**As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing. **The professional reasons for not accepting an audit would be:** (a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949; and (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and (C) Issuance of a qualified report. There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him under the circumstance of Issuance of qualified report. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised. From the above it can be concluded that Vineet & Associates may accept the audit of TLP Ltd if CA V is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, CA V feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit of TLP Ltd.	

QNO 704.600	First Schedule, Part I,Cl,9 -- Relied on Management Certificate Bhaskar CNO – PE.720	(N21E)
	CA Mehta was appointed as the Auditor of CS Ltd. for the year 2020-21 in the place of retiring auditor CA Gupta. CA Mehta accepted the appointment after obtaining a certificate from the management that the provisions of the Sections 139 and 140 of the Companies Act, 2013 have been complied with. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.	
Answer	**In the given case, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management that the provisions of the Sections139 and 140 of the Companies Act, 2013 have been complied with.** Clause (9) of Part I of the First Schedule to Chartered Accountants Act, 1949 provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a Company without first ascertaining from it whether the requirements of Sections 139 and 140 of the Companies Act, 2013, in respect of such appointment have been duly complied with. Under this clause it is obligatory on the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment. Under Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for	

certain as to whether the Company has complied with the provisions of Sections 139 and, 140 of the Companies
Act, 2013. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to verify the relevant records of the Company and ascertain as to whether the Company has, in fact, complied with the provisions of the above sections. If the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor should not
accept the audit assignment.

Applying the above clause to the given case, the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor, CA Mehta should not have accepted the audit assignment. But on the other hand, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management which is not enough and hence CA Mehta is deemed to be guilty of professional misconduct.

QNO 705.000	**First Schedule, Part I,Cl,9 Disqualification** **Bhaskar CNO – PE.740**	**Old Course – (M10E, P17M)**
	Mrs. Fair is a Director of XYZ Private Limited, having 15% shareholdings in the company. During 2014, the company appointed C.A. Mr. Lovely, Mrs. Fair's spouse, as its statutory auditor. On Mr. Lovely's advice, the company issued fresh equity shares in 2014-15, in the ratio of one share for every two shares held by the shareholders of the company. Mr. Lovely used to deliver audit report for subsequent years without any comments or disclosures, thereupon	

Answer

Part I -- Relevant Laws

- Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Section 141(3)(f) of the Companies Act, 2013

Part II -- Requirements of Relevant Laws

➢ **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 139 and 140 read with Section 141 of the Companies Act, 2013, in respect of such appointment have been duly complied with.

➢ **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.

Part III – Case Discussion

➢ In this case Mrs. Fair is a Director of XYZ Private Limited and the company has appointed Mr. Lovely, Chartered Accountant, Mrs. Fair's spouse, as its statutory auditor.

Part IV – Conclusion

Mr. Lovely should not accept the appointment as statutory auditor of the company, where his wife Mrs. Fair is director. This is contravention of section 141(3)(f) of the Companies Act, 2013.Therefore, Mr. Lovely is liable for misconduct as per Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Author's Note

Additional Points that can also be mentioned in this question.

➢ Appointment of Auditor in case of Relative Holding Substantial Interest:
Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that if an auditor expresses his opinion on the financial statements of any business or enterprises in which

he, his firm or a partner in his firm has a substantial interest, he is committing professional misconduct.

- **Council Guidelines 2008 & AS 18**

  Further as per Council General Guidelines, a member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons, who are his "relatives" within the meaning of AS 18 have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise.

Where Auditor and Company are related (Tips)

- **Where Auditor and Company are having relation of any kind, Clause (4) of Part I of the Second Schedule should be referred in all questions and if substantial interest is not found conclusion should be given not guilty but mentioning the clause is must.**
- **Where Auditor and Company are having relation of any kind Council guidelines should be referred in all questions**
- **AS 18 (always when relative is involved)**

  As per AS 18 Relative" means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by that individual in his/her dealings with the reporting enterprise
- **Companies Act section shall also be referred. (if question mentions the following:-)**
  - **If CA himself or relative is director or is in employment with company as director or KMP - Section 141(3)(f) of the Companies Act, 2013**
  - **If CA himself or relative is holding shares in company and question tells about the face value of the shares held by relative - Section 141(3)(d) of the Companies Act, 2013.**
  - **And where section 141(3) applies Clause (9) of Part I of the First Schedule also applies**

QNO 706.000	First Schedule, Part I,Cl,9 Improper Appointment (Declined to Accept) Bhaskar CNO – PE.740	Old Course – (N08E, N11R, N12M, M15E, P17M, M21E) New Course- (S17M)

M/s AWE & Co, Chartered Accountants were appointed as Auditors of WOW Ltd. for the F.Y. 2019-20. Since they declined to accept the appointment, the Board of Directors appointed M/s GDC & Co, a CA firm as the auditor in the place of M/s AWE & Co. This was accepted by M/s GDC & Co. Discuss this with reference to Chartered Accountants Act, 1949 and Companies Act, 2013.

OR

CA. X was appointed as the Auditor of ABC Ltd. for 2014-15. Since he declined to accept the appointment, the Board of Directors appointed CA. Y as the auditor in the place of CA. X, which was also accepted by CA. Y.

Answer

Part I -- Relevant Laws

- Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Section 139 of the Companies Act, 2013

Part II -- Requirements of Relevant Laws

- **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 now Section 139 and 140 read with Section 141 of the Companies Act, 2013, in respect of such appointment have been duly complied with.
- **Section 139 of the Companies Act, 2013**

  Board can appoint the auditor in the case of casual vacancy under Sections 139(8)(i) and Section 139(6) of the Companies Act, 2013. The non-acceptance of appointment by CA. X does not constitute a casual vacancy to be filled by the Board. In this case, it will be deemed that no auditor was appointed in the AGM.

  Further, as per Section 139(10) of the Companies Act, 2013 when at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

	Part III – Case Discussion ➢ In the present case, CA X declined to accept appointment as auditor of ABC Ltd and the company appointed CA Y as the auditor without communicating with CA X. **Part IV – Conclusion** ➢ The appointment of the auditor by the Board is defective in law. Hence CA. Y is guilty of professional misconduct as per Clause (9) of the First Schedule as he accepted the appointment without verification of statutory requirements.
	Author's Note **As per Companies Act 2013, now acceptance by auditor is not required after appointment .Now in fact prior approval is required before appointment . This question and the answer needs to be changed .**

QNO 707.000	**First Schedule, Part I,Cl,10 -- Charging Percentage of Debt Recovery** **Bhaskar CNO – PE.760**	**Old Course – (M17R, M18E, M20R)** **New Course – (M18M, M20R)**
	PQR Pvt Ltd. approached CA. Whai, a Chartered Accountant in Practice, for debt recovery services. CA Whai accepted the work and insisted for fees to be based on 2% of the debt recovered. **OR** **Alora Pvt. Ltd. approached CA. Neha, a practicing Chartered Accountant since 1998, for recovery of debts amounting Rs 20 crore. CA Neha accepted the work and requested to charge fees** @ 1.5% of the debt recovered**. Later on she raised a bill for debts recovered and charged ` 27 lacs for recovering 90% of the debts.**	
Answer	**Part I -- Relevant Laws** ▪ **C**lause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ This clause prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him. ➢ **Regulation 192** However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered. **Part III – Case Discussion** ➢ In the given case, CA. What has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192). **Part IV – Conclusion** ➢ Hence, CA. What will not be held guilty for professional misconduct.	

QNO 707.020	**Fees as percentage of Loan** **Bhaskar CNO – PE.760**	**Old Course – (N08E, N11R, N12M, M15R, P17M, N18E)**
	D, a practising Chartered Accountant examined and reported on the prospective financial statements for one of his clients to obtain a cash credit facility of Rs75 lakhs from a Private Bank. The Bank has sanctioned the cash credit facility for Rs 60 lakhs to his client. Consequent to the sanction of loan by Bank, he charged a fee of Rs 60, 000 based on 1% of the credit facility sanctioned. **OR** **Mr Clever, a Chartered Accountant, prepared a project report for one of his client, Mr King, to obtain long term loan of Rs 100 lakhs from a scheduled bank and decided to charge fees** @10% of the loan approved **Subsequently, the bank approved the loan amounting to Rs 80 lakhs Consequent to the approval of loan by the bank, Mr Clever raised an invoice for his services @10% of the loan approved, as decided.**	
Answer	**Part I -- Relevant Laws** ▪ Clause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949	

Part II -- Requirements of Relevant Laws

- The clause prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him. However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949.

- **Regulation 192**
  The Council of the Institute has framed regulation 192 which exempts certain professional services from the operation of Clause (10). In the case of "certain fund-raising services", the fees may be based on a percentage of the fund raised.

Part III – Case Discussion

- In the present situation, CA. D examined and report on the prospective financial statements to obtain a cash credit facility from a private bank. Consequent to sanction of loan by bank, he charged 1% of credit facility sanctioned as his fees.

Part IV – Conclusion

- The services rendered by CA D are not covered under the said exemption.CA D is liable for professional misconduct as he has charged fees at 1% on the credit facilities sanctioned, which is prohibited under clause 10 of Part I of 1st schedule to CA Act 1949.

Author's Note:

I had long discussion with audit team of BOS, I also strongly feel it is part of fundraising but BOS says words used are "Certain Fundraising Services" and now what is this "certain" services need to be listed out by ICAI but they have not done it yet, even after 6 years of regulation amendment. They say till the time ICAI issues list we will assume no services are allowed.

So final conclusion, no fundraising servicing is allowed till ICAI defines what do you mean by "Certain Fundraising Services"

QNO 709.000	First Schedule, Part I,Cl,10 Fees on Percentage Basis (Liquidator) Bhaskar CNO – PE.760	Old Course – (M15E, M16M, P17M, N17M, N18M, M20M) New Course – (M20M)

XYZ & Co. appointed CA. M, a practicing chartered accountant, as liquidator of the company**. CA. M** charged his professional fees based on percentage of the realisation of assets

Answer

Part I -- Relevant Laws

- Clause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

  However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.

Part III – Case Discussion

- In the given case, CA. M, a practicing Chartered Accountant, has acted as liquidator of XYZ & Co. and charged his professional fees on percentage of the realisation of assets.

Part IV – Conclusion

- Therefore, CA. M shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.

QNO 711.000	First Schedule, Part I, Clause 11 Accepting Directorship Where Partner is Auditor Bhaskar CNO – PE.780	Old Course – (N10E, P17M)
	Mr. B is a practising Chartered Accountant holding a valid certificate of practice. He accepted the appointment as Director of the Green World Co. Ltd. Mr. C, a partner of Mr. B is statutory auditor of the said company.	

Answer

Part I -- Relevant Laws

- Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Council Guidelines
- Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- Section 141(3)(c) of the Companies Act, 2013
- Section 141(4) of the Companies Act, 2013

Part II -- Requirements of Relevant Laws

➢ **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

The clause prohibits a member to engage in any business or occupation other than the profession of chartered accountants so to engage. It does not prohibit a Chartered Accountant from being a director of a company, except managing director or a whole time director. But if any of the partners is interested in such company as an auditor then he cannot be director of the said company.

➢ **Council Guidelines**

Further, the Council of the Institute of Chartered Accountants of India has categorically stated that in cases where a member is a director of a company, the firm, in which the said member is a partner, should not express any opinion on its financial statements.

➢ **Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949**

The clause states that expressing an opinion on financial statements of any business or enterprise in which he, his firm or a partner of his firm has a substantial interest would constitute misconduct.

➢ **Section 141(3)(c) & 141(4) of the Companies Act, 2013**

Additionally, Section 141(3)(c) of the Companies Act, 2013 also disqualifies a person to be appointed as an auditor if he is a partner of an officer of the company. Furthermore, section 141(4) of the Companies Act, 2013 requires the appointed auditor to vacate his office if he incurs any of the disqualifications mentioned under sub-section (3).

Part III – Case Discussion

➢ In the present case Mr. B has accepted the directorship in a Company, where his partner Mr. C is an auditor, without obtaining specific permission of the council.

Part IV – Conclusion

➢ Hence, Mr. B will be held guilty for professional misconduct under Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

Also, in cases, where a member of the Institute is a director of a company ,the firm in which said member is a partner should not express any opinion on its financial statements. Hence Mr. C, a partner of Mr. B, should vacate the office.

QNO 712.000	First Schedule, Part I,Cl,11 Accepting Position on Managing Director Bhaskar CNO – PE.780	Old Course – (M07E, M09R, N13R, P17M)
	A chartered accountant in practice takes up the appointment as managing director of a public limited company.	

Answer

Part I -- Relevant Laws

- Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Regulation 190A

Part II -- Requirements of Relevant Laws

➢ **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

A chartered accountant in practice is deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of chartered accountants, unless permitted by the council so to engage.

However, nothing contained in Clause (11) shall disentitle a chartered accountant from being a director of a company, unless he or any of his partners is interested in such company as an auditor.

- **Regulation 190A, of the Chartered Accountants Regulation, 1988**

It states a member in practice cannot engage himself in any business or occupation other than that of a chartered accountant except when permitted by the council. As per Appendix 10 of Chartered Accountants Regulations, 1988, a Chartered Accountant in practice may hold the office of a Managing Director a Whole-time Director of a body corporate, provided that the member and/or his relatives do not hold substantial interest in such concern, after obtaining the specific and prior approval of the Council.

Part III – Case Discussion

- In the given case, a chartered accountant in practice takes up the appointment as managing director of a public limited company.

Part IV – Conclusion

- He should seek prior approval of the council otherwise he would be held guilty of misconduct.

QNO 712.500	**Accepting Position of MD (Management Consultancy Co.)** Bhaskar CNO – PE.780	**New Course – (M21E)**

CA R, a Chartered Accountant in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends , CA S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto.

Answer

Part I -- Relevant Laws

- Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949
- Section 2(2)(iv) of the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

A Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

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

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

Part III – Case Discussion

- In the given case, CA R accepted the position of managing director without obtaining prior permission from the Institute.

	Part IV – Conclusion ➢ Thus, the action of CA R is valid.

QNO 713.000	**First Schedule, Part I,Cl,11 Business Occupation (Trading in Derivative)** **Bhaskar CNO – PE.780**	**Old Course – (N08E, N11R, N12M, N13E, N15R, P17M, M17E,)** **New Course – (S17M, M18R, N21M)**
	CA. Raj is a leading income tax practitioner and consultant for derivative products. He resides in Bangalore near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions, though he has not taken any permission for this. Is CA. Raj liable for professional misconduct?	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. **Part III – Case Discussion** ➢ In this case, CA. Raj is engaged in the occupation of trading in commodity derivatives **Part IV – Conclusion** ➢ Trading in commodity derivatives is not covered under the general permission. Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.	

QNO 713.500	**First Schedule, Part I,Cl,11 --Business Occupation (Multiple Occupation)** **Bhaskar CNO – PE.780**	**New Course – (N21M,N22M)**
	C.A. Bahubali is Special Executive Magistrate. He also took over as the executive chairman of Software Company on 1.4.2021. He is also a leading income tax practitioner and consultant for derivative products. He resides in Chennai near to the ION commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 38% of his time to settle the commodity transactions. He has not taken any permission for becoming Special Executive Magistrate. However, he has got special permission of Council of ICAI for becoming executive chairman and for trading in commodity derivatives. Is C.A. Bahubali liable for professional misconduct? Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.	
Answer	As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. In this case, C.A. Bahubali is Special Executive Magistrate, engaged in the occupation of trading in commodity derivatives and also took over as the Executive Chairman on 01.04.2021. In this context, it may be noted that the Special Executive Magistrate which is generally permitted for Members of the Institute in practice, further specific permission is required for holding the position of Executive Chairman and getting engaged in the occupation of trading in commodity derivatives. In the given situation, C.A. Bahubali is acting as Special Executive Magistrate which is generally permitted for Members of the Institute in practice. Further, He is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission. He also took over as the Executive Chairman for which specific permission is required. CA. Bahubali got the permission for the same from the Council of ICAI. **Conclusion**: Hence, CA. Bahubali is not guilty for acting as Special Executive Magistrate as it is covered under the general permission. He is also not guilty for holding the position of Executive Chairman after getting	

	specific permission of the Institute. However, he is guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 for getting engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

QNO 713.600	**First Schedule, Part 1,Cl,11--Business Occupation(Multiple Points)** **BHASKAR CNO—PE.780**	**New Course – (M23R)**
	Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper - setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members).	
Answer	**Given situation can be visualised in following parts:** A. **Mr S used to involve himself in equity research and used to advise his friends, relatives and other known people:** As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation. In the given case, though Mr S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr S shall not make him guilty of professional misconduct. B. Mr S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include: - Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination. - Owning agricultural land and carrying out agricultural activities. Therefore, in the given case, the activities of Mr S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct. C. **Mr. S was discharged insolvent: Disabilities for the Purpose of Membership:** Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period. In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council. In the given case, it is clearly stated that Mr S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.	

QNO 714.000	First Schedule, Part I,Cl,11 Directorship in Holding Company where he is auditor in Subsidiary Bhaskar CNO – PE.780	Old Course – (M08E, P17M)
	M, a Chartered Accountant in practice, is the Statutory Auditor of S Ltd. for the year ended 31st March 2015. In January 2015, he was appointed as a Director in H Ltd., which is the holding Company of S Ltd.	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A CA in practice cannot engage (unless permitted by the council) in any business or occupation other than the profession of Chartered accountant, but he can be a director of a company wherein he or any of his partners is not interested in such company as auditor. However, public conscience is expected to be ahead of law and the requirement of independence should be interpreted much more strictly. Members should thus not place themselves in position which would either compromise or jeopardise their independence. **Part III – Case Discussion** ➢ In the given case, M is the statutory auditor of S Ltd who was appointed as director in H Ltd which is the holding company of S Ltd. **Part IV – Conclusion** ➢ In view of the above, an auditor of a subsidiary cannot be a director of a holding company as it will affect his independence.	
	Author's Note • **As per Committee on Ethical Standards has decided, director of holding should not become auditor in subsidiary company, though it is not prohibited by Company Act 2013.** • **As per Sec 141(3) directors of company cannot become auditors in the same Company. But the Companies Act 2013 didn't disqualify directors of holding company or subsidiary company from doing so. Hence Sec 141(3) is not referred.**	

QNO 714.500	First Schedule, Part I,Cl,11 --Directorship in Holding Company where he is auditor in Subsidiary Case Study & Recover Consultant Bhaskar CNO – PE.780	Old Course—(M21M) New Course—(M21M)
	M/s SS limited is a partly owned subsidiary **of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered** Mr. D to take up the position of Director **(not MD/ whole time director) of HH limited. At the same time, Mr. D's friend approaches him with an assignment** to act as a Recovery Consultant for a bank. Mr. D is now confused whether to accept or reject the offers. **He approaches you and seeks your advice on the same. Advise what Mr. D about what he can do with the offers with reference to the Chartered Accountants Act, 1949 and Schedules thereto**	
Answer	As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. Provided nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being MD or whole-time director) unless he or his partners is interested in such company as auditor. The Ethical Standards Board (ESB) noted that Public conscience is expected to be ahead of law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence. In the view of the above, the Board, via a clarification,	

	decided that the auditor of a Subsidiary company cannot be a Director of its Holding company, as it will affect the independence of the auditor. However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. 'acting as Recovery Consultant in the banking sector' is covered under general permission. In the given situation, M/s SS limited is a partly owned subsidiary of M/s HH limited. For the upcoming financial year, M/s DD & Co., Chartered Accountants, were appointed as the statutory auditors of SS limited. The CEO of the holding company was impressed with the knowledge and experience of Mr. D, one of the partners of the firm and hence, he offered Mr. D to take up the position of Director (not MD/ whole-time director) of HH limited. Further, Mr. D's friend approached him for an assignment for acting as a Recovery Consultant for a bank. Therefore, in view of above in the given case, Mr. D should not accept the offer to be appointed as director of HH Limited. However, he can accept the assignment offered by his friend and can act as a recovery consultant for a bank.

QNO 715.000	**First Schedule, Part I,Cl,11 General Permission (Editorship of Professional Magazine)** **Bhaskar CNO – PE.780**	**Old Course – (M16R, N20R, M21M)** **New Course – (N20R, M21M)**
	Comment on the following with reference to the Chartered Accountants Act, 1949, and Schedules thereto: CA. Sufi is practicing since 2008 in the field of company auditing. Due to his good practical knowledge, he was offered editorship of a 'Company Audit' Journal which he accepted. However, he did not take any permission from the council regarding such editorship.	
Answer	**Part I -- Relevant Laws** ➢ -Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. **Part III – Case Discussion** ➢ In the instant case, CA. Sufi accepted editorship of a journal for which he did not take any permission from the Council **Part IV – Conclusion** ➢ In this context, it may be noted that the editorship of professional journals is covered under the general permission. Therefore, CA. Sufi shall not be held guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.	

QNO 716.000	**First Schedule, Part I,Cl,11 --General Permission (Private Tutorship)** **Bhaskar CNO – PE.780**	**Old Course – (M16E, P17M, N18R, M18M)** **New Course – (M18M)**
	CA Ram is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others. Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Ram. He approached CA. Ram to take guidance on some topics of financial management subject related to his course. CA. Ram, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants. However, he forgot to take specific permission for such private tutorship from the Council.	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 ▪ Regulation 190A of the Chartered Accountants Regulation, 1988	

Part II -- Requirements of Relevant Law

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

- **Regulation 190A of the Chartered Accountants Regulation, 1988**
  A Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same there is no specific permission from the council would be necessary in the case of private tutorship.

Part III – Case Discussion

- In the given case, CA. Ram has started providing private tutorship to Mr. Ratan along with some other aspirants, without obtaining specific or prior approval of the Council.

Part IV – Conclusion

- On this context, it may be noted that the Council has provided general permission for providing such private tutorship. Therefore, CA. Ram would not be held guilty of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Author's Note

- **If at ICAI**
  - **Part Time Tutorship for ICAI courses — No Approval**
  - **Full Time Tutorship for ICAI courses — ICAI doesn't keeps full time CA Tutors.**
  - **Part Time / Full Time Lectureship for courses other than ICAI — Approval required**
- **If at other organisation**
  - **Part time / full time tutorship — approval required**
- **If at home, office etc (unorganised)**
  - **private tutorship — no approval required**

QNO 717.000	First Schedule, Part I,Cl,11 Lectureship Bhaskar CNO – PE.780	Old Course – (M13M, P17M) New Course- (S17M)

A chartered accountant holding certificate of practice and having four articled clerks registered under him accepts appointment as a full-time lecturer in a college. Also, he becomes a partner with his brother in a business

Answer

Part I -- Relevant Laws

- Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Regulation 190A and 191 to the Chartered Accountants Regulations, 1988

Part II -- Requirements of Relevant Laws

- **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949**
  The clause debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper.

- **Regulation 190A and 191 to the Chartered Accountants Regulations, 1988**
  Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation.

Part III – Case Discussion

- In the given case, Chartered Accountant accepts appointment as full time lecturer in a college and also becomes partner with his brother in business.

	Part IV – Conclusion ➢ A member can accept full- time lecturer-ship in a college only after obtaining the specific and prior approval of the Council. As also becoming a partner in a business with his brother would require specific permission the chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.
	Author's Note ➢ **Refer Note of QNO 716.000** ➢ **Clause 4 ,Part I ,Schedule 1 is also applicable as he, being a CA in practice has entered into partnership with his brother . No detail is provided regarding his brother.**

QNO 717.500	**First Schedule, Part I, Cl 11 --Agricultural Activity on Own Land** **Bhaskar CNO – PE.780**	**New Course- (M22M)**
	"Sanyam, a chartered accountant in practice is owner of three agriculture lands. He lost his father due to Covid Pandemic. After death of his father, he started carrying out agricultural activities. His neighbour Raja who is a farmer, filed a complaint against him to ICAI that being a member he is carrying out agricultural activities, therefore, he is liable for misconduct. You are required to examine the same with reference to the Chartered Accountants Act, 1949 and Schedules thereto."	
Answer	➢ Engaging into Agricultural Activity: As per Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. ➢ However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary. ➢ In this case, CA. Sanyam is owner of 3 agriculture lands, and he is carrying out agricultural activities which is covered under the general permission. ➢ Therefore, CA Sanyam is not guilty of professional misconduct under Clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949 and complain of neighbor to the Institute is not correct.	

QNO 719.000	**First Schedule, Part I,Cl,11 --Specific Permission (After Accepting Job)** **Bhaskar CNO – PE.780**	**Old Course – (M10E, M16M, P17M, N17M,N18M)** **New Course-(S17M, M18M)**
	CA. Aman, a practicing Chartered Accountant, took over as the executive chairman of Signora IT Ltd. on 01.04.2016. However, realizing about obtaining prior approval from the Council of the ICAI for engaging into other business, he applied to the Council for permission within 10 days	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 ▪ Regulation 190A to the Chartered Accountants Regulations, 1988 **Part II -- Requirements of Relevant Laws** ➢ **Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949** A Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage. ➢ **Regulation 190A of the Chartered Accountants Regulation, 1988** A Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same, specific permission from the council would be necessary for holding office of managing director or a whole-time director of a body corporate.	

	Part III – Case Discussion ➢ In the instant case, CA. Aman took over as the executive chairman on 01.04.2016 and applied for permission later. Based on the given facts, he was engaged in other occupation, after 01.04.2016 and before the application for approval, without the permission of the Council. **Part IV – Conclusion** ➢ Therefore, CA. Aman is guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

QNO 720.000	**First Schedule, Part I,Cl,11 --Specific Permission (No Permission & No Intimation to ICAI)** **Bhaskar CNO – PE.780**	**Old Course – (P17M)**
	Mr. J started his practice as Chartered Accountant in 2014. During 2015, he got an offer for the post of Chief Accountant of a Software Development Company, as a fulltime employee, for a salary of ` 60,000 per month. On accepting this offer, Mr. J converted his practice into a partnership firm by taking a fresh Chartered Accountant as his partner. Mr. J neither intimated the Institute nor obtained permission from the Institute about his employment. Will Mr. J be held guilty under the Chartered Accountants Act?	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 ▪ Regulation 190A to the Chartered Accountants Regulations, 1988 **Part II -- Requirements of Relevant Laws** ➢ **As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949** A Chartered Accountant in practice shall not engage in any business or occupation other than the profession of accountancy except with the permission of council. ➢ **Regulation 190A to the Chartered Accountants Regulations, 1988** Part (B) of Appendix 10 to the Chartered Accountants Regulations, 1988 requires member of the Institute in practice to engage in full-time or part-time employment after obtaining the specific and prior approval of the Council. **Part III – Case Discussion** ➢ In the instant case, Mr. J has accepted the full time salaried employment in addition to the practice of Chartered Accountancy without obtaining permission of the Institute. **Part IV – Conclusion** ➢ Mr. J will be held guilty since he has accepted the full time salaried employment in addition to the practice of Chartered Accountancy without obtaining permission of the Institute. Further, Mr. J will be held guilty of professional misconduct under Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 if contravenes any of the provisions of the Act since he has failed to inform the Institute.	

QNO 721.000	**First Schedule, Part I,Cl,11 --Specific Permission (Part Time Employment)** **Bhaskar CNO – PE.780**	**Old Course – (N06E, P17M)**
	Mr. J.J. a practicing Chartered Accountant engages himself as part time finance manager of Quick Return Securities Ltd. He is of the view that as both functions are independent, he need not take permission from the Institute.	
Answer	**Part I -- Relevant Laws** ▪ Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant is deemed to be guilty of professional misconduct if he engages in any business other than the profession of Chartered Accountant unless permitted by the Council for the same. **Part III – Case Discussion** ➢ In the given case, Mr. J. J. a practicing Chartered Accountant is engaging himself as part time Finance Manager without the permission of the Institute.	

	Part IV – Conclusion ➢ Mr. J.J. is deemed to be guilty of professional misconduct, which is misconduct attracted by Clause (11) of Part I of First Schedule.

QNO 721.500	**First Schedule, Part I,Cl,11 --Specific Permission (Promoter Director & Involvement in Family Business)** **Bhaskar CNO – PE.780**	**New Course—(N20E)**
	CA AB, a practicing chartered accountant, is a promoter director of ABG Pvt. Ltd. and moreover he is also a sleeping partner in his family business of garments manufacturing firm. Is CA. AB liable for professional misconduct as per Chartered Accountant Act 1949?	
Answer	**Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949** debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. **Promoter/Promoter Director** - There is no bar for a member to be a promoter / signatory to the Memorandum and Articles of Association of any company. There is also no bar for such a promoter / signatory to be a Director Simplicitor of that company irrespective of whether the object of the company include areas which fall within the scope of the profession of chartered accounts. Therefore, members are not required to obtain specific permission of the Council in such cases. **Sleeping partner in the family business Prior Approval** - Members of the Institute in practice may engage in the following category, among other points, of business or occupations, after obtaining the specific and prior approval of the Council in case of: Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken. In the given case, CA AB is a promoter director of ABG Pvt Ltd and also he is a sleeping partner in his family business of garments manufacturing firm. Applying the above to the given case, it can be concluded that-CA AB: • As Promoter Director- Not guilty of professional misconduct under Chartered Accountants Act, 1949 • As Sleeping Partner- guilty of professional misconduct under Chartered Accountants Act, 1949 as he did not obtain prior approval of the Council.	

QNO 722.000	**First Schedule, Part I,Cl,12 --Signing (Audit Queries)** **Bhaskar CNO – PE.800**	**Old Course – (N16M, N17R)**
	Mr. 'Anuj' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Youth' a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. 'Youth' has issued the audit queries to client which were raised during the course of audit in the name of M/s A & Co.	
Answer	**Part I -- Relevant Laws** ▪ Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements". The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.	

	Part III – Case Discussion ➢ In this case CA. 'Anuj' proprietor of M/s A & Co., went abroad and delegated the authority to another Chartered Accountant Mr. Youth, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants. Mr. 'Youth', a chartered accountant being employee of M/s A & Co. had issued audit queries which were raised during the course of audit. **Part IV – Conclusion** ➢ Here "Youth" is right in issuing the query since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
	Author's Note **The Council in this connection clarified that the Attest function for the purpose of this Resolution would cover services pertaining to audit, review, certification, agreed upon procedures, and compilation, as defined in the Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services published in the July, 2001 issue of the Institute's Journal."** **So, anything covered under attest function cannot be considered as routine work.**

QNO 723.000	**First Schedule, Part I,Cl,12 - Signing (Multiple Matters)** **Bhaskar CNO – PE.800**	**Old Course – (M11E, M14E, P17M, M17M)** **New Course – (S17M, M18M, N19R, N19E, S21M, N21M)**
	Mr. 'A' is a practicing Chartered Accountant working as proprietor of M/s A & Co. He went abroad for 3 months. He delegated the authority to Mr. 'Y' a Chartered Accountant his employee for taking care of routine matters of his office. During his absence Mr. 'Y' has conducted the under mentioned jobs in the name of M/s A & Co. **(i) He issued the audit queries to client which were raised during the course of audit.** **(ii) He issued production certificate to a client under Central Excise Act, 1944.** **(iii) He attended the Income Tax proceedings for a client as authorized representative before Income Tax Authorities.** **Please comment on eligibility of Mr. 'Y' for conducting such jobs in name of M/s A & Co. and liability of Mr. 'An' under the Chartered Accountants Act, 1949.** **OR** **CA. Smart, a practicing Chartered Accountant was on Europe tour between 15-9-15 and 25-9-15. On 18-9-15 a message was received from one of his clients requesting for a stock certificate to be produced to the bank on or before 20-9-15. Due to urgency, CA. Smart directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.** **OR** **Mr. 'K', a practicing Chartered Accountant is the proprietor of M/s K & Co. since 1995. He went abroad in the month of December 2018. He delegated the authority to Mr. 'Y' a Chartered Accountant, his employee for taking care of the important matters of his office. During his absence Mr. 'Y' has conducted the undermentioned jobs in the name of M/s K & Co.** **(i) He issued Net worth certificate to a client for furnishing to a Bank.** **(ii) He attended the GST proceedings for a client as authorized representative before GST Authorities.**	
Answer	**Part I -- Relevant Laws** ▪ Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ A Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements". The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for	

	information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc. **(i)** **Part III – Case Discussion** ➢ In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India. In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. **Part IV – Conclusion** ➢ Here "Y" is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act. **(ii)** **Part III – Case Discussion** ➢ In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India. In the given case, Mr. 'Y', a chartered accountant being employee of M/s A & Co. has issued production certificate to a client under Central Excise Act, 1944. **Part IV – Conclusion** ➢ Issuance of production certificate to a client under Central Excise Act, 1944 by Mr. "Y" being an employee of M/s A & Co. (an audit firm), is not a routine work and it is outside his authorities. Thus, CA. 'A' is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949. **(iii)** **Part III – Case Discussion** ➢ In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India. In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. **Part IV – Conclusion** ➢ Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule of the Chartered Accountants Act, 1949.
	Author's Note **Refer Note of QNO 722.000 for better understanding of what does not falls under routine work.**

QNO 724.000	**First Schedule, Part I,Cl,12 --Signing (Power of Attorney)** **Bhaskar CNO – PE.800**	**Old Course – (M07E, N08R, M09R, N13R,P17M)** **New Course – (S17M)**
	S, a Practicing-Chartered accountant gives power of attorney to an employee chartered accountant to sign reports and financial statements, on his behalf.	
Answer	**Part I -- Relevant Laws** ▪ Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949 ▪ Section 26 of the Chartered Accountants Act, 1949 ▪ Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ **Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949** A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on	

his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

➢ **Section 26 of the Chartered Accountants Act, 1949**

This clause read in conjunction with Section 26 of the Chartered Accountants Act, 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a Chartered Accountant in practice or a firm of Chartered Accountants in his or its professional capacity.

The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise.

➢ **Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**

It states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

Part III – Case Discussion

➢ In the given case, S, a Practicing Chartered accountant gives power of attorney to an employee-chartered accountant to sign reports and financial statements, on his behalf.

Part IV – Conclusion

➢ Accordingly, S is guilty of professional misconduct under Clause (12) of Part I of First Schedule and also under Clause (1) of Part II of Second Schedule for contravening Section 26.

Author's Note

- **Whenever a particular section is involved with no other clause Schedule 2 , Part2 ,Clause 1 can be referred**
- **Students can write this standard answer in all question of Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

QNO 724.500	**First Schedule, Part I,Cl,12 – Delegation of works to his articles and staff** **Bhaskar CNO – PE.800**	**New Course – (S21M, N21M)**

Mr. S, the auditor of ABC Pvt. Ltd. has delegated following works to his articles and staff:
i. Issue of audit queries during the course of audit.
ii. Issue of memorandum of cash verification and other physical verification.
iii. Letter forwarding draft observations/financial statements.
iv. Issuing acknowledgements for records produced.
v. Signing financial statements of the company.
Is this correct as per the Professional Ethics and ICAI's guidelines and pronouncements?

Part I -- Relevant Laws

- Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949
- Council Clarification

Part II -- Requirements of Relevant Laws

➢ **Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949**

A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

➢ **Council Clarification**

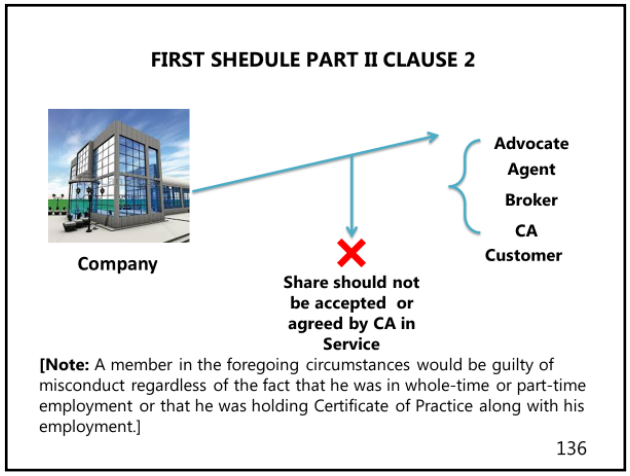
The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- Issue of audit queries during the course of audit.
- Asking for information or issue of questionnaire.
- Letter forwarding draft observations/financial statements.
- Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
- Acknowledging and carrying on routine correspondence with clients.

	• Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients. • Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts. • Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act. • Any other matter incidental to the office administration and routine work involved in practice of accountancy.
	Part III – Case Discussion ➢ In the instant case, Mr. S, the auditor of ABC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.
	Part IV – Conclusion ➢ Therefore, Mr. S is correct in allowing first four tasks i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles. ➢ However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, Mr. S is wrong in delegating signing of financial statements to his staff. ➢ In view of this, S would be guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule of the Chartered Accountants Act, 1949.

QNO 729.000	**First Schedule, Part II,Cl,2 --Share of Fees from Lawyer of Company** **Bhaskar CNO – PE.840**	**Old Course – (M14E, M16M, P17M, N19E)** **New Course – (S17M, N19E)**
	Mr. 'C', a Chartered Accountant holds a certificate of practice while in employment also, recommends a particular lawyer to his employer in respect of a case. The lawyer, out of the professional fee received from employer paid a particular sum as referral fee to Mr. 'C'. **OR** **Mr. C a Chartered Accountant employed as Senior executive in charge of Tax in a company, and not holding certificate of practice recommends a particular lawyer to his employer in respect of a case.** The lawyer, out of the professional fee received from the employer of Mr. C paid a particular sum as referral fee to Mr. C **. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto**	
Answer	**Part I -- Relevant Laws** ▪ Clause (2) of Part II of the First Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws**	

- A member of the Institute(other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.



Part III – Case Discussion

- In the present case, Mr. C who beside holding a certificate of practice, is also an employee and by referring a lawyer to the company in respect of a case, he receives a particular sum as referral fee from the lawyer out of his professional fee.

Part IV – Conclusion

- Therefore, Mr. C is guilty of professional misconduct by virtue of Clause (2) of Part II of First schedule.

Author's Note

AABCC is the shortcut to remember this clause.
A,A- Advocate ,Agent / B-Broker / C-CA, C-Customer

QNO 730.000	**First Schedule, Part III, Cl,2 --Not Responding to ICAI (Date of Leaving Services of the Firm)** Bhaskar CNO – PE.880	**Old Course – (M10E,P17M) New Course-(S17M, M22M)**

Mr. X, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm. On 31st December 2016 he leaves the services of the firm. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm.

Answer

Part I -- Relevant Laws

- Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

- A member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

- ICAI
- Council
- Quality Review Board
- Committee
- Applet Authority
- Disciplinary Committee
- Board of Discipline
- Disciplinary Directorate

Part III – Case Discussion

- In the given case, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant.

Part IV – Conclusion

- Therefore, Mr. X is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949.

Author's Note

Students don't write the names of all authorities and that's why loose ,marks in this clause.

There are total 8 authorities in the picture above . The first 4 are in ICAI hierarchy in the order of importance and the next 4 are in Discipline hierarchy in the order of importance

QNO 731.000	First Schedule, Part III,Cl,2 --Not Responding to ICAI (Non-Submission on Form 18) Bhaskar CNO – PE.880/ CNO – PE.1080	Old Course – (M13M, P17M, M17E) New Course – (N18E)

X, a chartered accountant in practice, in spite of several reminders from the Secretary of the Institute of Chartered Accountants of India fails to submit Form 18. Is he liable for misconduct?

Answer

Part I -- Relevant Laws

- Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949
- Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Laws

➢ **Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949**

The clause requires a member to supply the information called for by the Council or any of its Committees

➢ **Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**

The clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulation made thereunder.

Under the former clause, it is misconduct for chartered accountants generally, if they do not supply the information called for by the Council. The Secretary acts for the Council; hence, request from the Secretary amounts to a request from the Council. Besides, it is also a contravention of Regulation of the Chartered Accountants Regulations, 1988.

Part III – Case Discussion

➢ In the present case, X, a chartered accountant in practice, inspite of several reminders from the Secretary of the Institute of Chartered Accountants of India fails to submit Form 18.

Part IV – Conclusion

➢ Thus, failure to submit Form 18 constitutes professional misconduct.

QNO 731.100	Clause (2) of Part III of First Schedule -- Did Not Fill Columns Bhaskar CNO – PE.880	Old Course – (M14E, P17M) New Course- (S17M)

Mr. 'G', while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.

Answer

Part I -- Relevant Standards & Laws

- As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949.

Part II -- Requirements of Relevant Standards & Laws

➢ A member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

Part III – Case Discussion

➢ In the given case, Mr. "G", a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.

Part IV – Conclusion

➢ Details of engagement in business need to be disclosed while applying for the certificate of practice as it was the information called for in the application, by the Institute. Thus, Mr. G will be held guilty for professional misconduct under the Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.

QNO 732.000	First Schedule, Part IV,Cl,2 Disrepute to Institute (Cheques Bounced) Bhaskar CNO – PE.480/ CNO – PE.940	Old Course – (M08E, P17M, N17E, N20R, N20E) New Course – (N20R)

Case 1

CA. D, a chartered accountant in practice availed of a loan against his personal investments from a bank. He issued 2 cheques towards repayment of the said loan as per the instalments due. However, both the cheques were returned back by the bank with the remarks "Insufficient funds".

OR

(Similar Question)

P, a Chartered Accountant availed a loan against his securities held as investments from a nationalized bank. He issued 2 cheques towards repayment of the said loan. Both the cheques were returned unpaid by the bank with the remark "Refer to Drawer". Comment with reference to the Chartered Accountants Act, 1949 as amended by the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto.

Or

Case 2

Ms. Preeto, a CA, had an account with a bank. The normal balance in this account remained at a level below ` 5,000. The bank inadvertently credited this account with a cheque of ` 2,70,000 belonging to another account holder. When CA. Preeto came to know about this she withdrew the amount of ` 2,75,000 and closed the bank account. After 1 year the bank noticed the mistake and claimed ` 2,75,000 with interest. CA. Preeto contested this claim. Can the bank approach the Institute of Chartered Accountants of India for disciplinary action against CA. Preeto?

Answer

Part I -- Relevant Laws

- Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949
- Section 21 of the Chartered Accountants Act
- Negotiable Instruments Act 1881

Part II -- Requirements of Relevant Laws

➢ **Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949**

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

A Chartered Accountant is expected to maintain the highest standard of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work would expose him to disciplinary action.

➢ **Section 21 of the Chartered Accountants Act**

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct".

The question whether a particular act or omission constitutes "other misconduct" should be based on facts and circumstances of each case.

➢ **Negotiable Instruments Act 1881,**

Where any cheque drawn by a person for the discharge of any liability is returned by the bank unpaid, either for insufficiency of funds or the cheque amount exceeds the arrangements made by the drawer of the cheque, the drawer of such cheque shall be deemed to have committed an offence.

Case 1

Part III – Case Discussion

➢ In the given case the cheque was dishonoured with the remark "Insufficient Funds".

Part IV – Conclusion

➢ Therefore, CA D is liable for misconduct under Clause 2 of Part IV of the First Schedule of the Chartered Accountants Act, 1949

Case 2

Part III – Case Discussion

➢ In the instant case, CA. Preeto, a CA, had an account with a bank from which she withdrew the amount of ` 2,75,000 and closed the account. This amount of ` 2,75,000 was pertaining to ` 5,000

	minimum balance and ` 2,70,000 belonging to other account holder and inadvertently credited to his account by the bank.
	Part IV – Conclusion
	➢ The said act of CA. Preeto to withdraw the money which does not belongs to her will bring disrepute to the profession. Hence under this clause the bank can file a suitable complaint under Clause 2 of Part IV of First Schedule of the Chartered Accountant Act, 1949 with the Institute of Chartered Accountants of India.
	Author's Note **In the first case it is important to mention Negotiable Instruments Act 1881 in the answer. Even though it is important to mention this in the answer students don't mention this and loose marks.**

QNO 733.000	**First Schedule, Part IV,Cl,2 --Disrepute to Institute (Failed to Return Books)** **Bhaskar CNO – PE.480/ CNO – PE.940**	**Old Course – (M13E, M16M, P17M, N17M, N18M)** **New Course – (N18M)**
	CA. X, a practicing Chartered Accountant, failed to return the books of account **and other documents of ABC Ltd.** despite many reminders from the company**. The company had** settled his entire fees dues also.	
Answer	**Part I -- Relevant Laws** ▪ Section 21 of the Chartered Accountants Act, 1949 ▪ Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949	
	Part II -- Requirements of Relevant Laws ➢ **Section 21 of the Chartered Accountants Act, 1949** A member is liable to disciplinary action under section 21 of the Chartered Accountants Act, 1949, if he is found guilty of any professional or "Other Misconduct". ➢ **Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949** As per Clause (2) of Part IV of the First Schedule to the said Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, • In the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. • Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months; A member may be found guilty of "Other Misconduct" as per Clause (2) under the aforesaid provisions rendering himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.	
	Part III – Case Discussion ➢ In the given case, CA. X failed to return the books of accounts and other documents of his client without any reasonable cause.	
	Part IV – Conclusion ➢ Therefore, CA X would be held guilty of other misconduct under the aforesaid provisions.	

QNO 735.000	**First Schedule, Part IV,Cl,2 --Disrepute to the Institute (Quid Pro Quo)** **Bhaskar CNO – PE.940**	**Old Course – (N11E, P17M, N17M)**
	CA. X, a practicing Chartered Accountant, failed to return the books of account **and other documents of ABC Ltd. despite many reminders from the company. The company had settled his entire fees dues also.** **OR** **CA Raj, a Chartered Accountant in practice approached Manager of a Nationalised Bank for a loan of Rs. 36 lakhs.** He has also informed the Manager that if the loan is sanctioned, the Income Tax return of the Manager and Manager's wife will be filed for free of cost, as quid Pro quo for the loan sanctioned.	
Answer	**Part I -- Relevant Laws** ▪ Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949	

	Part II -- Requirements of Relevant Laws ➢ A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or to the Institute as a result of his action whether or not related to his professional work. Accordingly, a Chartered Accountant is also expected to maintain the highest standards and integrity even in his personal affairs and any deviation from these standards calls for disciplinary action. **Part III – Case Discussion** ➢ In the given case, CA Raj, a Chartered Accountant in practice approached Manager of a Nationalised Bank for a loan and offered for filing Income tax Returns without any fees. **Part IV – Conclusion** ➢ This approach of CA Raj brings disrepute to the profession of a Chartered Accountant. Hence, CA Raj will be held guilty of other misconduct under Clause (2) of Part IV of the First Schedule of the Chartered Accountants Act, 1949.

QNO 736.000	**First Schedule, Part IV,Cl,2 --Disrepute to the Institute (RCM Misappropriation)** **Bhaskar CNO – PE.940**	**Old Course – (P17M, N20M)** **New Course – (N20M,M23M)**
	Mr. R, a Chartered Accountant in practice has been elected as the treasurer of a Regional Council of the Institute. The Regional Council had organized an international tour through a tour operator **during the year for its members. During the audit of the Regional Council, it was found that** Mr. R had received a personal benefit of ` 50,000 from the tour operator.	
Answer	**Part I -- Relevant Laws** ▪ Section 21 & 22 of CA Act. **Part II -- Requirements of Relevant Laws** ➢ **Section 21 of the Chartered Accountants Act, 1949** It provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct." Though the term "Other Misconduct" has not been defined in the said Act, this provision enables the Council to enquire into any misconduct of a member even if it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards even in his non-professional work, would expose him to disciplinary action. The Council has also laid down that among other things "misappropriation by an office-bearer of a Regional Council of the Institute of a large amount and utilization thereof for his personal use" would amount to "other misconduct". **Part III – Case Discussion** ➢ In the present case, Mr. R, Treasurer of Regional Council participated in an international tour and received personal benefit of INR 50000 from the tour operator. **Part IV – Conclusion** ➢ Thus, in the instant case, Mr. R would be liable for disciplinary action.	
	Author's Note In case where there is a other misconduct always mentioned section 21 & 22 of CA Act. These sections explain that Institute has right to go beyond defined misconduct of 1st and 2nd schedule and its process. One should also mention Clause 2, Part 4, Schedule 1 which covers act involving disrepute to the Institute. ICAI has been inconsistent, sometimes they mention section 21 & 22 and sometimes clause 2 . So, both should be always mentioned.	

QNO 737.000	**First Schedule, Part IV,Cl,2 --Disrepute to the Institute (Use of Influence on Get Loans)** **Bhaskar CNO – PE.940/ CNO – PE.1160**	**Old Course – (N10E, P17M, M19M)** **New Course – (S17M, M19M)**
	YKS & Co., a proprietary firm of Chartered Accountants was appointed as concurrent auditor of a bank. YKS used his influence for getting some cheques purchased and thereafter failed to repay the loan/overdraft.	

Answer	**Part I -- Relevant Laws** ▪ Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949. **Part II -- Requirements of Relevant Laws** ➢ As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work. Here the Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards calls for disciplinary action. **Part III – Case Discussion** ➢ In the present case, YKS & Co, being a concurrent auditor used his position to obtain the funds and failed to repay the same to the bank. **Part IV – Conclusion** ➢ This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable. Therefore, YKS & Co will be held guilty of other misconduct under Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949.

737.010	**First Schedule, Part IV,Cl,2 --Disrepute to the Institute (Other Work by Article)** **Bhaskar CNO – PE.920**	**Old Course – (N19R)** **New Course –(N18R,N19R, M22R)**
	CA Kumar who is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period.	
Answer	**Part I -- Relevant Laws** ▪ Part IV of the First Schedule to the Chartered Accountants Act, 1949 ▪ Part III of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Laws** ➢ 'Other Misconduct' which has been defined in **Part IV of the First Schedule and Part III of the Second Schedule**. These provisions empower the Council even if it does not arise out of his professional work This is considered necessary because a Chartered Accountant is expected to maintain the **highest standards of integrity** even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action. **Part III – Case Discussion** ➢ CA Kumar has engaged his Articled Assistant for his own election campaigning for the central Council elections of ICAI. **Part IV – Conclusion** ➢ Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'. Hence, CA Kumar is guilty of 'Other Misconduct'.	
	Author's Note ICAI has answered this question differently. All the cases which are of other misconduct, generally ICAI refers to Sec 21 / 22 and Clause 2, Part IV, First Schedule. But here they have in general referred to other misconduct of BOTH SCHEDULES, I would suggest this approach if same question is asked and if you remember it. Else give standard answer of other misconduct.	

QNO 738.000	Second Schedule, Part I, Cl,1 --Confidentiality Breached While giving Information to Bank Bhaskar CNO – PE.960	Old Course-- (N10R, M14R, P17M, N20E) New Course- (S17M, S21M)

XYZ Co. Ltd. has applied to a bank for loan facilities. **The bank on studying the financial statements of the company notices that you are the auditor and** requests you to call at the bank for a discussion. **In the course of discussions, the bank asks for your opinion regarding the company and** also asks for detailed information regarding a few items in the financial statements. The information is available in your working paper file. What should be your response and why?

OR

Tiger Ltd. has applied to a bank for loan facilities. The bank on studying the financial statements of the company notices some discrepancies in the books of the company. Upon discussion with the auditor of the company, the bank manager requested for detailed information regarding a few items in the financial statements. The information is available in the working paper file of the auditor. What should be the response of the auditor in this regard?

Answer

Part I -- Relevant Standards & Laws

- Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (1) of Part I of the Second Schedule**

Clause (1) of Part I of the 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 the client or otherwise than as required by law for the time being in force.

➢ **SA 200 on " Overall Ob Author's Note**
Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"

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 information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

Part III – Case Discussion

➢ In the instant case, the bank has asked the auditor for detailed information regarding few items in the financial statements available in his working papers. Having regard to the position stated earlier, the auditor cannot disclose the information in his possession without specific permission of the client. As far as working papers are concerned, working papers are the property of the auditor. The auditor may at his discretion, make portions of or extracts from his working papers available to his client".

Part IV – Conclusion

➢ Thus, there is no requirement compelling the auditor to divulge information obtained in the course of audit and included in the working papers to any outside agency except as and when required by any law.

Author's Note

⚠ **# Mistake point**

It is very common mistake **made by students that they** don't refer relevant SA's**. They only refer the clauses of professional ethics while solving professional ethics question. Brief of** relevant applicable standards should also by provided by students**, because the answers provided by institute also contains such reference but in an "inconsistent manner". That's why only few questions have reference**

	of relevant SA's. Like wherever there is breach of confidentiality you should refer SA 200 also.

QNO 739.000	**Second Schedule, Part I, Cl,1 --Confidentiality Breached While Presenting Paper** **Bhaskar CNO – PE.960**	**Old Course-- (M04E, N14E, N16R, P17M)** **New Course—(S17M,M22M)**

Mr. Parekh, a Chartered Accountant was invited by the Chamber of Commerce to present a paper in a symposium on the issues facing Indian Leather Industry. During the course of his presentation he shared some of the vital information of his client's business under the impression that it will help the Nation to compete with other countries at international level

OR

Mr. Shreyansh, a Chartered Accountant in practice was invited to deliver a seminar on Amendments in Schedule III and CARO 2020 which was attended by professionals as well as by representatives of various Industries. One section of audience raised a particular issue unique to the industry to which it pertains. Mr. Shreyansh enthusiastically explained the issue and elaborated how he solved this, for his client facing the same issue with worked out examples from the computer storage device using the actual data of one of his clients with full identification of client details being displayed to the group for the sake giving clarity on a topic in a real-life situation. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer

Part I -- Relevant Standards & Laws

- Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- Code of Ethics
- SA 200 on "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"

Part II -- Requirements of Relevant Standards & Laws

➢ **Disclosure of Client's Information:**

Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 deals with the professional misconduct relating to the disclosure of information by a chartered accountant in practice relating to the business of his clients to any person other than his client without the consent of his client or otherwise than as required by any law for the time being in force would amount to breach of confidence.

➢ **The Code of Ethics**

The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. The Chartered Accountant may however, disclose the information in case it is required as a part of performance of his professional duties.

➢ **SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"**

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 information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

Part III – Case Discussion

➢ In the given case, Mr. Parekh has disclosed vital information of his client's business without the consent of the client under the impression that it will help the nation to compete with other countries at International level.

Part IV – Conclusion

➢ Thus, it is a professional misconduct covered by Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949

Author's Note

⚠ **# Mistake point**

Clause 1 talks about breach of confidentiality. Code of ethics further clarifies that it is applicable to past clients also. ICAI is inconsistent in referring to code of ethics in answers. You can make a rule to refer it wherever there is breach of confidentiality.

QNO 740.000	Second Schedule, Part I, Cl 3 Financial Forecast Bhaskar CNO – PE.1000	Old Course-- (P17M)
	Z, a Chartered Accountant, certifies a financial forecast of his client which was forwarded to the client's bank based on which the bank sanctioned a loan to the client.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (3) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ SAE 3400 "The Examination of Prospective Financial Information" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (3) of Part I of the Second Schedule** Under Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. ➢ **SAE 3400 "The Examination of Prospective Financial Information"** Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor needs to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same. **Part III – Case Discussion** ➢ In the instant case, Mr. Z has certified a financial forecast of his client which was forwarded to the client's bank based on which the bank sanctioned a loan to the client. **Part IV – Conclusion** ➢ Thus, Mr. Z will not be held guilty of misconduct if all the requirements have been complied with or vice versa.	
	Author's Note **Refer note after QNO – 743.000**	

QNO 741.000	Second Schedule, Part I, Cl,3 --Financial Forecast (Certified) Bhaskar CNO – PE.1000	Old Course-- (M05E, M17E) New Course-- (N18M)
	L, a chartered accountant prepares and certifies projected financial statements **of his client Abacus Ltd. Abacus Ltd. forwarded the same to their banks to secure some loans and bank, on that basis sanctioned a loan.** **OR** **Lily, a chartered accountant** prepares and certifies projected financial statements **of his client Amazon Ltd. Amazon Ltd. forwarded the same to their banks to secure some loans and bank, on that basis sanctioned a loan**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (3) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ SAE 3400 "The Examination of Prospective Financial Information" **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (3) of Part I of the Second Schedule** Under Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. ➢ **SAE 3400 "The Examination of Prospective Financial Information"** Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the	

	management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor needs to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same. **Part III – Case Discussion** ➢ In the instant case, Mr. L, a chartered accountant, has prepared and certified a projected financial forecast of his client Abacus Ltd. which was forwarded to the client's bank to secure some loans and based on which the bank sanctioned a loan to the client is not in order. **Part IV – Conclusion** ➢ Thus, Mr. L will be held guilty of misconduct in view of above
	Author's Note **Refer note after QNO – 743.000**

QNO 742.000	**Second Schedule, Part I, Cl 3 --Financial Forecast (Does Not Vouch)** **Bhaskar CNO – PE.1000**	**Old Course-- (M14E, N16M, P17M)**
	Mr. 'E', a practicing Chartered Accountant, was requested by one of his clients to prepare a projection for next five years and also a report on the same. Mr. 'E' after having prepared the same stated in his report 'The sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts. **He also stated that he** does not vouch for the accuracy of the forecasts**.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (3) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ A chartered accountant in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. Accuracy does not refer to arithmetical accuracy. All forecasts are estimates based on certain assumptions duly evaluated on a consideration of various relevant factors and cannot be ascertained with accuracy. The Guidance Note on Accountants Report on Profit Forecasts and/or Financial forecast considered the implications of this clause and made it clear that the chartered accountant can participate in the preparation of profit or financial forecasts and review them. But, first of all, he should clearly indicate in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts and, secondly, he should not vouch for the accuracy of the forecasts. **Part III – Case Discussion** ➢ In the instant case, Mr. E after having prepared the projections for next five years stated in his report, "the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts." He also stated that he does not vouch for the accuracy of the forecasts. **Part IV – Conclusion** ➢ Therefore, there is no violation of the Chartered Accountants Act, 1949 and its Regulations.	
	Author's Note • **Institute has given answer as per old guidance note, in which preparation and examination both were allowed by a chartered accountant, but after SA 3400 the situation has changed. As per SA 3400 a chartered accountant cannot do 2 things together i.e. preparation and examination, so answer of this particular question should be modified that , preparing and examining both is not allowed as on today as per SA 3400 ,hence guilty of misconduct** • **Also refer note after QNO – 743.000**	

QNO 743.000	Second Schedule, Part I, Cl,3 --Financial Forecast (Offered) Bhaskar CNO – PE.1000	Old Course-- (M08E, M16R, P17M) New Course—(S17M)
	As a Chartered Accountant in practice, you are asked to conduct a review of the "Profit Forecast" prepared by a Company in connection with its application for a Term loans from a bank	

Answer

Part I -- Relevant Standards & Laws

- Clause (3) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- SAE 3400 "The Examination of Prospective Financial Information"

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (3) of Part I of Second Schedule to The Chartered Accountants Act, 1949**

A CA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

➢ **SAE 3400 "The Examination of Prospective Financial Information"**

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes.

Thus, while making report on projection, the auditor needs to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

Part III – Case Discussion

➢ In the instant case, as a chartered accountant in practice, we are asked to conduct a review of "profit forecast" prepared by a company in connection with its application for a term loan from a bank.

Part IV – Conclusion

➢ Hence, the offer can be accepted if the above requirements are complied with.

Author's Note
Refer note after QNO – 743.000

Authors Note

⚠ **# Mistake point (QNO- 740.000/741.000/742.000/743.000)**

Below are the analysis of various questions related to financial forecast. Institute has given different answers on the basis of words used in the question. However, students usually don't think about it much and write a common answer to all the questions related to financial forecast.

Following suggestions can be used to gain maximum marks in questions related to financial forecast and projected financial statements.

➢ **Note 1**

When the question only mentions **"Chartered Accountant, certifies a financial forecast/projection of his client"**

Here students should try to find in the question whether something is mentioned related to Vouching the accuracy of the forecast or projections?

- If yes, then answer it accordingly-
  - If question states CA Vouches (i.e. SAE 3400 not followed) – Guilty
  - If question states CA does not Vouches (i.e. SAE 3400 followed) – Not Guilty
- If nothing is mentioned in the question, then answer it accordingly-

  Write a conditional answer that –
  - If CA Vouches accuracy for the forecast or projections, SAE 3400 is not followed– Guilty

- If CA does not Vouches for accuracy of the forecast or projections, SAE 3400 followed– Not Guilty

➢ **Note 2**

When the question mentions **"Chartered Accountant, prepares & certifies a financial forecast /projection of his client"**

Answer should consist of two parts:

- Preparation

  Preparing and at the same time examining a financial forecast /projection of his client is not allowed as per SA 3400 as it says it is the responsibility of management to prepare. Earlier as per Guidance Note on Accountants Report on Profit Forecasts and/or Financial forecast it was allowed to prepare an examine at the same time, but this GN is discontinued after introduction of SAE 3400 in 2007.

- Certification

  Same as note 1

➢ **Final Conclusion: -**

As per SAE-Preparation is not allowed and certification is allowed subject to conditions specified above.

QNO 744.000	**Second Schedule, Part I, Cl 4 --Evaluation of Cost is Not Giving Opinion on Financial Statements** **Bhaskar CNO – PE.1020**	**Old Course-- (N04E, N08R, N14E, P17M, M18E, N20E)**

A firm of Chartered Accountants was appointed by a company to evaluate the costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the company.

OR

A firm of Chartered Accountants was appointed by a company to evaluate the costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the company. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.

Answer

Part I -- Relevant Standards & Laws

- Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (4) of Part I of the Second Schedule**

It states that expressing an opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest would constitute misconduct.

Also, the Council of the Institute of Chartered Accountants of India has stated that in cases where a member of the Institute is a director of a company, or the firm in which the said member is a partner, should not express any opinion on its financial statements.

Part III – Case Discussion

➢ As per facts of the case, the firm has been retained to evaluate the cost of products manufactured by it for its information system. It is a part of management consultancy service of the firm and moreover its partner was on the Board.

Part IV – Conclusion

➢ Hence, the firm can perform this assignment and it will not constitute misconduct. However, the firm while accepting the position as auditor in future would have to consider whether it would be possible to act in independent manner and express opinion on financial statements

Authors Note:

- Reference of companies' act shall be given only when specifically asked by question.

QNO 745.000	Second Schedule, Part I, Cl 4 --Not Covered in Definition of Relative Bhaskar CNO – PE.1020	Old Course-- (N12E, P17M)
	Mr. A has been appointed statutory auditor of a private limited company where his spouse's sister's husband is having 75% ownership	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Guidance Note of ICAI over Substantial Interest. ▪ AS 18 - Related Party Disclosures **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (4) of Part I of the Second Schedule** It states that if an auditor expresses his opinion on the financial statements of any business or enterprises in which he, his firm or a partner in his firm has a substantial interest, he is committing professional misconduct. ➢ **AS 18** Further as per Council General Guidelines, a member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons, who are his "relatives" within the meaning of AS 18 have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise. **Part III – Case Discussion** ➢ In the given case Mr. A, has been appointed as statutory auditor of a private limited company where his spouses' sisters' husband is having 75 % ownership i. e. substantial interest. **Part IV – Conclusion** ➢ As per AS 18, spouses' sisters' husband is not covered in the definition of the term relative. Therefore, appointment of Mr. A as statutory auditor in such company would not amount to professional misconduct as per Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	
	Authors Note: • Refer note in QNO 747.000	

QNO 746.000	Second Schedule, Part I, Cl 4 Substantial Interest by Relative (Brother) Bhaskar CNO – PE.1020	Old Course-- (M09E, P17M)
	P, a Chartered Accountant in practice, accepts appointment as statutory auditor for LMN Pvt. Ltd. Q, brother of P has substantial interest in LMN Pvt. Ltd.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Section 141(3)(f) of the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (4) of Part I of the Second Schedule** A CA in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest. The above restriction is also made applicable for relatives of the members. ➢ **Section 141(3)(f) of the Companies Act, 2013** Further, 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. **Part III – Case Discussion** ➢ In the instant case, since Q, a relative has a substantial interest in LMN Pvt. Ltd **Part IV – Conclusion** ➢ Thus, P will be guilty of misconduct in terms of above clause. P cannot conduct the audit and needs to vacate the office.	
	Authors Note: • Refer note in QNO 747.000	

QNO 747.000	Second Schedule, Part I, Cl 4 --Substantial Interest by Relative (Wife) Bhaskar CNO – PE.1020	Old Course-- (M04E, P17M)
	Mr. Shah, a Chartered Accountant certified the financial statements of a company in which his wife is a Director holding substantial interest.	

Answer

Part I -- Relevant Standards & Laws

- Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- AS 18 - Related Party Disclosures
- Section 141(3)(f) of the Companies Act, 2013

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949**
It states that if an auditor expresses his opinion on the financial statements of any business or enterprise in which he, his firm or partner in his firm has a substantial interest, he is committing professional misconduct.

➢ **AS 18**
Further a member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons, who are his "relatives" within the meaning of AS 18 have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise.

The Council also emphasizes that the aforesaid requirement of Clause (4) is equally applicable while performing all types of attest functions by the members

➢ **Section 141(3)(f) of the Companies Act, 2013**
This is further a contravention of section 141(3)(f) of the Companies Act, 2013, which requires that 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.

Part III – Case Discussion

➢ In the given case, Mr. Shah, Chartered Accountant, has certified the financial statements of a company in which his wife is a director with substantial interest.

Part IV – Conclusion

➢ Hence, this amounts to professional misconduct which attracts Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949 and Mr. Shah shall have to vacate the office accordingly.

Author's Note

➢ **Where Auditor and Company are related (744.000/745.000/746.000/747.000)**
Where Auditor and Company are having relation of any kind, Clause (4) of Part I of the Second Schedule **should be referred in all questions and** if substantial interest is not found conclusion should be given not guilty but mentioning the clause is must**.**

➢ Further where Auditor and Company are having relation of any kind **should be referred in all questions**

➢ AS 18 (**always** when relative is involved)
As per AS 18 Relative" means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by that individual in his/her dealings with the reporting enterprise

➢ Also along with above, Companies Act section shall also be referred. **(if question mentions the following)**
- If CA himself or relative is director or is in employment with company as director or KMP - Section 141(3)(f) of the Companies Act, 2013
- If CA himself or relative is holding shares in company and question tells about the face value of the shares held by relative - Section 141(3)(d) of the Companies Act, 2013.
- And where section 141(3) applies Clause (9) of Part I of the First Schedule also applies.

QNO 747.050	Second Schedule, Part I, Cl 4 --Substantial Interest by Father-in-Law. Bhaskar CNO – PE.1020	Old Course-- (N16M)
	Mr. Rajkumar, the director of Unite Ltd., is holding 25% shares in the company. His daughter-in-law,	

	CA. Rani, is in practice for 15 years **where she** provides consultancy services and conduct statutory audits**. She has created her niche in statutory audits. The company wanted to appoint her as the statutory auditor of the company for the five consecutive financial years. Consequently, she was appointed by Unite Ltd. Examine the validity of appointment of CA. Rani.**
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ AS 18 - Related Party Disclosures ▪ Section 141(3)(f) of the Companies Act, 2013 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949** It states that if an auditor expresses his opinion on the financial statements of any business or enterprise in which he, his firm or partner in his firm has a substantial interest, he is committing professional misconduct. ➢ **AS 18** Further a member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons, who are his "relatives" within the meaning of AS 18 have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise. The Council also emphasizes that the aforesaid requirement of Clause (4) is equally applicable while performing all types of attest functions by the members ➢ **Section 141(3)(f) of the Companies Act, 2013** This is further a contravention of section 141(3)(f) of the Companies Act, 2013, which requires that 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. **Part III – Case Discussion** ➢ In the given case, Mr. Shah, Chartered Accountant, has certified the financial statements of a company in which his wife is a director with substantial interest. **Part IV – Conclusion** ➢ Hence, this amounts to professional misconduct which attracts Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949 and Mr. Shah shall have to vacate the office accordingly.
	Author's Note: **In Companies Act and in CA Act we have to see whether person is a relative from point of view of Chartered Accountant/Auditor.** **In this particular question father-in-law is a director having 25% and more holding in the company. Father-in-law does not come under the definition of relative, whether in Companies Act or CA Act. So Chartered Accountant can do audit.** **But Institute has taken definition of relative from the point of view of director i.e. son's wife is relative.** **We think it is inappropriate and the Chartered Accountant is not guilty**. But if similar question comes in exam then you should explain both the point of view.

QNO 747.070	**Second Schedule, Part I, Cl 4 -- Resigned as Director and accepted the Statutory Auditor position** **Bhaskar CNO – PE.1020**	**New Course-- (S21M, N21E)**
	Mr. D, a practicing CA, is appointed as a Director Simplicitor **in XYZ Pvt. Ltd. After one year of appointment, Mr. D** resigned as the Director and accepted the Statutory Auditor position **of the company. Is Mr. D right in accepting the auditor position?**	
	Part I -- Relevant Standards & Laws ➢ Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ➢ Section 141 of the Companies Act, 2013 ➢ Clarifications issued by the Council **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949** A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he	

expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

- **Section 141(3)(f) of the Companies Act, 2013**

  Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g., tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

- **Clarifications issued by the Council**

  As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

Part III – Case Discussion

- In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in XYZ Pvt. Ltd. After one year of appointment, Mr. D resigned as the Director and accepted the Statutory Auditor position of the company.

Part IV – Conclusion

- In view of above provisions Mr. D cannot accept the Directorship of the company until the completion of two years after his resignation. Thus, CA, D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

QNO 747.080	**Second Schedule, Part I,Cl,4 -- Resigned as Director and accepted the Statutory Auditor Position (One More Case)** **Bhaskar CNO – PE.1020**	**Old Course— (M21M)** **New Course— (M21M)**

Mr. Dhawal, a practicing CA, is appointed as a Director Simplicitor in Gautam Pvt. Ltd. After three year of appointment, Mr. Dhawal resigned as the Director and accepted the Statutory Auditor position of the Company. Is Mr. Dhawal right in accepting the auditor position? **Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.**

As per Clause (4) of Part I of the Second Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. Dhawal, a practicing CA, is appointed as a Director Simplicitor in Gautam Pvt. Ltd. After three year of appointment, Mr. Dhawal resigned as the Director and accepted the Statutory Auditor position of the Company. In view of above provisions Mr. Dhawal can accept the Directorship of the company as tenure of two years after his resignation is completed.

Thus, CA, Dhawal would not be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the Chartered Accountants Act, 1949.

QNO 747.090	Second Schedule, Part I,Cl,4 --Issuing Certificate for Relative Bhaskar CNO – PE.1020	New Course— (N22R)
	"Comment on the following with reference to the with reference to the Chartered Accountants Act, 1949 and Schedules thereto: **(a) CA Dev started practice in Punjab in the year 2019. CA Dev issued 'Turnover Certificate' for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of availing cash credit facility and machinery term loan. Brother of CA Dev was proprietor of M/s. ASAUS Traders.**	
	As per Clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest. Further, it is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in Accounting Standard (AS) - 18. In the given situation, CA Dev started practice in Punjab in the year 2019. CA Dev issued Turnover certificate for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of obtaining Loan. Brother of CA Dev is proprietor of M/s. ASAUS Traders. Brother is very well covered in the definition of relative mentioned in Accounting Standard (AS)-18. Hence, CA Dev is guilty of professional misconduct.	

QNO 748.000	Second Schedule, Part I, Cl 5 --Irregularities in pension fund Bhaskar CNO – PE.1040	Old Course-- (N06E, M13M, N16R, P17M, N18M)
	The superannuation-cum-pension fund for the employees of a company was under a separate 'trust'. Both the company and the trust were under the same management. The auditor, who was auditing the accounts of the company as well as the trust noted some irregularities in the operation of the trust and commented upon these irregularities in the confidential report given to the trustees but did not mention about these irregularities in his report on the Annual accounts of the Trust.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Supreme Court Case: -Kishorilal Dutta vs. P. K. Mukherjee **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (5) of Part I of the Second Schedule** A Chartered Accountant in practice is deemed to be guilty of professional misconduct under Clause (5) of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading". ➢ Kishorilal Dutta vs. P. K. Mukherjee On similar facts it was held by the Supreme Court in Kishorilal Dutta vs. P. K. Mukherjee that it was the duty of the Chartered Accountant to have disclosed the irregularities and contravention to the beneficiaries of the fund in the statement of accounts signed by him. **Part III – Case Discussion** ➢ In this case, the Chartered Accountant was aware of the contraventions and irregularities committed by the trust as these were referred to in the confidential report given by the Chartered Accountant to the trustees of the company. However, he had issued the annual accounts without any qualification. **Part IV – Conclusion** ➢ Accordingly, in the present case also it has to be held that the Chartered Accountant is guilty of professional misconduct if the amount of irregularities is proved material.	

QNO 749.000	Second Schedule, Part I, Cl 5 --Loan from PF Fund Bhaskar CNO – PE.1040	Old Course-- (M04E, P17M) New Course-- (N21M)
	Mr. Joe, a Chartered Accountant during the course of audit of M/s XYZ Ltd. came to know that the company has taken a loan of 10 lakhs from Employees Provident Fund. The said loan was not reflected in the books of account. However, the auditor ignored this information in his report	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949. **Part II -- Requirements of Relevant Standards & Laws** ➢ A chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. **Part III – Case Discussion** ➢ In this case, Mr. Joe has come across information that a loan of `10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts. **Part IV – Conclusion** ➢ Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. Joe has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	
	Author's Note **In SA's misstatement include Omission, But this is old Law both are covered in different Clauses. Let's Stick to it.**	

QNO 750.000	Second Schedule, Part I, Cl,5 --Loan from PF Fund Bhaskar CNO – PE.1040	Old Course-- (M09E, N11E, P17M, M18E, N18E, M19M) New Course—(S17M, M19M)
	In the course of his audit assignment in M/s Bailey Ltd., CA Soft came to know that the company, due to financial crunch and unable to meet employee's salary, has taken a loan of Rs 50 lacs from Employees Gratuity Fund. The said loan was not reflected in the book of account of the company and the auditor ignored this transaction in his report.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ A chartered Accountant in practice will be held liable form is conduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading. **Part III – Case Discussion** ➢ In this case, CA. Soft has come across information that a loan of `50 lakhs have been taken by the company from Gratuity Fund. **Part IV – Conclusion** ➢ This is contravention of Rules and the said loan has not been reflected in the books of account. Further, this material fact has also to be disclosed in the financial statements. The very fact that CA. Soft has failed to disclose this fact in his report, he would be guilty for professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	

QNO 751.000	Second Schedule, Part I, Cl,5 --Non-Creation of Sinking Fund Bhaskar CNO – PE.1040	Old Course-- (N10R, M14R)
	Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: **CA. Dice had signed the Balance sheet of QR Ltd. for the year ended 31St March 2019 which failed to give disclosure of the charge created for Z 4.35 crores against the Corporate Guarantee given in favour of a Group Company. The Balance Sheet size of the company filed with the Registrar of Companies was Z 26.12 crores.** **OR** **Qurashi, a Chartered Accountant, failed to report to the shareholders of the Zee Ltd, about the non-creation of a sinking fund in accordance with the Debenture Trust Deed and did not make clear that**	

	the amount shown as Sinking Funds were borrowed from the Managing Agents of the Zee Ltd
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ As per Clause 5 of Part I of Second Schedule to the Chartered Act, 1949, if a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to disclose a material fact known to him which is not disclosed in the financial statement, but disclosure of which is necessary in making such financial statement in a professional capacity. **Part III – Case Discussion** ➢ In the instant case, CA Dice was in duty bound to see that the nature and subject matter of the charge created for Z 4.35 crores against the Corporate Guarantee given in favour of a Group Company. **Part IV – Conclusion** ➢ Hence, CA Dice was found guilty of misconduct.

QNO 751.500	**Second Schedule, Part I, Cl,5 --Non-Creation of Sinking Fund (Focus on Materiality)** **Bhaskar CNO – PE.1040**	**New Course-- (N20E)**
	Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto: **CA. Dice had signed the Balance sheet of QR Ltd. for the year ended 31St March 2019 which failed to give disclosure of the charge created for Z 4.35 crores against the Corporate Guarantee given in favour of a Group Company. The Balance Sheet size of the company filed with the Registrar of Companies was Z 26.12 crores.**	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ It may be observed that this clause refers to failure to disclose a material fact, which is known to him, in a financial statement reported on by the auditor. It is obvious, that before a member could be held guilty of misconduct, materiality has to be established. The determination of materiality has been provided in SA 320, "Materiality in Planning and Performing an Audit". Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain, among other points, that Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both. **Part III – Case Discussion** ➢ In this case, CA Dice has signed a Balance Sheet which failed to give disclosure of ` 4.35 crores (considered material fact applying above SA 320 principle) against the corporate guarantee given in favour of a Group Company. Size of Balance Sheet of QR Ltd is ` 26.12 crore. **Part IV – Conclusion** ➢ This material fact has to be disclosed in the financial statements. Keeping in view the above, he is attracted by the provisions of professional misconduct under Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	

QNO 753.000	**Second Schedule, Part I, Cl 6 --False information to Tax Authorities** **Bhaskar CNO – PE.1040**	**Old Course -- (N07E, M11R, N13R, P17M)** **New Course -- (S17M, N18E)**
	A practicing Chartered Accountant was appointed to represent a company before the tax authorities. He submitted on behalf of his client's certain information and explanations to the authorities, which were found to be false and misleading.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Clause (6) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ Clause (5) of Part I of the Second Schedule	

If a member in practice fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading, where he is concerned with that financial statement in a professional capacity, he will be held guilty under Clause (5).

- **Clause (6) of Part I of the Second Schedule**
  As per Clause (6) of Part I of Second Schedule if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity, he will be held guilty under Clause (6).

Part III – Case Discussion

- In given case, the Chartered Accountant had submitted the statements before the taxation authorities. These statements are based on the data provided by the management of the company. Although the statements prepared were based on incorrect facts and misleading, the Chartered Accountant had only submitted them acting on the instructions of his client as his authorized representative.

Part IV – Conclusion

- Hence the Chartered Accountant would not be held liable for professional misconduct

Author's Note

Here it is assumed CA was not aware that facts were incorrect and misleading. You can take other assumption and write alternative answer possible.

This question has been answered as per Professional Ethics. Look for QNO 378.100 in "Liabilities of Auditor" for similar question when it is specifically asked to answer as per Income Tax Act.

QNO 754.000	Second Schedule, Part I, Cl,6 Orders Under Negotiation Bhaskar CNO – PE.940/ CNO – PE.1040	Old Course-- (M15R, P17M, M20M) New Course-- (M20M,M23M)

Mr. Brainy, a Chartered Accountant in practice, is the auditor of Fair Ltd. He advised the Managing Director of the company to include 'orders under negotiation' in sales, to reflect higher profit and better financial position for obtaining bank loans in future. Mr. Brainy, thereafter, gave clean reports on the balance sheet prepared accordingly without examining the accounts.

Answer

Part I -- Relevant Standards & Laws

- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- **Clause (7) of Part I of the Second Schedule**
  It states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

- **Clause (2) of Part IV of the First Schedule**
  A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

Part III – Case Discussion

- In the given case, Mr. Brainy, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts. Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company.

Part IV – Conclusion

- Therefore, Mr. Brainy will be held guilty for professional and other misconduct under above mentioned Clauses to the Chartered Accountants Act, 1949.

Author's Note
Clause (6) of Part I of Second Schedule can also be referred as over valuation of sales consists a material misstatement, and a clean report has been issued by auditor

QNO 755.000	Second Schedule, Part I, Cl,7 –Audit Report Not Filed Within Time Bhaskar CNO – PE.1040	Old Course-- (M13E, P17M, N17M, N19R, N20M) New Course-- (S17M, N18R, N19R, N20M)

CA Dev, a practicing Chartered Accountant, did not complete his work relating to the audit of the accounts of a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirements

Answer

Part I -- Relevant Standards & Laws

- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

➢ A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

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

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, it was held, under a case, that he was guilty of professional misconduct under Clause (7).

Part III – Case Discussion

➢ In the given case, CA. Dev has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements.

Part IV – Conclusion

➢ Therefore, CA. Dev will be held guilty of professional misconduct under Clause (7) of Part I of the Second Schedule of the Chartered Accountants Act, 1949.

QNO 756.000	Second Schedule, Part I, Cl,7 –Failed to Discover Fraud which was expected to be detected Bhaskar CNO – PE.1040	Old Course-- (N10R, M14R, P17M, M18E) New Course—(N21E)

The Cashier of a company committed a fraud and absconded with the proceeds thereof. This happened during the course of the accounting year. The Chief Accountant of the company also did not know about fraud.

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

Discuss the position of the auditor with regard to the disciplinary proceedings.

OR

You were the statutory auditor of Speed Ltd., a PSU, for the year 2016-17. In the course of your audit, you did not observe any fraud having been committed during that year. However, the C & AG audit staffs during their routine inspection found that chief cashier of the Company have committed a fraud in Debtor s ledger and absconded with the amount. Investigation made in the fraud revealed that the Auditor did not exercise proper skill and care and performed his working an improper way.

Director of the Company intends to file disciplinary proceedings against the Auditor with the ICAI. Discuss the position of the auditor with regard to the disciplinary proceedings under Chartered Accountants Act, 1949 and Regulations there to.

Answer

Part I -- Relevant Standards & Laws

- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements"

Part II -- Requirements of Relevant Standards & Law

➢ **Clause (7) of Part I of the Second Schedule**

- **Failure to Exercise Reasonable Care and Skill:** Apparently, as it appears from the facts of the case that the auditor did not exercise proper skill and care and that he performed

his work in a desultory and haphazard manner. In this matter, the test for auditor's liability lies in whether he has applied reasonable care, skill and caution called for in the circumstances of the case and whether he reasonably used all the information that he came across in the course of audit.

- Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 requires that it is the duty of an auditor to bring to bear in the work he has to perform that skill, care and caution as per the circumstances in an honest and reasonable manner.

➢ **SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements"**

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional scepticism.

Part III – Case Discussion

➢ Cash is a very significant item in any situation and the fact that the cashier had left during the year without notice should have placed the auditor on alert as regards the cash book. In fact, the very fact that the cashier was absconding, i.e., left without any notice constituted sufficient circumstances to excite suspicion of the auditor to probe to the bottom.

Thus, having regard to SA 240 and a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

Part IV – Conclusion

➢ As it appears from the facts of the case, the auditor has been grossly negligent in performing his duties which constitutes professional misconduct. Thus, such instances require reference to Disciplinary Committee of the Council of the Institute.

~~If a member is found guilty by the Council of any of the acts or omissions stated in the Schedule, its finding with recommendations are to be referred to the High Court for decision.~~

Author's Note

➢ After 2007 amendment, going to high court is not required as per revised disciplinary proceedings

➢ Whenever question says fraud was not detected / handled properly also refer that there is failure to apply principles of SA 240.

QNO 756.500	**Second Schedule, Part I,Cl,7 --Putting Digital Signature on Resignation Letter of Previous Auditor** **Bhaskar CNO – PE.1040**	**New Course-- (N22R)**

Comment on the following with reference to the with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

Aagam Private Limited requested CA Sheetal, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited. CA Sheetal, without verifying the genuineness of the resignation letter, digitally signed the form and the said form was uploaded on the website of Registrar of Companies.

Answer

As per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Aagam Private Limited requested CA Sheetal, a practicing chartered accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied and pasted by another Director of Aagam Private Limited.

CA Sheetal, without verifying the genuineness of the Resignation Letter, digitally signed the Form and the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Rohit from directorship of the Aagam Private Limited had been occurred. It was noted that CA Sheetal had not taken any step to verify forged signature

	on resignation letter which anyone would have taken in normal circumstances. Consequently, CA. Sheetal would be held liable for professional misconduct as per Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

QNO 757.000	Second Schedule, Part I, Cl,7 --Certificate of Consumption Bhaskar CNO – PE.980/ CNO – PE.1040	Old Course-- (N10E, P17M) New Course-- (N18M)
	Mr. Mohan is a practising Chartered Accountant. He issued a certificate of consumption which did not reflect the correct factual position of the consumption of raw material by the concerned entity. It is found that the certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949 ▪ Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (2) of Part I of the Second Schedule** A chartered accountant is held guilty of professional misconduct if he certifies or submits a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or employee in his firm or any other chartered accountant in practice. ➢ **Clause (7) of Part I of the Second Schedule** Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 also applies to this case which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties. **Part III – Case Discussion** ➢ Mr. Mohan has issued a certificate of consumption which does not reflect the correct factual position of the consumption of raw material by the concerned entity. He has failed in his duty of examining the record. He has relied on the minutes of Board of director's meeting which is not proper evidence to show the consumption of raw material. The relevant record of production and stock register should have been scrutinized thoroughly and properly. **Part IV – Conclusion** ➢ Mr. Mohan will be held guilty of Professional Misconduct under Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	
	Author's Note ➢ **Whenever Certification is done without collecting proper evidence . Following shall be referred-** • **Clause 7 Part 1 of Second Schedule** • **Clause 2 Part 1 of Second Schedule** • **Clause 8 Part 1 of Second Schedule**	

QNO 757.500	Second Schedule, Part I, Cl 8 --MIS, Internal Inspection Report, Photos Instead of Attending Physical Verification Bhaskar CNO – PE.1040	New Course— (N20E)
	Nam & Co. conducted Stock Audit of DEF Ltd. as per instructions issued by HEG Bank. However instead of visiting the site **where the stock was lying, the** firm relied on the Management Information Systems report along with inspections reports and photographs of Stock taken by the employees of DEF Ltd. The photographs were also carrying the date and time printed on them. **Comment with reference to the Chartered Accountants Act, 1949 and its schedules thereto.**	
Answer	According to Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties". It is a vital clause which usually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.	

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

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.
From the above, it can be concluded that Nam & Co. is guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

QNO 758.000	**Second Schedule, Part I, Cl 8 Circulation Certification** **Bhaskar CNO – PE.1040**	**Old Course-- (M04E, N08E, M10E, N11E, N11R, M12E, N12M, P17M)** **New Course—(S17M,N22M, M23M)**

CA. ZZ who conducted ABC audit of a Marathi daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Accounts.

OR

CA. Prakash, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e., by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printer's bills and by not caring to ascertain how ma ny copies were sold and paid for. Is CA. Prakash liable to professional misconduct? Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto.

Answer

Part I -- Relevant Standards & Laws

- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- Chartered Accountant in practice is deemed to be guilty of professional misconduct if he "does not exercise due diligence or is grossly negligent in the conduct of his professional duties".

Part III – Case Discussion

- CA. ZZ conducted ABC audit of a Marathi daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Accounts

Part IV – Conclusion

- In the instant case, CA. ZZ did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts.

  To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential.

  Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence.

  Hence, CA. ZZ is guilty of professional misconduct as per Clause (7) of Part I of Second Schedule of Chartered Accountants Act, 1949.

Author's Note

- **Whenever Certification is done without collecting proper evidence. Following shall be referred-**
  - **Clause 7 Part 1 of Second Schedule**
  - **Clause 2 Part 1 of Second Schedule**
  - **Clause 8 Part 1 of Second Schedule**

QNO 759.000	**Second Schedule, Part I, Cl,8 –No Checking as No Change in Balance (Investments)** **Bhaskar CNO – PE.980/ CNO – PE.1040**	**Old Course-- (M10E, P17M, N20M)** **New Course-- (S17M, N18M, N20M)**
	Mr. A, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2015-16, the investment appeared in the Balance Sheet of the company of `10 lakhs and was the same amount as in the last year. Later on, it was found that the company's investments were only `25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.	

Answer

Part I -- Relevant Standards & Laws

- Clause (2) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949
- Clause (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

➢ As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, under

- **Clause (2) of Part I of the Second Schedule**
  If he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice
- **Clause (7) of Part I of the Second Schedule**
  Does not exercise due diligence or is grossly negligent in the conduct of his professional duties.
- **Clause (8) of Part I of the Second Schedule**
  If fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion

➢ The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

Part III – Case Discussion

➢ In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Part IV – Conclusion

➢ Accordingly, Mr. A, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

QNO 759.500	**Second Schedule,Part I,Cl,9 --Audit of Listed Company Without Peer Review Certificate** **Bhaskar CNO – PE.1040**	**New Course-- (M22E)**
	"CA K qualified as Chartered Accountant and started practice as proprietor in the name of M/s K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto."	

Answer

Clause (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" and if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures

	from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts and circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers. **Audit of Listed Companies:** Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI. In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the Chartered Accountants Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with. **Alternative Solution** Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the Chartered Accountants Act, 1949 and the regulations and guidelines made by Council thereunder. The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement. As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement. **Audit of Listed Companies:** Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, and hold a valid certificate issued by the Peer Review Board of the ICAI. In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on 14.05.2022 but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the Chartered Accountants Act, 1949.

QNO 760.000	**Second Schedule, Part I,Cl,10 --Did not keep money is separate bank account** **Bhaskar CNO – PE.1060**	**Old Course-- (N06E, P17M, M17R, N19R)** **New Course—(N19R)**
	M/s XYZ a firm of Chartered Accountants received ` 2 lakhs in January, 2015 on behalf of one of their clients, who has gone abroad and deposited the amount in their Bank account, so that they can return the money to the client in July, 2015, when he is due to return to India.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ A Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended". **Part III – Case Discussion** ➢ XYZ received the money in January, 2015 which is to be paid only in July 2015; hence it should be deposited in a separate bank account. **Part IV – Conclusion** ➢ In this case XYZ have failed to keep the sum of `2 lakhs received on behalf of their client in a separate Bank Account. Hence, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.	

QNO 761.000	Second Schedule, Part I, Cl,10 --Did not keep money is separate bank account (For Advance tax) Bhaskar CNO – PE.1060	Old Course-- (M10E, P17M) New Course—(N20E)
	Mr. Z, a practicing Chartered Accountant, received a sum of `1 lac on 1.9.2014 from a Client who intends to leave abroad for a period of a year, with a request that his advance tax liabilities to be paid over the three instalments. On 15th September 2014, 15th December 2014 and 15th March, 2015. After remitting the 1st instalment of advance tax on 15.9.2014, Z did not keep the Balance Money in a separate Bank account and he is of the opinion he will remit the money within reasonable time as per payment schedule of Advance tax	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ A Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he fails to keep moneys of his client other than the fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time. The term reasonable time would depend upon the circumstances of the case. Moneys which are intended to be spent within a reasonably short time need not be put in a separate bank account. **Part III – Case Discussion** ➢ Thus, in the instant case, Mr. Z should have kept the balance money into a separate bank account after remitting the first instalment of advance tax **Part IV – Conclusion** ➢ Hence, he is guilty of professional misconduct as per Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949.	

QNO 762.000	Second Schedule, Part I, Cl,10 --Did not keep money is separate bank account (For Advance tax, Adjusted with Fees Outstanding) Bhaskar CNO – PE.1060	Old Course-- (N14E, N16M, P17M, M19M) New Course—(M19M)
	M/s . ABC, a firm of Chartered Accountants received ` 2 lakhs in March, 2014 from a client to pay the Advance Tax. However, the firm has used that money for its own purpose and later on adjusted the same with the outstanding fee payable.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 **Part II -- Requirements of Relevant Standards & Laws** ➢ A Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended". **Part III – Case Discussion** ➢ M/s. ABC received the money in March 2014 for payment of the advance tax; hence it should be deposited in a separate bank account. **Part IV – Conclusion** ➢ Since in this case M/s. ABC have failed to keep the sum of `2 lakhs received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under clause 10 of part I of Second Schedule.	

QNO 763.000	Second Schedule, Part I,Cl,10 --Did not keep money is separate bank account (No Investment Made) Bhaskar CNO – PE.1060	Old Course-- (M04E, P17M) New Course—(S17M)
	A charitable institution entrusted ` 10 lakhs with its auditor's M/s Ram and Co., a Chartered Accountant firm, to invest in a specified security. The auditors pending investment of the money, deposited it in their Savings bank account and no investment was made in the next three months.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949	

	Part II -- Requirements of Relevant Standards & Laws ➢ If a Chartered Accountant in practice fails to keep moneys of his clients in a separate bank account or fails to use such moneys for purposes for which they are intended then his action would amount to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949. In the course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilise such funds only in accordance with the instructions of the client or for the purposes intended by the client. **Part III – Case Discussion** ➢ In the given case by depositing the client's money by M/s Ram and Co., a firm of Chartered Accountants, in their own savings bank account, the auditors have committed a professional misconduct. **Part IV – Conclusion** ➢ Hence in the given case, M/s Ram & Co. will be held guilty of professional misconduct under clause 10 of part I of Second Schedule.

QNO 764.000	**Second Schedule, Part I, Cl,10 –Using Client Money For Own Purpose** **Bhaskar CNO – PE.1060**	**Old Course-- (N14R, P17M)** **(New Course--M18E)**
	Mr. Ram, a Chartered Accountant in practice, received ` 15,00,000 on 15th December 2014 on behalf of one of his clients, who has gone to USA. Mr. Ram deposited the said amount in his saving bank account (SB Account). **As per instruction of the client, the said amount is to be returned to the client on March 31, 2015** when he will return to India. **On the occasion of birthday of his wife Sita, Mr. Ram withdrew ` 5,00,000 and spent on Birthday party.** He re-deposited ` 5,00,000 in the said SB account on 25th March 2015 and then returned the entire amount of ` 15,00,000 to the client on March 31, 2015.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Connected case Law: Mr. R. S. Murugai Vs. (1) S K Gadh & (2) V. K. Bajaj **Part II -- Requirements of Relevant Standards & Laws** ➢ A Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended." **Part III – Case Discussion** ➢ Mr. Ram received the money on 15th December 2014 which is to be paid to the client only on March 31, 2015. Hence, it should be deposited in a separate bank account. **Part IV – Conclusion** ➢ Since in this case Mr. Ram have failed to keep the sum of `15 lakhs in a separate Bank Account and utilised the part money for personal purpose on birthday occasion, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.	

QNO 765.000	**Second Schedule, Part II, Cl,1 –Loan for Article ship** **Bhaskar CNO – PE.1080**	**Old Course-- (M05E, N14E, P17M)**
	M/s. ABC, a firm of Chartered Accountants has taken a loan for acquiring computers, from a company whose Managing Directors' son is an Articled Trainee with A, a partner of M/s ABC.	
Answer	**Part I -- Relevant Standards & Laws** ▪ Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 ▪ Regulation 47 of the Chartered Accountant's Regulations, 1988 **Part II -- Requirements of Relevant Standards & Laws** ➢ **Clause (1) of Part II of the Second Schedule** A chartered accountant is deemed to be guilty of professional misconduct if he contravenes any of the provisions of Chartered Accountants Act, 1949 or Regulations made thereunder.	

➢ **Regulation 47 of the Chartered Accountant's Regulations, 1988**
Regulation 47 of the Chartered Accountant's Regulations, 1988, prohibits a member from accepting any premiums or loans or any deposit in any form from an articled clerk directly or indirectly.

Part III – Case Discussion

➢ M/s ABC has taken loan from a company whose Managing Director happens to be father of articled clerk with Mr. A, a partner of M/s ABC.

Part IV – Conclusion

➢ In this case, the articled trainee has no direct interest in that company. There has been a case wherein a chartered accountant was held guilty of professional misconduct because he took a loan from a firm in which the articled clerk and his father were both interested. But, in this case as per the facts, the articled trainee has no direct interest in the company. However, if relationship, direct or indirect, can be established in view of relationship of articled trainee with MD of the company, Mr. A of M/s ABC would be held liable for professional misconduct.

Thus, M/s ABC would be guilty of professional misconduct under this clause if it is proved that the loan was related to the engagement of the articled clerk.

Author's Note

⚠ **# Mistake point**

➢ Direct Interest -CA will be Guilty
- **If loan taken from article**
- **If loan is taken from proprietorship or partnership firm in which article is proprietor or partner**
- **If loan is taken from company in which article has substantial shareholding**

➢ Indirect Interest (Due to relationship) -CA will be Guilty
- **If loan is taken from proprietorship or partnership firm in which article's father is proprietor or partner**
- **If loan is taken from company in which article's father has substantial shareholding.**

➢ **However, if there is some connection as given in this question but indirect interest cannot be proved, write conditional answer taking assumptions regarding interest of article. If assumed that:**
- **Article has indirect interest – Guilty**
- **Article has no indirect interest – Not Guilty**

QNO 766.000	Second Schedule, Part II, Cl,1 Stipend Payment Bhaskar CNO – PE.1080	Old Course-- (N12R, N15R, N17E, N18M) New Course-- (N21M)

Case1

CA. X is a chartered accountant in practice. He has an articled trainee H. X has informed H that since his practice and receipt of fees is seasonal, the stipend would not be paid in the months of April to December, but would be paid from January to March and the shortfall for the earlier 9 months will be made good in these 3 months along with interest @ 5% p.a.

Answer

Part I -- Relevant Standards & Laws

- Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949
- Regulation 48 of the Chartered Accountant's Regulations, 1988

Part II -- Requirements of Relevant Standards & Laws

➢ **Clause (1) of Part II of the Second Schedule**
A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

Case 1

Part III – Case Discussion

➢ In the given case, CA. X has failed to make the payments of stipend to articled assistant every

	month in accordance with Regulation 48.
	Part IV – Conclusion
	➢ The fact that the articled assistant will be compensated with extra sum in the form of interest on late payment is not relevant and the plea that cycle of professional receipts from clients is seasonal is not acceptable. Therefore, CA. X is guilty of professional misconduct under Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 as he has contravened Regulation 48 by not making the payment every month.

QNO 766.500	**Second Schedule, Part II, Cl,1 UDIN not Generated** **Bhaskar CNO – PE.1080**	**New Course-- (N20E)**
	Mr. Kushal, a practicing Chartered Accountant has signed the GST Audit Reports, Tax Audit Reports u/s 44AB of the Income tax Act, 1961 for the financial year 2019-20 that are filed online using Digital Signature and without generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Is the contention of Mr. Kushal valid? Give your comments with reference to the Chartered Accountants Act, 1949 and schedules thereto.	
	Non Generation of UDIN: Whereas, to curb the malpractice of false/certification/attestation by the unauthorized persons and to eradicate the practice of bogus certificates and to save various regulators, banks, stakeholders etc. from being misled, the Council of the Institute decided to implement an innovative concept to generate Unique Document Identification Number (UDIN) mandatorily for all kinds of the certificates/GST and tax audit reports and other attest function in phased manner, for which members of the ICAI were notified through the various announcements published on the website of ICAI at the relevant times. In exercise of the powers conferred on it under clause 1 of Part II of the Second Schedule to the Chartered Accountants Act,1949, the Council of the Institute of Chartered Accountants of India issued the following guidelines for information of public and necessary compliance by members of the Institute A member of the Institute in practice shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him which are made mandatory from the following dates through announcements published on the website of the ICAI- • For all Certificates w.e.f. 1st February,2019. • For all GST and Tax Audit Reports w.e.f. 1st April, 2019. • For all other Audit, Assurance and Attestation functions, w.e.f. 1st July, 2019. **Conclusion**: UDIN will be applicable to GST & Tax Audit Reports signed by Mr. Kushal for the financial year 2019-20 that are filed online using Digital Signature. In case where there is no field for mentioning UDIN on digitally signed online reports, UDIN has to be generated and communicated to "Management" or "Those Charged with Governance" for disseminating it to the stakeholders from their end. Hence he will be held guilty under Clause 1 of Part II of the Second Schedule to the Chartered Accountants Act,1949.	

QNO 768.000	**Second Schedule, Part II, Cl,3 --False Information to Council about Article Attending College** **Bhaskar CNO – PE.1080/ CNO – PE.1120**	**Old Course-- (M12E, P17M)**
	A Chartered Accountant in practice had confirmed in the application made by his articled clerk to the Council for permission to study that the normal working hours of his office were 11 a.m. to 6 p.m. and the hours during which the articled clerk was required to attend college classes were 7 a.m. to 9.30 a.m. On inquiry from Principal of College, it was ascertained that the articled clerk used to attend classes from 10 a.m. to 1.55 p.m. The Chartered Accountant pleaded ignorance about the articled clerk attending the college classes during office hours. Will the Chartered Accountant be held guilty of professional misconduct?	
Answer	**Part I -- Relevant Standards & Laws**	
	▪ As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 ▪ As per Clause (3) of Part II of Second Schedule to the Chartered Accountants Act, 1949	

Part II -- Requirements of Relevant Standards & Laws

- **Clause (1) of Part II of Second Schedule**

  A member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council.

  The chartered accountant, as per Regulations also, is expected to impart proper practical training. There is a specific circular issued which guides on timing for training for article ship.

Part III – Case Discussion

- In the instant case, on inquiry from Principal of College, it was ascertained that the articled clerk used to attend classes from 10 a.m. to 1.55 p.m. The articled clerk must have not been attending office on a regular basis

Part IV – Conclusion

- Since the articled clerk must have not been attending office on a regular basis, the explanation of the Chartered Accountant cannot be accepted. It is also quite likely that the articled clerk would be availing leave quite often and coming late to the office.

  Under the circumstances, the Chartered Accountant is guilty of misconduct for making a misstatement to the institute in regard to the discharge of his professional duties.

Note:

- **As per Clause (3) of Part II of Second Schedule to the Chartered Accountants Act, 1949**

  Alternative Solution is possible as per Schedule II, Part II, Clause (3), a member is deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

  In the instant case, X knew about the college timing of his articled assistant and he had given false information to the institute knowing them to be false and hence he will be deemed to be guilty of professional misconduct.

Author's Note

Institute has provided an alternative solution also, however as per author it should not be an alternative solution but shall form part of the answer. Following clauses shall be mentioned:

- Clause (1) of Part II of Second Schedule **– As CA has contravened with the provisions of the Act or regulation.**
- Schedule II, Part II, Clause (3) **- CA has provided false information to the institute regarding the office hours of article assistant.**

QNO 769.000	**Second Schedule, Part II, Cl,3 --False Information to Council about Article, where article was employed at company** **Bhaskar CNO – PE.1080/ CNO – PE.1120**	**Old Course-- (M16M, N17M, N18M, N19M)** **New Course—(N18M ,N19M)**

A Chartered Accountant in practice certified in requisite Form that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 10 a.m. and 6 p.m. on a monthly salary of Rs. 17,000 and attended the office of the Chartered Accountant thereafter until 7 p.m. The Chartered Accountant pleaded that the articled assistant was on audit of the company.

Answer

Part I -- Relevant Standards & Laws

- As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- A member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder, or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training.

Part III – Case Discussion

- A Chartered Accountant in practice certified that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 10 a.m. and 6 p.m. on a monthly salary of Rs. 17,000 and attended the office of the Chartered Accountant thereafter until 7 p.m.

The Chartered Accountant pleaded that the articled assistant was on audit of the company.

Part IV – Conclusion

- In the instant case, the articled assistant is not attending office on timely basis and the explanation of the Chartered Accountant that the articled assistant was on audit of the company cannot be accepted particularly in view of the fact that articled assistant is getting monthly salary from that company. The Chartered Accountant would be held guilty of professional misconduct in regard to the discharge of his professional duties.

Author's Note

Schedule II, Part II, Clause (3) shall also be mentioned as CA must have provided false information to the institute regarding the office hours of article assistant.

QNO 770.000	Second Schedule, Part II, Cl,3 Included name of CA in empanelment without his knowledge Bhaskar CNO – PE.1120	Old Course-- (N07E, N08R, M11R, N13R, M16E, N16M, P17M, N18R, M18M, M20R) New Course-- (M18M, M20R)

AB & Co., a firm of Chartered Accountants, included the name of P as a partner while filing an application for empanelment as auditor for Public Sector bank branches. It was subsequently noticed that on the date of application, P was not a partner with AB & Co

Answer

Part I -- Relevant Standards & Laws

- As per Clause (3) of Part II of Second Schedule to the Chartered Accountants Act, 1949

Part II -- Requirements of Relevant Standards & Laws

- A Chartered Accountant whether in practice or not is guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its committees, Directors (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

Part III – Case Discussion

- In the instant case A B & Co. included another Chartered Accountant name as partner in his firm, in his application for empanelment as Auditor of branches of Public Sector Banks submitted to the Institute. In fact, such a member was not a partner of the said firm on the date of application.

Part IV – Conclusion

- He will be held guilty of professional misconduct.

Author's Note

It's a misconduct of second schedule part II clause 3 because empanelment for branch audits is done by ICAI not individual banks. Application was made to ICAI. If false information is given in tender , empanelment to other parties then first schedule part III clause 3 would have been applicable.

QNO 770.500	Multiple Cases UNIQUE	Old Course-- (N21R) New Course-- (N21R)

The Director (Discipline) of the ICAI received information of alleged misconduct against Mr. Jayprakash, the proprietor of JP & Associates, as follows:-

(i) Audit of a college was accepted by JP & Associates in which Mr. Jayprakash is working as a part-time lecturer and also, he had not taken permission of the ICAI for working as a part-time lecturer in the college.

(ii) An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP C Associates' was mentioned.

On the basis of above information and along with certain evidence against Mr. Jayprakash, he was found guilty and so he was reprimanded and a fine of ₹ 1 lakh was imposed by an order passed against him dated 12th July, 2020.

Against the said order, Mr. Jayprakash preferred an appeal with the Appellate Authority on 17th August, 2020 by submitting a statement of appeal along with the application form of appeal. During such appellate proceedings, it was discovered that the said statement of appeal contained some facts

	which were false to which Mr. Jayprakash admitted it to be false and apologized for it. **(a) Mr. Jayprakash has violated which of the provisions of the Chartered Accountants Act, 1949?** **(b) Before which authority, the matter of Mr. Jayprakash would have been placed and what maximum punishment could have been imposed on him by the said authority in accordance with the Chartered Accountant Act, 1949?**
Answer	Mr. Jayprakash has violated following provisions of the Chartered Accountants Act, 1949: (i) As per Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest. In this connection, as per the decision of the Council of the ICAI, a Chartered Accountant should not by himself or in his firm name accept the audit of a college, if he is working as a part-time lecturer in the college. Thus, by accepting audit of a college in which he is working as a part -time lecturer, Mr. Jayprakash has violated the restriction imposed under Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949. (ii) As per Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Members of the Institute in practice may engage in a part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute, after obtaining the specific and prior approval of the Council in each case. Mr. Jayprakash had not taken permission of the ICAI for working as a part -time lecturer in the college and so has violated the restriction imposed under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949. As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means. In this connection, members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, mentioning a firm's name or CA Logo is not permitted. An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor ,JPC Associates' was mentioned. Thus, firm's name was mentioned which is not allowed and thus, Mr. Jayprakash has violated the restriction imposed under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949. (iv)As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the ICAI shall be deemed to be guilty of professional misconduct, if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority, any particulars knowing them to be false. Mr. Jayprakash in the statement of appeal submitted with the Appellate Authority mentioned some facts knowing them to be false and thus, he has violated the restriction imposed under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

	(b) As Mr. Jayprakash has been alleged of misconduct falling in First as well as Second Schedule, so the matter would be placed before the Disciplinary Committee. The maximum punishment which could have been imposed on him by the said authority would be:- (i) reprimanding the member. (ii) removing name of the member permanently or for any duration, it thinks fit. (iii) imposing fine upto ` 5,00,000.

QNO 776.500	**NETWORK GUIDELINES & ROTATION** **Bhaskar CNO – PE.1430**	**New Course—(N22M)**
	AJ & Associates and PK & Co., chartered accountant firms have joined the Network firm A to Z & Affiliates registered with Institute. AJ & Associates was statutory auditor of B Ltd. for last 10 years. Due to rotation of auditor as per section 139 (2) of Companies Act, 2013, B Ltd. retires AJ & Associates and appoints PK & Co., as auditor for the year 2020-21. Comment as per Chartered Accountant Act, 1949 - Guidelines for Networking.	
Answer	As per Council General Guidelines, 2008, Chapter XV, Guidelines for Networking, once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular in those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring. In the given situation, AJ & Associates was statutory auditor of B Ltd. For last 10 years and due to rotation of auditor as per section 139(2) of the Companies Act, 2013 B Ltd., retires AJ & Associates and appoints PK & Co. as auditor for the year 2020-21. It may be considered that AJ & Associates and PK & Co., chartered accountant firms have joined the network firm namely A to Z & Affiliates registered with Institute. In view of above Guidelines for Networking PK & Co., is disqualified for appointment as an auditor of B Ltd.	

PART - 4 COUNCIL GUIDELINES

Author's Note

Common for answers related to Council Guidelines 2008

Clause (1) of Part II of Second Schedule is not mentioned by the institute in any of the answers related to Council Guidelines 2077608. Module also maintains the institute's view.

However, if the students want to include additional reference, they can also mention the clause below:
"As per Clause (1) of Part II of Second Schedule, a member of the institute will be held guilty of professional misconduct if he contravenes any of the provisions of this act or regulations made thereunder or any guidelines issued by the council"

QNO 771.000	Audit Fees Progressive Basis Bhaskar CNO – PE.1180	Old Course-- (N08R, M09E, M11R)
	D, who conducts the tax audit u/s 44AB of the Income Tax Act, 1961 of M/s ABC, a partnership firm, has received the audit fees of ` 25,000 on progressive basis in respect of the tax audit for the year ended 31.3.2015. The audit report was, however, signed on 25.5.2015.	
Answer	**Part I -- Relevant Laws** ▪ Council General Guidelines2008- Appointment of an auditor when he is indebted to a concern ▪ Explanation to Section 288 of Income Tax Act, 1961 ▪ ICAI Research Committee **Part II -- Requirements of Relevant Laws** ➢ **Council General Guidelines, 2008** A member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ` 1,00,000/-. ➢ **Explanation to Section 288 of Income Tax Act, 1961** An individual who, or his relative or partner is indebted to the assessee cannot conduct tax audit, provided that the relative may be indebted to the assessee for an amount not exceeding INR 1,00,000. ➢ **ICAI Research Committee** However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage. **Part III – Case Discussion** ➢ In the instant case, Mr. D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. He has received the audit fees of ` 25,000 in respect of the tax audit for the year ended 31.3.2015 which is on progressive basis. **Part IV – Conclusion** Therefore, Mr. D will not be held guilty for misconduct	

QNO 772.000	Previous Audit Fees Unpaid, Sick Unit Bhaskar CNO – PE.1180	Old Course-- (N05E, N16E, P17M)
	Mr. C accepted the statutory audit of M/s PSU Ltd., whose net worth is negative for the year 2013-14. The audit was to be conducted for the year 2014-15. The audited accounts for the year 2014-15 showed liability for payment of tax audit fees of ` 15,000 in favour of Mr. E, the previous auditor. **OR** **Mr C accepted the statutory audit of M/s PSU Ltd, whose net worth is negative for the year 2007-08 The audit was to be conducted for the year 2008-09 The audited accounts for the year 2008-09 showed**	

	liability for payment of tax audit fees of Rs15,000 in favour of Mr E, the previous auditor
Answer	**Part I -- Relevant Laws** ▪ Council General Guidelines 2008-Appointment of an Auditor in case of non-payment of undisputed fees **Part II -- Requirements of Relevant Laws** ➢ A member of the Institute of Chartered Accountants of India in practice shall be deemed to be guilty of professional misconduct if he accepts appointment as auditor of an entity in case the undisputed audit fee of another chartered accountant for carrying out the statutory audit under Companies Act or various other statutes has not been paid. ➢ As per the proviso, such prohibition shall not apply in case of a sick unit where a sick unit is defined to mean "where the net worth is negative". **Part III – Case Discussion** ➢ In the given case, Mr. C accepted the statutory audit of M/s PSU Ltd., whose net worth is negative for the year 2013-14. **Part IV – Conclusion** ➢ In the instant case, though the undisputed fees are unpaid, Mr. C would still not be guilty of professional misconduct since the M/s PSU Ltd. is a sick unit having negative net worth for the year 2013-14.

QNO 773.000	**Fees from Other Assignments** **Bhaskar CNO – PE.1180**	**Old Course-- (M07E, M09R)**
	A is the auditor of Z Ltd., which has a turnover of ` 200 crore. The audit fee for the year is fixed at ` 50 lakhs. During the year, the company offers an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of ` 1 crore. A seeks your advice on accepting the assignment.	
Answer	**Part I -- Relevant Laws** ▪ Council General Guidelines 2008 - Appointment as Statutory Auditor **Part II -- Requirements of Relevant Laws** ➢ A member of the Institute in practice shall not accepts the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of ` 50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council **excluding** audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority. **Part III – Case Discussion** ➢ In the given case, A auditor of Z Ltd having turnover INR 200 crore fixed audit fees at INR 50 Lakhs. During the year, the company offers A an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of ` 1 crore **Part IV – Conclusion** ➢ In view of the above position, it would be a misconduct on A's part if he accepts the management consultancy assignment for a fee of ` 1 crore.	

QNO 774.000	**Minimum Fees** **Bhaskar CNO – PE.1160**	**Old Course-- (N05E, M09R, M09E, N15E, P17M, M19M)** **New Course-- (M19M)**
	M/s LMN, a firm of Chartered Accountants having 5 partners accepts an audit assignment of a newly formed private limited company for audit fees of ` 5,000.	
Answer	**Part I -- Relevant Laws** ▪ Council General Guidelines 2008 - Minimum Audit Fee in respect of Audit ▪ (Repealed Now) **Part II -- Requirements of Relevant Laws** ➢ This chapter of Council General Guidelines 2008is repealed from 8th June 2011. So, there is no minimum or maximum audit fees.	

Recommendatory fees are generally given every year at the end in Guidance Note on Tax Audit. However, such prescribed minimum audit fee is recommendatory, not mandatory in nature.

Part III – Case Discussion

- M/s LMN, a firm of Chartered Accountants have 5 partners and have accepted an audit assignment of a newly formed private limited company for audit fees of Rs 5,000.

Part IV – Conclusion

- So as per the above acceptance of audit assignment by M/s LMN, a firm of Chartered Accountants for audit fees of Rs 5,000 is not violation of any provisions.

No of partner in the firm for determination of fees is of no relevance as the relevant **Chapter XII of Council General Guidelines 2008 which talks about the minimum audit fee in respect of Audit has been repealed.**

Therefore M/s LMN will not be held liable for guilty of misconduct.

QNO 774.010	**Council General Guideline 2008--Tax Audit Limit** **Bhaskar CNO – PE.1160**	**New Course-- (S17M)**

A member of the institute shall not accept in a year more than the specified number of tax audits under section 44AB of the Income Tax Act.
Mr. Gaurav is a partner in M/s. XYZ & Co., a firm of Chartered Accountants with 6 partners. During the assessment year 2015-16, Mr. Gaurav alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

Answer

Part I -- Relevant Laws

- Council General Guidelines 2008

Part II -- Requirements of Relevant Laws

- As per Council General Guidelines 2008, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961.

  It is also provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

  In the case of firm of Chartered Accountants in practice "the specified number of tax audit assignments" means, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

  Further, as per clarification issued by the Institute on Tax Audit Assignments, tax audit reports may be signed by the partners in any manner whosoever in accordance with specified audit limits. Thus, one partner can individually sign all the tax audit reports subject to specified tax audit assignment limits on behalf of all the partners in the firm of Chartered Accountants in practice or all the partners of the firm can collectively sign the tax audit reports.

Part III – Case Discussion

- In the instant case, there are 6 partners in M/s XYZ & Co., a Chartered Accountants firm, accordingly specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6 partners) = 360. Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports. This maximum limit of 360 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report

Part IV – Conclusion

- Assuming Mr. Gaurav has signed 290 tax audit reports consisting of both corporate and non-corporate assessee on behalf of firm and remaining partners are signing audit reports within the specified number of tax audit assignments u/s 44AB i.e. Up to 70.
  Hence, Mr. Gaurav shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360.

QNO 776.000	Not Maintaining Books of Accounts (Not Exceeding 44AA Limit) Bhaskar CNO – PE.1160	Old Course-- (M05E, N05E, M16R, N16R, P17M, N18E) New Course—(S17M, M18R, N19E,N22E)

L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.

OR

L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961. (P17M)

OR

CA. Elegant is in practice for two years and runs his proprietorship firm in the name of "Elegant & Co.". He maintains notes in his mobile in which he writes the fees received from various clients. Based on his record, he prepares and files his income tax return.

OR

Write a short note on Record of Audit Assignments (as required by ICAI regulations)

OR

Mr. X, a Chartered Accountant in Practice filed his income tax return for the Assessment Year 2018-19under section 44ADA of the Income Tax Act, 1961, declaring his income on presumptive basis. In a disciplinary proceeding against him for an alleged misuse of funds of his clients, it was asked that he should submit his books of accounts for the financial year ended on 31/03/2018. Mr. X refused to submit books of accounts on the ground that he had not maintained any books and even for income tax purposes, he submitted his Return of Income on a presumptive basis. Is he right in putting such a defence? Analyze the issues in the light of Professional Code, if any

Answer

Part I -- Relevant Laws

- Council General Guidelines 2008- Specified number of audit assignments
- Council General Guidelines 2008- Maintenance of books of accounts

Part II -- Requirements of Relevant Laws

➢ **Chapter VIII of Council General Guidelines 2008 - Specified number of audit assignments**

The Council of the Institute of Chartered Accountants of India specified that a Chartered Accountants in practice as well as a firm in practice shall maintain a record of the audit assignments accepted as laid out in guidelines issued by the Council of the ICAI under Part II of Second Schedule to the Chartered Accountants Act, 1949 in respect of ceiling on audits containing following particulars:

- Name of Company Audit/ Assignment.
- Regn. No.
- Date of appointment with Registrar of Companies.
- Date of acceptance.
- Date on which Form ADT-1 as per the provisions and rules made under Companies Act, 2013.

➢ **Chapter V of the Council General Guidelines, 2008 - Maintenance of books of accounts**

A member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of accounts including the following-

(i) a Cash Book
(ii) a Ledger

Part III – Case Discussion

➢ In the given case, L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.

Part IV – Conclusion

➢ Hence, Mr. L is guilty of professional misconduct.

OTHERS (P.E)

QNO 779.000	Excessive Fees Bhaskar CNO – PE.1180	Old Course-- (M13R, N15R, M17M, P17M, M18M) New Course-- (M18M)

MNC Pvt. Ltd. appointed CA. Posh for some professional assignments like company's ROC work, preparation of minutes, statutory register etc. For this, CA. Posh charged his fees depending on the complexity and the time spent by him on each assignment. Later on, MNC Pvt. Ltd. filed a complaint against CA. Posh to the Institute of Chartered Accountants of India (ICAI) that he has charged excessive fees for the assignment's comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI.

Answer

Part I -- Relevant Standards & Laws

- Provisions of Chartered Accountants Act, 1949
- Council General Guidelines, 2008

Part II -- Requirements of Relevant Standards & Laws

- The prescribed scale of fees for the professional assignments done by the chartered accountants is recommendatory in nature. Charging an excessive fee for a professional assignment does not constitute any misconduct in the context of the **provisions of the Chartered Accountants Act, 1949 and regulation** made thereunder since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between the member and the client.

Part III – Case Discussion

- In the given case, CA. Posh has charged excess fees comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI. In this context, it may be noted that the scale of fees is the minimum prescribed scale of fees.

Part IV – Conclusion

- From the above facts and provisions, it may be concluded that CA. Posh is not liable for any misconduct under the Chartered Accountants Act, 1949. Therefore, the contention of MNC Pvt. Ltd. is not tenable.

Author's Note

Minimum fees were prescribed in council guidelines 2008 however these minimum fees are discontinued from 2011.As on today CA institute is not having any mandatory minimum or maximum fees.

Recommendatory fees is given in annexures of tax audit guidance notes, however being recommendatory in nature Chartered Accountants may or may not follow it.

QNO 780.000	Fundamental Principles Bhaskar CNO – PE.010	Old Course-- (N16E,N22E)

The professional accountants need to observe certain fundamental principles, which are covered in the Code of Ethics of the Institute of Chartered Accountants of India. Briefly explain each of the five principles which needs to be complied by the Chartered Accountants?

In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:

i) Integrity – A professional accountant shall comply with the principle of integrity, **which requires an accountant to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness.

(ii) Objectivity – A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

(iii) Professional Competence and Due Care – A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

(a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and

	professional standards and relevant legislation; and (b) act diligently in accordance with applicable technical and professional standards. **(iv) Confidentiality** – A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. **(v) Professional Behaviour** – A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that accountant knows or should know might discredit the profession. Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

QNO 780.005	**Types of Threats** **Bhaskar CNO – PE.140**	**New Course—(N20E)**
	The audit team is preparing to conduct audit for ABC Company for the period ending 31.3.2020. However, the audit team has not received its audit fees from ABC Company for its audit concluded for the period ended 31.3.2019. The audit team might be tempted to issue a favourable report so that ABC Company is able to secure a loan to settle the fees outstanding for their 31.3.2019 audit. The audit team is not complying the fundamental principles of auditing hence hindering the Auditor's Independence. Explain the types of threats that may hinder Auditor's Independence while issuing Audit Report.	
Answer	In the given case of ABC Company, audit team is preparing to conduct its audit for the F.Y ending on 31.03.2020. Audit firm did not receive its fees for the F.Y ending on 31.03.2019. Audit team is tempted to issue a favourable report so that auditee can secure a loan to settle auditor's outstanding fees. The audit team did not comply with fundamental principles of auditing and hence compromising Auditor's Independence. Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories: The Code of Ethics for Professional Accountants prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are: 1. Self-interest threats**,** which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement. 2. Self-review threats**,** which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non-audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor is having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit. 3. Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, and e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. 4. Familiarity threats are self-evident **and** occur when auditors form relationships with the client

	where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees. 5. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

QNO 780.010	**Self Interest VS Self Review** **Bhaskar CNO – PE.140**	**New Course-- (M18E)**
	Distinguish Self-interest threat from self-review threat in an Assurance Engagement.	
Answer	**Part I -- Relevant Standards & Laws** **As per Code of Ethics of ICAI** **Part II -- Requirements of Relevant Standards & Laws** ➢ **Self Interest Threat:** Self-interest threats, which may occur as a result of the financial or other interests of a professional accountant or of a relative. Circumstances that may create self-interest threat • A financial interest in a client or jointly holding a financial interest with a client. • Undue dependence on total fees from a client • Having a close business relationship with a client. • Concern about the possibility of losing a client. • Potential employment with a client. • Contingent fees relating to an assurance engagement. ➢ **Self-Review Threat:** Self-review threats, which may occur when a previous judgment needs to be re- evaluated by the professional accountant responsible for that judgment; **Examples of circumstances that may create self -review threats** • The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice. • Reporting on the operation of financial systems after being involved in their design or implementation. • Having prepared the original data used to generate records that are the subject matter of the engagement. • A member of the assurance team being, or having recently been, a director or officer of that client. • A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement. • Performing a service for a client that directly affects the subject matter of the assurance engagement.	

QNO 780.050	**Engagement specific safeguards for threats-** **Bhaskar CNO – PE.170**	**New Course-- (M19E)**
	A professional accountant in public practice is always subject to various threats in compliance with fundamental principles of his profession and you, as a professional accountant, is worried about engagement specific threat in your audit assignment of M/s Soft Ltd. and want to implement some measures to eliminate and reduce the same. Enumerate some engagement specific safeguards which you may introduce in your work environment to ward off such threats.	
	➢ **Engagement-specific safeguards in the work environment may include** • Consulting **an independent third party, such as a committee of independent directors**, a professional regulatory body or another professional accountant. • **Discussing ethical issues with those charged with governance** of the client.	

- **Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.**
- Involving an **additional professional accountant** to review the work done or otherwise advise as necessary.
- Involving **another firm to perform or re-perform part of the engagement.**
- **Rotating senior assurance team personnel.**

QNO 782.005	KYC – Applicability Bhaskar CNO – PE.1120	New Course-- (S21M)

Mr. F, a Chartered Accountant, gave advisory services to PQR Pvt. Ltd. Further, he gave them GST consultancy, compilation engagement for historical financial information and helped in ERP set up. Later, the company turned out to be a part of a group of companies involved in money laundering. Mr. F was asked to provide details of the companies. Mr. F refused on the grounds that he gave only consultancy services to the company and wasn't supposed to keep any information about the company. Is Mr. F right as per the guidelines issued by the ICAI?

Part I -- Relevant Standards & Laws

- **As per KYC Norms of Council of ICAI**

Part II -- Requirements of Relevant Standards & Laws

- The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI issued such norms to be observed by the members of the profession who are in practice.
- In the given case of PQR Pvt. Ltd., a Corporate Entity, Mr. F should have kept following information:
  - **General Information**
    - Name and Address of the Entity
    - Business Description
    - Name of the Parent Company in case of Subsidiary
    - Copy of last Audited Financial Statement
  - **Engagement Information**
    - Type of Engagement
  - **Regulatory Information**
    - Company PAN No.
    - Company Identification No.
    - Directors' Names & Addresses
    - Directors' Identification No.

Author's Notes
KYC is applicable only to attest function. Here Attest function covers Compilation Engagement, Audits & Review. For only Consultancy work KYC is not required.

QNO 782.010	Internal Audit + GST Audit Bhaskar CNO – PE.1020	Old Course-- (M19R) New Course—(M19R)

WCP & Co LLP are the internal auditors of DEF Ltd. WCP & Co LLP also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously.

- **The Council of the Institute,** while considering the issue whether an internal auditor of an entity can also undertake GST Audit of the same entity as required under the Central Goods and Service Act, 2017, decided, that internal auditor of an assessee, whether working with the organization or independently practising Chartered Accountant being an individual chartered accountant or a firm of chartered accountants, cannot be appointed as his Tax auditor (under the Income Tax Act,1961). Upon consideration, **the Council decided that based on the conflict in roles as statutory and internal auditor simultaneously, the bar on internal auditor of an entity to accept tax audit** (under Income Tax Act, 1961) will also be applicable to GST Audit (under the Central Goods and Service Act, 2017). Accordingly, an Internal Auditor of an entity cannot undertake GST

	Audit of the same entity. ➢ In the instant case, WCP & Co LLP are the internal auditors of DEF Ltd. and it also agreed to undertake Goods and Service Tax (GST) Audit of DEF Ltd simultaneously & Co LLP will be held guilty for misconduct.

	Author's Note
	Restrictions on Internal Auditor
	• Internal auditor cannot be appointed as statutory auditor, tax auditor, GST auditor, cost auditor & bookkeeper of company. So internal auditor cannot do 5 things.
	• Statutory auditor cannot do 3 things, but they can do other 2 things
	  ○ Statutory auditor cannot become internal auditor, cost auditor & bookkeeper
	  ○ Statutory auditor can become tax auditor, GST auditor
	• In short to remember, internal auditor cannot do anything, statutory auditors and tax auditors can be same

19 Miscellaneous

QNO 784.500	Ind AS (Applicability)	Old Course-- (N17E, M19M) New Course-- (N18M, M19M, N19E)

As an auditor of a company registered under section 8 of the Companies Act, 2013 you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian According Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2019 under Ind-AS.
The management of the company is however of the strong view that being a section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are therefore prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statements ?

Part I -- Relevant Standards & Laws

- **Section 129(1) of the Companies Act, 2013**
- **Section 133 of the Companies Act, 2013**
- **Section 8 of the Companies Act, 2013**

Part II -- Requirements of Relevant Standards & Laws

➢ **Applicability of IND AS:**

- **Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:**
- Financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013
  And
- the items contained in such financial statements shall be in accordance with the accounting standards.
- **Further, as per section 133 of the Companies Act, 2013,**
  - the Central Government has notified Companies (Indian Accounting Standards) Rules, 2015 in exercise of the powers conferred by section 133.
  - The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.
- Here, it may be noted that the companies covered under **Section 8** are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, companies registered under Section 8 are not exempted from the requirements of **section 133 and section 129 of the Companies Act, 2013**.

Part III – Case Discussion

➢ In the given case, only contention of management that being a section 8 company having charitable object, Ind-AS cannot apply to the company, therefore financial statements prepared under the earlier GAAP and a note for the same is given.

Part IV – Conclusion

➢ It is not tenable. However, the auditor is required to ensure the applicable monetary limits w.r.t Ind-AS and need to advise the management to prepare the financial statements as per Ind-AS accordingly. In case of non-compliance the auditor should report accordingly.

QNO 786.100	No provision of PF on leave encashment	Old Course-- (N20E)
	G Ltd. changed its employee remuneration policy from April 2019 4 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy., the employees can either utilize or encash it. As at 31st March, 2020, the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed. leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment.	
Answer	**Change of Employee Remuneration Policy-PF on Leave Encashment: As per Para 11 of AS-15 on "Employee Benefits"**, issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences. In the given situation, G Ltd. has changed its employee remuneration policy from April 1, 2019 regarding providing for 12% contribution to PF on leave encashment. Since the company obtained actuarial valuation for leave encashment, it is obvious that the **compensated absences are accumulating in nature**. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date. Here, G Ltd. will accumulate the amount of leave encashment benefits as it is the **liability of the company to provide 12% PF** on amount of leave encashment. Hence the **contention of the auditor is correct** that full provision should be made by the company.	

QNO 786.200	Remote Working Model (Pros and Cons)	Old Course-- (N20E)
	Auditing virtually through remote working model has its own pros and cons for the Auditors. Elucidate any four pros and cons with reasons	

Answer

Auditing Virtually through Remote Working Model -

Auditing virtually has several benefits as well as disadvantages for the Auditors, the details of which are summarised as under.

Pros of auditing virtually through remote working model:

Particulars	Remarks
Heightened use of Technology for better execution	Virtual audit is possible only with the use of technology. Hence embracing technology helps in better audit delivery and in making auditors tech savvy to prepare for the future
Improved Audit Quality	Use of technology helps in improving the audit quality.
Greater Audit Coverage	With the interplay of technology and the availability of quality time — the audit coverage could be enhanced significantly.
Audit Efficiencies	Through proper planning, upfront engagement with the client, audit efficiencies are possible
Lesser cost of delivery	The cost of audit delivery would be comparatively lesser through remote working.
Higher scalability	The possibility of capacity ramp up is feasible without any restrictions on availability of space etc.
High speed	Information can be generated very quickly. Even complex reports in specific report format can be generated for audit purposes without

	much loss of time. This cuts down the time enabling the auditor to extend their analytical review with high speed of operation.
Low clerical error	Computerised operation being a systematic and sequential programmed course of action the changes of commission of error is considerably reduced. Clerical error is highly minimised
Concentration of duties	Computer programs perform more than one set of activities at a time thereby restricting the duty of personnel involved in the work.
Control distribution of the output and timely Corrections of errors	Auditor being able to control distribution of the output and ensuring the timely correction of errors, for example, if the wrong input file were to be used.
Cons of auditing virtually through remote working model:	
Lack of conclusive Evidence	Aspects such as physical verification of inventory etc. requires physical presence and the same cannot be done virtually.
High level of Dependency	Dependency on technology and various infrastructure associated with it would pose challenges
Increased Time in Coordination	Time spent in coordination is very high
Security and compliance issues	The entire audit process is carried out with the help of technology which is prone to various security concerns. Further, aspects relating to confidentiality, data protection etc. are very critical for a successful virtual audits. Further, the possibility of nonidentification of frauds/ reliance on fake scanned documents etc. is very high in a virtual audit environment
Feel of Audit and Client engagement	In the absence of face to face interactions, the real feel of the audit and the client engagement could be a challenge.
Non-availability of sufficient IT knowledge and expertise:	The audit team should have sufficient knowledge to plan, execute and use the results of the same. In the absence of sufficient knowledge it would be difficult to audit through remote working model
Non-availability of suitable computer facilities and data in suitable format:	The auditor may plan to use other computer facilities when the use of remote working model on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer
Impracticability of manual tests due to lack of evidence:	Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.
Time constraints in certain data	Time constraints in certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make

		arrangements for the retention of data required, or may need to alter the timing of the work that requires such data

QNO 786.500	COVID-19 Impact Case Study	Old Course-- (N20E)

William & Sons Limited are the well-known in the hospitality and the entertainment industry with their chain of hotels, travel agencies etc. They arrange packaged tours for customers both in India and abroad. A snapshot of their financials for the previous year ended 31ST March 2020 is given below:

Particulars	Amount in INR	Remarks
Share Capital	**5000**	**Includes fully convertible preference share capital (before 2021) of INR 2000 Mio**
Reserves & surplus	**200**	**Includes revaluation reserve of INR 100 Mio**
External commercial borrowing	**8800**	**No cover through hedging**
Current Assets	**2200**	**Primarily receivables from travel companies who were enjoying credit terms from the company**
Current Liabilities	**6550**	**Represents payments to creditors and banks**
Property Plant Equipment (incl Goodwill of INR 2200 Mio)	**11750**	**Goodwill has arisen based on the acquisition of hotels**

Their business has been severely impacted by COVID-19 pandemic during the period April to June 2020 and the Company has to submit its audited financial statements for the quarter ended 30 June 2020 to its investors. What are the key considerations to be taken into account whilst auditing the financial statements of the Company?

Answer

Key Audit Considerations to be taken into account whilst auditing the financial statements: The financial statements have various items which would have been affected by the outbreak of COVID-19. In addition to the detailed list of items of financial statements mentioned in the situation, specific accounting issues could arise in the following areas:

1. Share Capital:
   - **Status of conversion** of Preference Share Capital and implication;
2. Reserve and Surplus:
   - 50% of the reserve is revaluation reserve which is **not free reserve**.
3. External Commercial borrowing :
   - Repayment capacity.
   - Forex impact.
   - Any restructuring / **change** in the terms of repayments to be checked.
4. Current Assets:
   - **Expected credit losses** on the receivables considering the industry in which the company operates. In the instant case current assets are primarily receivable from travel companies who were enjoying credit terms from the company and impact of Covid-19 on travel agency needs assessment.
   - **Inventory valuation**, if any inventory is lying with the company.
   - **Current ratio** assessment
5. Current liabilities
   - **Repayment** capacity.
   - **Liquidity** position to be analysed.
6. Goodwill
   - **Impairment** assessment.
7. Property, Plant and Equipment:
   - **Impairment** assessment.
   - **Change in useful lives**/ residual values.

In the given situation, on account of COVID-19 which has been prevailing, the liquidity position of the

	Company is under distress. The **auditor is required to discuss with the management** as to how they are perceiving current and the near future position and thereafter assess the effect of estimation uncertainty or the risk assessment and audit evidence supporting these accounting estimates and related disclosures that may be affected by the impact of COVID-19 on the business of the entity and the economic environment. After assessment of the entire condition, the auditor may discuss **about the going concern position** of the company. The auditor is also required to **ensure disclosures to be given** in the financial statements are as per ICAI advisory.

QNO 786.800	**Treatment of various matters in financial statement.**	**Old Course-- (N20M) New Course—(N20M)**
Answer	**As an Auditor give your comments for the following disclosures made by a Company which adopted Ind AS for compilation of Financial Statements:** **(i) In the Balance Sheet, the sub-head inventories contained an item "goods in transit "against which a consolidated amount consisting of aggregate of the cost of raw materials in transit and loose tools which are billed on company, but delivery not been made to the company had been specified.** **(ii) Provision for doubtful debts of trade debtors was grouped under, "Provisions" undercurrent liabilities.** **(iii) Sale proceeds of scrap incidental to manufacture were included in "Other Income".**	
	➢ **Goods in Transits:** As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct. ➢ **Provision for Doubtful Debts of Trade Debtors was grouped in "Provisions" under current liabilities:** The term 'doubtful debts' is an adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37 "Provisions, Contingent Liabilities and Contingent Assets". Thus, provision should be shown as deduction from gross value of (net) trade receivable. ➢ **Sale Proceeds of Scrap incidental to manufacture were included in "Other Income":** Asper Ind-AS 2 "Inventories", sale proceeds of scrap incidental to manufacture should be deducted from the cost of the main product. Thus, presentation of sale proceeds of scrap as other income is not correct. Alternatively, sale of manufacturing scrap arising from operations for a manufacturing company could be treated as other operating revenue since the same arises on account of the company's main operating activity.	

QNO 795.000	**Disclosure as per Schedule III (Multiple Cases)**	**Old Course— (N20E)**
	Comment on the disclosure compliances from the following information in respect of the financial statements of PP Ltd. which have to be drawn up in compliance with Ind AS, under Division II of Schedule III to the Companies Act, 2013. **(i) Insurance claims receivable is classified as Non-current Trade Receivables.** **(ii) Foreign exchange differences relating to foreign currency borrowings to the extent not capitalized in accordance with Ind AS 23 is disclosed under other expenses.** **(iii) Interest on shortfall in payment of advance income-tax is clubbed with the current tax disclosed on the face of the statement to profit and loss account.** **(iv) Share based payment to employees in accordance with Ind AS 102 are disclosed under finance cost.** **(v) Expenditure on CSR activities has been disclosed in the notes to the cash flow statement.**	
Answer	**Division II of Schedule III of the Companies Act, 2013:** (i) Insurance claims receivable should be classified as **"other financial assets" and each such item**	

	should be disclosed nature-wise. Thus, disclosure of insurance claims receivable by the company under Non-current Trade Receivable **is not in compliance** with Division II of Schedule III of the Companies Act, 2013. (ii) Foreign exchange differences relating to foreign currency borrowings to the extent not capitalized in accordance with Ind AS 23 can be presented under the head **finance costs**. Thus, disclosure of foreign exchange difference relating to foreign currency borrowing to the extent not capitalised under other expenses is **not in compliance** with Division II of Schedule III of the Companies Act, 2013. (iii) Any interest on shortfall in payment of advance income-tax is in the nature of finance cost and hence should not be clubbed with the Current tax. The same should be **classified as Interest expense under finance costs.** However, such amount should be separately disclosed. Thus, disclosure of interest of shortfall by the company is **not in compliance** with Division II of Schedule III of the Companies Act, 2013. (iv) Share based payment to employees in accordance with Ind AS 102 should be disclosed under the **head Employee Benefits Expense.** Therefore, disclosure of share based payment to employees under Finance Cost is **not in compliance** with Division II of Schedule III of the Companies Act, 2013. Expenditure incurred on corporate social responsibility activities it is recommended that all expenditure on CSR activities, that qualify to be recognised as expense should **be recognised as a separate line item as 'CSR expenditure'** in the statement of profit and loss. Further, the relevant note should **disclose the break-up of various heads** of expenses included in the line item 'CSR expenditure'. Thus, disclosure of expenditure on CSR Activities in notes to the cash flow statement is **not in compliance** with Division II of Schedule III of the Companies Act, 2013.

QNO 796.000	**Depreciation Scheduled II Non-Compliance**	**Old Course—(N20E)**
	XYZ Limited has prepared the financial statements for the year 2019 -20 and mentioned in the significant accounting policies that depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management. The company has ignored the useful life of the assets mentioned in Schedule II of the Companies Act, 2013. As a statutory auditor of the company how would you deal with this?	
Answer	**Providing Depreciation ignoring Schedule II to the Companies Act, 2013: Section 129 of the Companies Act, 2013**, requires that the financial statements shall give a true and fair view of the state of affairs of the company and are in compliance with Accounting Standards. Further, as per **Schedule II to the Companies Act, 2013 on 'Useful Lives to Compute Depreciation'**, the useful life of an asset shall not ordinarily be different from the useful life specified therein. However, if such a company uses a useful life of the asset which is different from the above limits**, it shall disclose the justification for the same in its financial statement.** In the given case, M/S XYZ Limited has mentioned in the significant accounting policies that the depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management and ignored the useful lives of the assets as, provided under Schedule II to the Companies Act, 2013. Therefore, the statutory **auditor of the company should ensure** that the management has disclosed the justification for consideration of different useful life of the assets from that as indicated under Schedule II. If the justification has not been provided then the auditor of the company shall suggest to the management for the same and if the management refuses, the **auditor should qualify his report** accordingly.	

QNO 799.000	AS 29/ IND AS 37--Law Suit	Old Course-- (M14E, P17M) New Course--(S17M, S21M)
	ABC Company files a law suit against Unlucky Company for Rs 5 crores The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements As an auditor of Unlucky Company, how will you deal with the situation?	
Answer	**Existence of Contingent Liability**: As per IND AS 37/AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Further, 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. As per SA 570 "Going Concern", there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. 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 is one of the example of such event. 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 and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. In the instant case, ABC Company has filed a law suit against Unlucky Company for ` 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its financial statements. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of ` 5 crore by making provision for expenses as per IND AS 37/AS 29. If the management does not accept the request the auditor should qualify the audit report.	

QNO 799.500	Development Fees not paid.	New Course--(M21E)
	MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. for the FY 2020-2021. The Company is into the business of yarn manufacturing. For the purpose, cotton ginning is also done within the factory premises. Raw cotton is purchased from local market and processed in-house. The Company received a notice from the State Government to deposit market development fee for the last 5 years to the tune of Rs. 10.00 crores. The Company and all other organizations in the same business has not deposited the market development fee, taking shelter of an old circular issued by the Government. The trade association met with the government officials to resolve the matter and agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial years. The Company, however, disclosed the same in notes to accounts, as contingent liability, without quantifying the effect and proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements.	
Answer	**Forming an opinion and reporting on financial statements –** As per Ind AS 37, "Provisions, Contingent Liabilities and Contingent Assets", an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable . (a) an estimate of its financial effect, measured in the standard; (b) an indication of the uncertainties relating to the amount or timing of any outflow; and (c) the possibility of any reimbursement.	

	SA – 700 - Forming an opinion and reporting on financial statements: The auditor shall evaluate whether in view of the requirements of the applicable financial reporting framework – (i) The financial statements adequately disclose the significant accounting policies selected and applied; (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate; (iii) The accounting estimates made by the management are reasonable; (iv) The information presented in the financial statements is relevant, reliable, comparable and understandable; (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705. In the present case, auditor may consider modifying his opinion considering the financial effect of liability not disclosed properly

QNO 800.000	**Matters related to AS-1 where qualification will be required**	**Old Course— (N20E)**
	What are the circumstances in which auditors are required to qualify their reports of companies for mattes related to AS-I 'Disclosure of Accounting Policies'?	
Answer	While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards. As per AS 1 - Disclosure of Accounting Policies, in the case of a company, members should qualify their audit reports in case: (i) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, have not been disclosed, or (ii) accounts have not been prepared on accrual basis, or (iii) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or (iv) proper disclosures regarding changes in the accounting policies have not been made.	

QNO 800.500	**Non-Provisioning of Tax Liability**	**New course- (M21E,N22M)**
	ABC Ltd. has been dealing in tyres since 1995. The Company envisaged to expand its business and wanted to manufacture the tyres besides trading. Accordingly, the machinery was imported, installed and manufacturing operations commenced. The Government also gave certain incentives like power subsidy, land acquisition subsidy, etc. After 2 years of operations, Company received a notice from the Income Tax authorities to pay tax on incentive received in the form of power subsidy. The demand notice was served for Rs. 150.00 Lakhs. The Company however filed an appeal with higher tax authorities against the demand and the matter is undecided as on 31.03.2021. Legal team of the Company anticipated that tax liability might mature. The Company has not made a provision of anticipated tax liability. Considering the provisions of Companies Act, 2013, how an auditor of ABC Ltd. should see this matter and report in audit report, if required?	
Answer	**Audit report - Legal team anticipated tax liability but the company did not make any provision for that –** The Council of the Institute of Chartered Accountants of India has taken note of the fact that there is	

	a practice prevalent whereby companies do not make provision for tax even when such a liability is anticipated. It has expressed the view that on an overall consideration of the relevant provisions of law, non-provision for tax (where a liability is anticipated) would amount to contravention of the provisions of Sections 128 and 129 of the Companies Act, 2013. Accordingly, it is necessary for the auditor to qualify his report and such qualification should bring out the manner in which the accounts do not disclose a "true and fair" view of the state of affairs of the company and the profit or loss of the company. **Applying the above to the facts given in the question, auditor should qualify his report.** An example of the manner in which the report on the balance sheet and the Statement of Profit and Loss may be qualified in this respect is given below: "The company has not provided for taxation in respect of its profits and the estimated aggregate amount of taxation not so provided for is ` .....including.....for the Year ended on .....To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been overstated and to the extent of such aggregate non-provision, the reserves of the company appearing in the said balance sheet have been over-stated and the current liabilities and provisions appearing in the said balance sheet have been understated".

QNO 801.000	**AS 15--(Leave Encashment as and When Paid)**	**Old Course—(M13E, M16E, P17M New Course – (S17M, N18M, S21M)**
	Z Ltd changed its employee remuneration policy from 1st of April 2019 to S provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st March 20 the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment in view of relevant IND-AS.	
	As per Para 13 of Ind AS-19 on "Employee Benefits", notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time, an entity shall recognize the expected cost of short-term employee benefits in the form of paid absences, when the employees render service that increase their entitlement to future paid absences. Since the company obtained actuarial valuation for leave encashment, it is obvious that the paid absences are accumulating in nature. An enterprise should measure the expected cost of accumulating paid absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date. Here, Z Ltd. will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence, the contention of the auditor is correct that full provision should be provided by the company	

QNO 802.000	**Ind AS 24-- Related Party Disclosure, Exemption to Government Entities**	**New Course – (N18E)**
	You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ` 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ` 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report.	
	Related Party Disclosures: As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including	

commitments, with
(i) a government that has control or joint control of, or significant influence over, the reporting entity; and
(ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.
If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:
(1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
(2) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
(i) the nature and amount of each individually significant transaction; and
(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.
Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, 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.
In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in not tenable

QNO 803.000	**Sch III--Flexi Deposit**	**New Course – (N18M) Old Course—(M11E, M15R, P17M**

Zed Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are encashed and transferred to current accounts. As of 31st March, 2018 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances. Comment.

Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013: The instructions in accordance with which current assets being "cash and cash equivalents" should be made out to Part I of Schedule III to the Companies Act, 2013 states as follows:

(i) Cash and cash equivalents shall be classified as:
(a) Balances with banks;
(b) Cheques, drafts on hand;
(c) Cash on hand;
(d) Others (specify nature)

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(i) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(ii) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts. The disclosure

	of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct**.**

QNO 804.000	Sch III--GI (Current Assets & Liabilities)	Old Course-(M15E, P17M New Course – (S17M, S21M)
	MG Pvt. Ltd. seeks your advice while preparing the financial statements i.e. the general instructions to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and liabilities.	
	General Instructions for Preparation of Balance Sheet: **(i) General Instruction in respect of Current Assets:** An asset shall be classified as current when it satisfies any of the following criteria- (1) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle; (2) it is held primarily for the purpose of being traded; (3) it is expected to be realized within twelve months after the reporting date; or (4) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date. **(ii) General Instruction in respect of Current Liabilities**: A liability shall be classified as current when it satisfies any of the following criteria- (1) it is expected to be settled in the company's normal operating cycle; (2) it is held primarily for the purpose of being traded; (3) it is due to be settled within twelve months after the reporting date; or (4) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.	

QNO 805.000	Sch III—Presentation	Old Course-(M20R, M13E, M15R, P17M) New Course--(S17M, M18M, M20R, S21M)

The Balance Sheet of G Ltd. as at 31st March, 20 is as under. Comment on the presentation in terms of Division I and Division II of Schedule III.

Heading	Note No.	31st March, 20	31st March, 19
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money refundable	4	XXX	XXX
Non-Current Liabilities		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
Current Liabilities			
Trade Payables	6	XXX	XXX
Total		XXXX	XXXX
Assets			
Non-Current Assets			
Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
Current Assets			
Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		XXX	XXX
Total		XXX	XXX

(a) Following Errors are noticed in presentation as per Division I of Schedule III:
(i) Share Capital and Reserve & Surplus are to be reflected under the heading "Shareholders' funds", which is not shown while preparing the balance sheet.
Although it is a part of Equity and Liabilities, yet it must be shown under head "shareholders' funds". The heading "Shareholders' funds" is missing in the balance sheet given in the question.

(ii)Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head 'Surplus'. The balance of 'Reserves and Surplus', after adjusting negative balance of surplus shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

(iii)Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading "Reserves and Surplus".

(iii)Share application money refundable shall be shown under the sub-heading "Other Current Liabilities". As this is refundable and not pending for allotment, hence it is not a part of equity.

(v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
(vi) Under the main heading of Non-Current Assets, Property, Plant and Equipment are further classified as under:

(a) Tangible assets
(b) Intangible assets
(c) Capital work in Progress
(d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Property, Plant and Equipment as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading "Long term loans and advances" under the heading Non-Current Assets.

Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words "Fixed assets" shall be substituted with the words "Property, Plant and Equipment".
(e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
(f) Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013,

Trade Payables should be disclosed as follows:-
(A) total outstanding dues of micro enterprises and small enterprises; and
(B) total outstanding dues of creditors other than micro enterprises and small enterprises."

QNO 806.000	**Sch III--Presentation (Small Cases)**	**New Course--(M18E)**

As an Auditor give your comments for the following disclosures made by a Company which adopted IndAS for compilation of Financial Statements :
(i) In the Balance Sheet, the sub-head inventories contained an item goods in transit' in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified
(ii) Provision for doubtful debts of trade debtors was grouped in "Provisions" under current liabilities.
(iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".
(iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income"
(v) Payment towards a one time voluntary retirement scheme introduced during the year was included

	in " Employee Benefit Expense"
	(i) Goods in Transits: As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct. **(ii) Provision for Doubtful Debts of Trade Debtors was grouped in "Provisions" under current liabilities:** The term 'doubtful debts' is an adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37"Provisions, Contingent Liabilities and Contingent Assets". Thus, provision should be shown net in trade receivable. **(iii) In Statement of Profit and Loss, Prior Period Income was shown under Other Income:** As per Ind-AS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", Prior Period Income should not be shown in statement of profit and loss. The entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. **(iv) Sale Proceeds of Scrap incidental to manufacture were included in "Other Income"**: As per Ind-AS 2 "Inventories", sale proceeds of scrap incidental to manufacture should be deducted from the cost of the main product. Thus, disclosure of sale proceeds of scrap as other income is not correct. **(v) Payment towards a one time VRS during the year included in Employee Benefit Expenses:** As per Ind-AS 19 "Employee Benefits", if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits, in case it is not expected to be settled before twelve months the entity shall apply the requirements for long term employee benefits. In the instant case, it should be shown as short term employee benefits in place of Employee Benefit Expenses. Thus, treatment of such payment as employee benefit expenses is not correct.

QNO 807.000	**Sch III--Presentation (Multiple Cases)**	**New Course--(N18M)**
	Comment on the following with reference to Schedule III to the Companies Act, 2013: **(i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.** **(ii) A company has clubbed all other expenses under the head 'Other Expenses" on the basis of 1 percent of total revenue or Rs.5,000 whichever is higher.** **(iii) A company has shown Deferred Tax Liability under Non-Current Liabilities and Deferred tax assets under Non-Current Asset in balance sheet.**	
	A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities. (ii) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order. (iii) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.	

QNO 808.000	Sch III-- Multiple Small Cases (MP Ltd)	Old Course-(N18E) New Course--(S21M, N21M)
	The financial statements of Prabhu Ltd. as on March 31, 2020 are to be prepared under Division II of Schedule III to the Companies Act, 2013. Comment on the disclosure compliances for Prabhu Ltd. from the following information in the financial statements which are required to be drawn up in compliance with Ind AS. **(i) Property, Plant and Equipment include ` 2.50 crore for a boiler-plant under construction.** **(ii) Cash and cash equivalents include ` 1.25 crore deposited with a nationalized bank on 31st March, 2020 for 18 months. It is shown under current assets.** **(iii) Non-current assets include under caption "Biological assets other than bearer Plants" a sum of 1.50 crore being cost of cultivation for bringing to yield level, the cashew nut trees whose yield period, according to estimate shall not be less than 10 years.**	
	(i) Disclosure of Boiler Plant under Construction: Boiler plant under construction should be shown under the heading 'Capital Work in Progress' instead of Property Plan and Equipment. Thus, inclusion of value of boiler plant under construction in Property Plan and Equipment is not in order. **(ii) Disclosure of Cash and Cash Equivalents deposited with Nationalised Bank:** Bank deposits with more than 12 months maturity shall be disclosed under 'Other financial assets'. Therefore, disclosure of deposits rupees 1.25 crores in a nationalised bank for 18 months as Cash and Cash Equivalents is not in order as per Division II of Schedule III. **(iii) Disclosure of Cost of Cultivation for bringing to yield level the Cashew nut trees:** Cost of 1.5 crore rupees for Cultivation for bringing to yield level, the cashew nut trees whose yield period is more than one period will form part of 'Bearer Plant'. Hence it will not be considered as 'Biological Assets other than bearer plant'. Therefore, it should be shown under the heading 'Property Plant and Equipment' as Bearer Plant as per Division II of Schedule III.	

QNO 809.000	Sch III-- MSMSED Disclosure	Old Course-(M18E,M19M) New Course--(M19M)
	Director (Finance) of Alpha Ltd. is of the opinion that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013. They did not mention details regarding Micro, Small and Medium Enterprises (MSME). Give your view as statutory auditor of the Company and state the details required to be disclosed in notes regarding MSME	
	Details required to be disclosed in Notes regarding MSME: Opinion of Director (Finance) of Alpha Ltd. that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013, is not correct. The following details relating to Micro, Small and Medium Enterprises shall be disclosed by Alpha Ltd. in the notes: (i) **the principal amount and the interest due** thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year; (ii) **the amount of interest paid by the buyer** as per Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year; (iii) **the amount of interest due and payable** for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006; (iv) **the amount of interest accrued** and remaining unpaid at the end of each accounting year; and (v) **the amount of further interest remaining due** and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure as per Micro, Small and Medium Enterprises Development Act, 2006.	

QNO 810.000	Sch III-- Contingent Liability and Dividend	Old Course_(M20M) New Course--(N18R, M20M)
	Comment on the following with reference to Schedule III to the Companies Act, 2013: **(i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.** **(ii) A company has clubbed all other expenses under the head 'Other Expenses" on the basis of 1 percent of total revenue or Rs.5,000 whichever is higher.** **(iii) A company has shown Deferred Tax Liability under Non-Current Liabilities and Deferred tax assets under Non-Current Asset in balance sheet.**	
	(i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter -guarantees should not be disclosed as contingent liabilities. (ii) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order. (iii) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.	

QNO 811.000	AS 29--Employee	Old course- (N13E,P17M) New course- (M18R, M18E)
	Excellent Limited, a Company incorporated in India and listed with SEBI, has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rules and regulations. Employees are also entitled to claim a lump-sum payment to cover expenses on food and stay during the travel. The Company also gives option to employees that they can claim a Excellent Limited have following accounting policies to record these travel expenses: **(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the travel rule of the company therefore all travel expenses fall under the category of defined contribution plans.** **(ii) Since it is not related to the length of service of the employees, it is difficult to estimate reliably and there is no present obligation to pay employees as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", hence it is accounted for on claim basis.** **You are statutory auditor of Excellent Limited. What would be your guidance to audit team?**	
Answer	**Treatment of Employee Benefits Expenses:** The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said scheme encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus, i. Settlement allowance payable by the company is a defined retirement benefit, covered by AS	

	15. ii. A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation. iii. Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

QNO 812.000	AS 26--Membership Rights	Old course- (M6E, N15R, M16E, P17M) New course- (M18M)
	A Pvt.Ltd. started stock broking activities in 2016. For this purpose it acquired membership of a stock exchange for ` 110 lacs. While finalizing the accounts, the company disclosed the above amount under the Fixed Assets schedule as "Stock Exchange Membership Rights". The company also did not write off any amount since the rights would enable the company to perpetually carry on its business.	
Answer	**Stock Exchange Membership Rights:** A Pvt. Ltd. has paid ` 110 lacs for acquiring membership of stock exchange. Such membership rights provide exclusive right to A Pvt. Ltd. for carrying out stock broking activities. Thus, Stock Exchange Membership Rights are controlled by A Pvt. Ltd. and provide the basis for generating economic benefits to it. All these criteria appear to meet the definition of intangible assets as laid down in AS 26, "Intangible Assets". The Standard requires an entity to recognize an intangible asset if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably. In the instant case, membership rights of stock exchange acquired by A Pvt. Ltd. meet the criteria of identifiability, control and arising of future benefits as well as reliability of the amount of cost. Thus recognizing the membership rights as Fixed Assets is proper. However, the fact that the company did not write-off any amount since it would enable the company to perpetually carry on its business is not proper since AS 26 requires that all Intangible Assets to be amortised. For this purpose, a rebuttable presumption of 10 years is to be considered. Hence in the instant case, the company should have amortised such rights over 10 years. Since the company has not amortised any amount, the auditor will have to qualify his report and state the fact of non-compliance with AS 26	



CA Ravi Taori

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