PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

Answer any ***four*** *out of remaining five.*

Question 1

(a) Joy Ltd. is an entertainment company which runs a circus and travels around the country to entertain the masses. The circus began losing its popularity over the past few years and attendance has reportedly dropped by as much as 75% in the current financial year. Animal rights activists continuously targeted the circus for its use of animal creatures like elephants in the show. The CEO noted that the audience seemed to be abandoning the circus due to their expanding entertainment options. The high cost of moving the show from city to city eventually made the business model untenable. As a result, many key managerial personnel of the company left the company, there were delays in the payment of wages and salaries, and the bank from whom the company had taken funds also decided not to extend further finance or to fund further working capital requirements of the company.

When discussed with the management, the statutory auditor understood that the company had no action plan to mitigate such circumstances (Use of going concern assumption is inappropriate). Further, all such circumstances were not reflected in the financial statements of Joy Ltd. What course of action should the statutory auditor of the company take in the auditor's report in such situation? ***(5 Marks)***

(b) HAM Ltd. is engaged in the business of manufacturing of medicines. The manufacturing process requires raw materials such as hydrochloric acid, caustic soda and other chemicals for the manufacturing of various drugs. The Company has maintained large stock of raw materials of all types of chemicals being used. The nature of raw material is such that its physical verification requires the involvement of an expert. Management hired their expert for the stock taking and auditors also involved their expert for the same purpose.

The auditor observed that the work of the auditor's expert was not adequate for the auditor's purposes and he could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor.

Based on above, the auditor knows that it would be right to express a modified opinion in the auditor's report because he has not obtained sufficient appropriate audit evidence. But he was reluctant in doing so and issued a clean audit report and included the name of the expert in his report to reduce his responsibility for the audit opinion expressed.

Comment with respect to relevant Standard of Auditing relating to the action of the auditor of issuing clean audit report. ***(5 Marks)*** *(c) M/s ABC Limited is engaged in the business of construction of infrastructure and housing projects. While preparing the financial statements for the year ended 31.03.2023, management has made various accounting estimates and confirmed to the auditor that all necessary accounting estimates have been recognised, measured and disclosed in the financial statements are in accordance with the applicable financial reporting framework. The auditor during the course of audit observed some changed circumstances giving rise to the need for an accounting estimate. Inquiries of same were sought from the management. Can you list down some circumstances, change of which will result in inquiries from the management?* ***(4 Marks)***

Answer

(a) SA 570, "Going Concern", deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

When the use of going concern basis of accounting is inappropriate i.e., if the financial statements have been prepared using the going concern basis of accounting but in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

Also, when adequate disclosure of a material uncertainty is not made in the financial statements the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and in the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the present case, the following circumstances indicate the inability of Joy Ltd. to continue as a going concern:

- Losing popularity over the past few years.
- Animal Rights activists continuously targeting the circus.
- Audience abandoning the circus due to their expanding entertainment options.
- High Cost of moving the show from city to city making the business model untenable.
- Key Managerial Personnel leaving the Company.

- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

Therefore, considering the above factors it is clear that the going concern basis is inappropriate for the Company. Further, such circumstances are not reflected in the financial statements of the Company.

As such, the statutory auditor of Joy Ltd. should:

(1) Express an adverse opinion in accordance with SA 705 (Revised) and

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

The auditor is also required to report as per clause (xix) of CARO 2020 that on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date.

(b) As per SA 620, "Using the work of an Auditor's Expert", if the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence.

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

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. In such circumstances, the auditor may need the permission of the auditor's expert before making such a reference.

In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a clean report. The auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of an auditor's expert does not reduce his responsibility for that opinion.

(c) **As per SA 540,** "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

Question 2

(a) *While conducting audit of PC Ltd., CA. T decided to use sampling technique to test the trade receivables at the planning stage. He directed his team members to divide the whole population of trade receivables balances to be tested in a few separate groups called 'strata'. He directed to treat each stratum as if it was a separate population and divided the trade receivables balances of PC Ltd. for the Financial Year 2022 -23 into groups on the basis of personal judgment as follows:*

SI. No.	*Particulars*
1	*(a) Balances in excess of ₹ 50,00,000;*
2	*(b) Balances in the range of ₹ 40,00,001 to ₹ 50,00,000;*
3	*(c) Balances in the range of ₹ 30,00,001 to ₹ 40,00,000;*
4	*(d) Balances in the range of ₹ 20,00,001 to ₹ 30,00,000;*
5	*(e) Balances in the range of ₹ 10,00,001 to ₹ 20,00,000;*
6	*(f) Balances ₹ 10,00,000 and below*

From the above mentioned groups, CA. T directed to pick up different percentage of items for examination from each of the group. One of the team members, Mr. Neel, wants to use some other technique of sampling for the above purpose as the concept of stratification is not clear to him. You are required to explain the concept of stratification and its uses to Mr. Neel. ***(5 Marks)***

(b) *SPM Ltd., about to complete fifty years of age since its incorporation in the F.Y 2023-2024, decided during the F.Y year 2022-23 to upgrade its registered office at an important location in Mumbai city. As part of planned package, it decided to acquire a land very adjacent to the site of registered office, which had been owned by Mr. Parry, who is a director of the Company. Since he was reluctant to part with the ownership, he had been persuaded to convey the property in favour of the company in exchange of a site owned by the company located at the next street to the street where the registered office is situated, which is 1.50 times larger in area than that of the site owned by the director adjacent to the Registered office. Happier with what he was offered in negotiation, Mr. Parry agreed for transferring the property in favour of the company in a deed of exchange duly executed by authorized persons of the Board, and Mr. Parry. The registration formalities were completed by 31st December, 2022. Assuming that you are the engagement partner for the audit of the accounts of the company for the financial year ended on 31st March, 2023, give a list of additional audit procedures and reporting requirements, if any, that this transaction might trigger in your audit.* ***(5 Marks)***

(c) *Discuss the reporting of the following issues under tax audit report of PPK Limited engaged in - (i) giving consultancy for agriculture of sugarcane planting and (ii) cultivation / growing of sugarcane crop at a stretch of land for about 15 KMs taken on lease from state government.*

(i) *The company during the year absorbed another company- AFM Ltd., (resulting in the latter becoming merged with this Company). The purchase price over the value of net assets taken over was more by ₹ 40 lakhs. The Management wished to write it off over five years and to claim the same as depreciation for intangibles at rates as allowed by Income-tax Rules for intangible assets.*

(ii) *The Profit and loss statement of the company indicated the operating revenue of consultancy fees ₹ 75 lakhs and agriculture income of ₹ 225 lakhs (gross revenue from crop sale). The expenses included material consumed for plantation and add-ons for crop growing, staff cost - for plantation, interest cost (combined), depreciation for plantation equipment and its ancillary parts.* ***(4 Marks)***

Answer

(a) Concept of Stratification: Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

Uses of Stratification

1. Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
2. When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.
3. The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population. For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).
4. If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

(b) CARO Audit Procedures and Reporting:

In the given situation, SPM Ltd has entered into non-cash transactions with one of the directors, Mr. Parry during the year, by transferring the property (by Mr. Parry) in favour of the Company in a deed of exchange of a site owned by the company.

Paragraph 3 Clause (xv) of the CARO 2020 & Reporting Requirements:

The auditor is required to report the transaction as per Paragraph 3(xv) of the CARO, 2020 which states that whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

For reporting on the first part of this clause, the starting point of the auditor's procedures could be obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Act.

The second part of this clause requires the auditor to report whether the company has complied with the provisions of section 192 in this regard. Section 192(1) and (2) of the Act envisage the following compliances in respect of such transactions:

(i) The company should have obtained a prior approval for such arrangement by a resolution in the general meeting.

(ii) Notice for approval of the resolution should contain details of the arrangement along with the value of assets involved.

The auditor should check compliance with section 192(2) of the Act and verify the notice of the general meeting that it includes particulars of arrangement along with the value of the assets involved in such arrangements.

This transaction was duly executed by the authorised persons of the Board. The auditor has to state the fact whether approval has been obtained in the general meeting of the company.

Related Party Transactions

This is a transaction with a related party. The provisions of section 188 of the Companies Act, 2013 as regards Related Party Transactions are to be checked for compliance. Section 189 of the Companies Act, 2013 requires a register to be maintained wherein the contract with related parties are to be entered. The compliance with section 177 and section 188 has to be reported under Clause (xiii) of the CARO, 2020.

Documents to be verified:

A scrutiny of the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non- cash transactions.

- Register of Loans, Guarantee, Security and Acquisition Made by the Company, Register of Contracts with Related Party and Contracts and Bodies etc. in which Directors are Interested.
- Movements in the Fixed Asset Register.
- Minutes book of the General Meeting and Meetings of Directors.
- Report on Annual General Meeting.

(c) **(i)** In the given case, PPK Ltd. absorbed another company-AFM Ltd., and purchase price over the value net assets taken over was more by 40 lakh rupees. Since purchase price over the value of net assets taken over will be resulting in goodwill which is not recognised as per section 32 of the Income-tax Act, 1961. Hence, no reporting **under clause 18** will be required under tax audit report/Form 3CD.

(ii) **Expenditure Inadmissible Under Section 14A [Clause 21(h)]:** The tax auditor is required to report the amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income under Clause 21(h) of Form 3CD.

The provisions of sub-section (2) of section 14A shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Income-tax Act.

In the given situation, PPK Ltd is generating income both from agriculture as well as non-agriculture activities. Giving consultancy for agriculture of sugarcane planting is non-agriculture activity whereas, cultivation/ growing of sugarcane crop is an agriculture activity.

Since the total income of the assessee includes agriculture income of ₹ 225 lakh which is exempt from tax, the auditor would report that assessee has claimed expenses against agriculture income as per clause 21(h).

Further, interest cost which is combined for agriculture activities and non-agriculture activities would have to be allocated between exempt and taxable income. The tax auditor would note down the amount and mention against this clause.

Question 3

(a) *As a part of the listing process, M/s Sun Ltd. prepared and issued its prospectus to the public. The top executives thought that pending litigation against the company (which would cause a cash outflow of ₹ 1.25 crores) may affect the demand for share applications. Due to this, they omitted the fact, for the well-being of the company. Mr. A, who was well aware of this matter had authorised himself to be named in the prospectus as a director. However, Mr. A was a little reluctant, so he informed and agreed that he shall become such director after an interval of some time. Unfortunately, after a few days, but before joining of Mr. A as director, this matter got leaked and several subscribers sustained losses. Mr. A is now defending himself stating that he is currently not holding the director's post hence no action can be taken against him. Analyse and Comment on the situation.* ***(5 Marks)***

(b) *CTR & Associates is an audit firm with CA C and CA T as partners. M/s CTR & Associates has been appointed as statutory auditor of M/s TP Hotel Ltd. for the financial year 2022-23. The audit firm is a regular customer of the hotel and the partners usually used to stay in the same hotel at various locations in the course of travelling for their various professional assignments. Normally, payments for such stays are settled against monthly bills raised by the company. Give your comment on qualification of the audit firm with respect to the provisions of the Companies Act, 2013.* ***(5 Marks)***

(c) *SR and Associates are the statutory auditor of ABC Ltd. Audit of the company is pending for F.Y 2021-22 and 2022-23 due to a dispute between auditor and company with respect to certain proposed remarks by the auditor in the audit report for F.Y. 2021-22. The company removed the auditor on 02.05.2023 in shareholders meeting complying with all legal formalities. SR and Associates after coming to know about the removal, intimated the Registrar of Companies (ROC) through letter highlighting the points of dispute including* *non-existence of fixed assets, bogus creditors etc. ABC Ltd complained to ICAI against SR and Associates for their above letter to ROC. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto.* ***(4 Marks)***

Answer

(a) 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. 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.

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. A 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 ₹ 1.25 crore which may affect the demand for share application and had also authorized himself to be named in the prospectus as director.

(b) Indebtedness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ₹ 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further, a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as an auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, CTR & Associates, an audit firm with CA C & CA T as partners is appointed as statutory auditor of M/s. TP Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against monthly bills raised by the company.

Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of ₹ 5,00,000, CTR & Associates, is not disqualified to be appointed as statutory auditor of M/s TP Hotel Ltd as per section 141(3)(d)(ii). In the absence of the same, the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in terms of the section 141(3)(e) of the Companies Act, 2013, CTR & Associates are not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, they shall not be disqualified to act as an auditor and shall not require to vacate their office of auditor.

(c) 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 so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force.

An accountant, in public practice, has access to a great deal of information of his client which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment.

In the given situation, SR & Associates complained to the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors, etc. after coming to know about the removal. SR & Associates made voluntary disclosure of the information acquired during the professional engagement without the consent of the client and without there being any requirement in law to disclose the same.

Question 4

(a) BETA Ltd is engaged in the Construction business since year 2001. The auditor understands that a thorough construction estimate is vital to the viability of any construction business and requested the information related to financing and operating estimated costs from the management to review the outcome of accounting estimates included in the prior period financial statements and their subsequent re-estimation for the purpose of current period.

The management refused to provide the information to the auditor as it believed that the judgments and estimates made in the prior periods were based on the information available at that time, and the review of the prior period information should not be done by the auditor in the current financial year. With reference to the relevant SA, comment on whether the contention of management is correct or not. ***(5 Marks)***

(b) RB & Co. are the statutory auditors of Legal Finance Ltd., an NBFC engaged in the business of accepting public deposits and giving loans. Auditors are concerned that the format of the financial statements should be prepared as per the notification issued by the Ministry of Corporate Affairs dated 11th October, 2018. While auditing there was a difference of opinion between CA R and CA B regarding the disclosure of "Other Income" in the financial statements. CA R believes that there is no difference in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Is the contention of CA R correct? ***(5 Marks)***

(c) ABC & Co is a firm of Chartered Accountants located at Mumbai with branches at Calcutta and Chennai. During the financial year 2021-22, the firm carried out statutory audits of

(1) Eighteen listed companies consisting of -

(A) Ten companies with turnover exceeding ₹1000 crores - one public sector Listed Company, the rest nine being companies in private sector and

(B) Eight companies with turnover exceeding ₹500 crores and less than or equal to ₹1000 crores and

(2) Twenty four private limited companies.

The firm had subjected itself to Peer Review process during 2020-21 and continues to hold certificate issued by Peer Review Board with validity date unexpired. During the F.Y. 2022-23 it had been decided that the firm be subjected to Quality Review (QR) by QRB of the Institute. Can QR be so conducted for this firm? If yes, can one of the audits of listed companies- viz. audit of public sector Company done by firm in 2021-22 be subjected to QR by QRB, as this is the biggest statutory audit in terms of turnover of the auditee, as well as of complexity of audit issues involved? ***(4 Marks)***

Answer

(a) As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the management is not correct in refusing the relevant information to the auditor.

(b) Though presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent however there are certain following differences in the same:

(a) 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 ₹ 10 lakhs, whichever is higher.

(b) 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.

(c) 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.

(d) 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 showing those only as part of the notes.

(e) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired.

(f) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

In view of the above, contention of CA R that there is no difference in the presentation requirement between Division II and Division III of the Companies Act, 2013 is not correct.

(c) Peer review is a review of the systems and procedures of an audit firm. Peer review is a part of the activities of ICAI aimed at improving the quality of services. Whereas 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.

Further, 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 prescribed class of companies and bodies corporate including companies whose securities are listed on any stock exchange in India or outside India.

The Ministry of Corporate Affairs has clarified to the Quality Review Board that in view of Sec.132 (2) of the Companies Act, 2013 read with 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.

In the given situation, ABC & Co., a Chartered Accountant firm, is having unexpired validity date Peer Review Certificate issued by Peer Review Board. It was also decided to have Quality Review of ABC & Co. by Quality Review Board. In view of above, it can be concluded that Peer Review and Quality Review both are separate distinct activities. Therefore, Quality Review of ABC & Co. can be conducted in respect of twenty-four private limited companies.

Further, considering the above, in the case of statutory audits of all 18 listed entities, NFRA has power to oversee quality of services of these audit firms. Therefore, none of the audits of listed companies – viz. audit of public sector company done by firm in 2021-22 can be subjected to Quality Review by Quality Review Board irrespective of the fact that it is biggest statutory audit in terms of turnover of the auditee, as well as of complexity of audit issues involved.

Question 5

(a) MBP Ltd. is into the footwear manufacturing business and started its operations in the year 2015. For the last two financial years, the company's profit declined even when there was an increase in the sales and production of goods by the company. So, the management of

MBP Ltd. felt a need to assess how well their team is applying its strategies and resources. They appointed Mr. Pal to conduct the management audit with the objective of detecting and overcoming current managerial deficiencies.

After completing the management audit, Mr. Pal is in the process of drafting the final management audit report. Briefly discuss the steps to be taken into consideration by him in preparing the management audit report. ***(5 Marks)***

(b) CA Mohan has been appointed as a Peer Reviewer for M/s TB & Associates. He has asked for all the management consultancy engagements done by the firm and representations before various authorities carried out by the M/s TB Associates for his peer review during the period considered for peer review purposes by the board. He has also sent out a mail to Peer Review Board regarding his selections. Mr. T, the managing partner of the firm believes that these areas are outside the scope of the Peer Reviewer. Is the contention of Mr. T correct or not? ***(5 Marks)***

(c) LMN Ltd., a manufacturing concern, sold a house property owned by it in Chennai for a consideration of ₹ 58 lakhs, to Mr. X on 14.09.2022. LMN Ltd. purchased the house property in the year 2017 for ₹ 45 lakhs. The stamp duty value on the date of transfer i.e. 14.09.2022·is ₹ 74 lakhs for the said house property. How would you deal with this matter in the tax audit report of LMN Ltd.? ***(4 Marks)***

Answer

(a) The Steps to Prepare the Management Audit Report:

(i) **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.

(ii) **Supporting information -** The management auditor should supplement his report with appropriate audit evidence which sufficiently and convincingly supports the conclusions.

(iii) **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.

(iv) **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.

(v) **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.

(vi) **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.

Alternative Answer

(a) The Steps to Prepare the Management Audit Report

(i) **Title -**The management audit report should have a short but descriptive title so that its subject matter can be easily identified.

(ii) **Objectives** - The management auditor may describe the objectives of the audit assignment.

(iii) **Scope -**The management auditor may give a brief description of the activities audited by him.

(iv) **Findings, conclusions and opinions -**These may be given either department wise or in the order of importance. All the facts and data pertaining to the situation should be assembled, classified and analysed. Each finding should be discussed comprehensively and correlated with other findings. Conclusions and opinions should normally follow the findings. Tables or graphs may be used for the presentation of statistical data in appendices.

(v) **Recommendations-**A management audit report may include recommendations for potential improvements. However, care should be taken in making recommendations in order that the auditor's own objectivity may not become the subject matter of question. He may point out defects and make recommendations in a broad manner on how to overcome them. He should avoid providing detailed procedures in the capacity of an auditor. Normally specifying procedures etc. should rest with consultants.

(vi) **Auditee's views -**The auditee's views about audit conclusions or recommendations may also be included in the audit report in appropriate circumstances.

(vii) **Summary -**A summary of conclusions and recommendations may be given at the end. This is particularly useful in long reports.

A summary of past observations and their implementation and closure status may also be included as a part of the Management Audit Report. This should also highlight the escalations made because of the non-implementation of the agreed audit recommendations and the revised implementation timelines, if any.

(b) Selection of Assurance Service Engagements for Review: Peer Review Guidelines defines the scope of peer review which revolves around compliance with technical, professional and ethical standards; quality of reporting; systems and procedures for carrying out assurance services; training programmes for staff including articled and audit assistants involved in assurance engagements, self-evaluation under Audit Quality Maturity Model or any other guideline issued by the Centre for Audit Quality, compliance with directions and / or guidelines issued by the Council to its Members, including fees to be charged, number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records and compliance with directions and / or guidelines issued by the Council in relation to article assistants and / or audit assistants, including attendance register, work diaries, stipend payments, and such other related records. 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 means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

Assurance engagements does not include Management Consultancy Engagements; Representation before various authorities, engagements to prepare tax returns or advising clients in taxation matters, engagements for the compilation of financial statements; engagements solely to assist the client in preparing, compiling or collating information other than financial statements, testifying as an expert witness, 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; and Engagement for Due diligence.

In the given situation, CA. Mohan is appointed as a peer reviewer for M/s TB & Associates, has asked for all the management consultancy engagements done by the firm and representations before various authorities carried out by M/s TB & Associates for peer review. In view of above, Peer Review of management consultancy engagements and representation before various Authorities by CA. Mohan is not correct as management consultancy engagements and representation before various authorities are not covered in the scope of Assurance engagement and Peer Review is directed at assurance engagement only.

(c) Reporting Requirement Under Clause (17) of Form 3CD: In the given case, LMN Ltd., has sold a house property during the year for a consideration of rupees 58 lakh which is less than stamp duty value i.e. rupees 74 lakh. Hence, tax auditor is required to report on the same under Clause 17 of Form 3CD.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.

The detailed information required to be furnished is 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.

Question 6

(a) *SAM Yarns Limited - a listed Company, having its registered office at Meerut is engaged in manufacturing of various types of yarns to be supplied to the textile mills. The Company has installed pollution control equipment for processing the pollutants so that before discharge of effluents outside factory, the level of pollution is kept at a level below the prescribed standard. The Company managed to get pollution clearance certificate by unfair means, while still there continues to be breach of pollution control laws in matters of discharge of polluting effluents. Amount of ₹ 10.25 Lacs had been incurred for arranging clearance certificate and the amount incurred unlawfully had been booked as pollution recycling expenditure. The matter had not reached to those in governance, and the Director-Finance who is a Chartered Accountant came to know of these matters on review of major expenditure incurred during the period. Comment the action/responses expected of Director - Finance (CA Rahul) referring to any applicable requirements of Responses for NOCLAR under Code of Ethics.* ***(5 Marks)***

(b) *When auditing in an automated environment, the auditor should be aware, adhere to, and be guided by the various standards, guidelines, and procedures that may be relevant to both audit and the automated environment. Explain briefly the following common standards and guidelines that are relevant in this context-*

(i) The Cyber security Framework.

(ii) Control Objectives for Information and Related Technologies.

(iii) The Payment Card Industry.

(iv) Information Technology Infrastructure Library. ***(5 Marks)***

(c) AB Ltd wants to acquire a unit of CT Ltd. AB Ltd is uncertain about the future viability of the unit under consideration. You are appointed to investigate economic and financial position of the unit. What are the factors that you shall consider while studying the economic and financial position of the business? ***(4 Marks)***

OR

RR & Co have been appointed as the auditors of HDG Insurance Company Limited. While conducting its audit, engagement partner noticed various actuarial assumptions disclosed by way of notes to the accounts and several other important actuarial processes being followed in accordance with general regulatory guidelines. Actuaries in the life insurance business have gained tremendous importance.

Explain the role of the auditor in the actuarial process, and the area of the insurance business where the actuarial department concentrates. ***(4 Marks)***

Answer

(a) In the given situation, SAM Yarns Limited, a listed company, has installed pollution control equipment for processing the pollutants to keep the level of pollution below the prescribed standard. The company managed to get pollution certificate by unfair means whereas breach of pollution control laws still continues. For arranging clearance certificate amount of 10.25 lakhs had been incurred unlawfully. CA. Rahul, Director Finance, came to know about these matters on review of the same during the period.

NOCLAR, under Code of Ethics, is applicable on professional accountants in service, and in practice. Among those in practice, it applies to Auditors, as well as professional services other than Audit.

It is applicable to Senior Professional Accountants in service, being employees of listed entities. Senior professional accountants in service ("senior professional accountants") includes directors.

NOCLAR takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.

CA Rahul, Director-Finance is expected of taking the following action/responses:

- Obtaining an Understanding of the Matter.
- Addressing the Matter.
- Determining Whether Further Action Is Needed.
- Seeking Advice.
- Determining Whether to Disclose the Matter to an Appropriate Authority.
- Imminent Breach.
- Documentation.

(b) When auditing in an automated environment the auditor should be aware, adhere to and be guided by the various standards, guidelines and procedures that may be relevant to both audit and the automated environment. **Given below are some of the common standards and guidelines that are relevant in this context include:**

(i) **The Cybersecurity Framework (CSF)** published by the National Institute of Standards and Technology is one of the most popular frameworks for improving critical infrastructure cybersecurity. This framework provides a set of standards and best practices for companies to manage cybersecurity risks.

(ii) **Control Objectives for Information and Related Technologies (CoBIT)** is best practice IT Governance and Management framework published by Information Systems Audit and Control Association. CoBIT provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.

(iii) **The Payment Card Industry – Data Security Standard or PCI-DSS**, is the most widely adopted information security standard for the payment cards industry. Any company that is involved in the storage, retrieval, transmission or handling of credit card/debit card information are required to implement the security controls in accordance with this standard.

(iv) **ITIL (Information Technology Infrastructure Library) and ISO 20000** provide a set of best practice processes and procedures for IT service management in a company.

Example for ITIL and ISO 20000 - change management, incident management, problem management, IT operations, IT asset management are some of the areas that could be relevant to audit.

(c) For studying the economic and financial position of the business, the following should be considered:

(i) The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?

(ii) What will be the trend of the sales and profits in the future? 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.

(iii) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?

(iv) Whether the business is operating at its 100 percent capacity or improvements can be made to reach at full productivity?

OR

(c) Role of Auditor: 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.

Hence, the auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, the 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.