PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I : ACADEMIC UPDATE
(Legislative Amendments as per the Companies Act, 2013 and Rules made thereunder)

1. Reporting under Companies (Auditor's Report) Order, 2015 [CARO, 2015]: The Central Government, after consultation with the Institute of Chartered Accountants of India, has issued the Companies (Auditor's Report) Order, 2015, (CARO, 2015) under section 143(11) of the Companies Act, 2013, dated 10th April, 2015. The requirements of the Order are supplemental to the existing provisions of section 143 of the Act regarding the auditor's report.

The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein. For example, examination of the system of internal control is one of the basic audit procedures employed by the auditor. The fact that the Order requires a statement regarding the internal control system applicable to purchases of inventory and fixed assets, and sale of goods and services only is no justification for the auditor to conclude that an examination of internal control regarding the other areas of a company's business is not important or not required.

Applicability of the Order: The CARO, 2015 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13.

However, the Order specifically **exempts** the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined under the Insurance Act,1938;

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;

(v) a small company as defined under clause (85) of section 2 of the Companies Act; and

(vi) a private limited company with a paid up capital and reserves not more than ₹ 50 lakh and which does not have loan outstanding exceeding ₹ 25 lakh from any bank or financial institution and does not have a turnover exceeding ₹ 5 crore at any point of time during the financial year.

Matters to be included in the Auditor's Report: Paragraph 3 of the Order requires the auditor to include a statement in the auditor's report on the following matters, namely-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

(ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;

(b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;

(c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

(iii) whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act. If so,

(a) whether receipt of the principal amount and interest are also regular; and

(b) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest.

(iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.

(v) in case the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed there under, where applicable, have been complied with? If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) where maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, whether such accounts and records have been made and maintained.

(vii) (a) is the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

(b) in case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

(c) whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 and rules made thereunder has been transferred to such fund within time.

(viii) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

(ix) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported.

(x) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

(xi) whether term loans were applied for the purpose for which the loans were obtained.

(xii) whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

Reasons to be Stated for Unfavourable or Qualified Answers: Where the answer to any of the questions referred to in paragraph 3 of the Order is unfavourable or qualified, in the auditor's report, the auditor shall also state the reasons for such unfavourable or qualified answer, as the case may be.

Further, where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Consequential Amendment to the Format of the Auditor's Report of a Company: The Auditing and Assurance Standards Board has issued illustrative formats of the auditor's report on financial statements of a company under the Companies Act, 2013. While reporting on the requirements of CARO, 2015, a reference thereto also needs be added in the main audit report under the "Report on Legal and Other Regulatory Matters" paragraph as follows:

"Report on Other Legal and Regulatory Requirements

As required by the Companies (Auditor's Report) Order, 2015 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of section 143 of the

Companies Act, 2013, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

As required by Section 143(3) of the Act, we report that:

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2. **<u>Companies (Cost Records and Audit) Rules, 2014:</u>** The Central Government has amended the Companies (Cost Records and Audit) Rules, 2014 dated 31st December, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

   Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

   The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/industry/sector/product/service prescribed under the said rule are given below:

   (A) Regulated Sectors-

   (i) Telecommunication services made available to users by means of any transmission or reception of signs, signals, images etc. (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India.

   (ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.

   (iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.

   (iv) Drugs and Pharmaceutical.

   (v) Sugar and industrial alcohol.

   (B) Non-Regulated Sectors-

   (i) Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items.

   (ii) Turbo jets and turbo propellers.

   (iii) Tyres and Tubes.

   (iv) Steel; Cement.

(v) Production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.

As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in **Form CRA-1**. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2015, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-

(i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.

(ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

Casual Vacancy in the Office of a Cost Auditor: Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in **Form CRA-2** within 30 days of such appointment of cost auditor.

3. General Features of Cost Records: The following general features of the cost records to be maintained in the books of accounts as per Form CRA-1 pursuant to rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014 have been amended by the Central Government *vide* notification dated 31st December, 2014-

(i) Material Costs- Proper records shall be maintained showing separately all receipts, issues and balances both in quantities and cost of each item of raw material required for the production of goods or rendering of services under reference.

The material receipt shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition. Finance costs incurred in connection with the acquisition of Material shall not form part of material cost.

Spares which are specific to an item of equipment shall not be taken to inventory, but shall be capitalized with the cost of the specific equipment. Cost of capital spares or insurance spares, whether procured with the equipment or subsequently, shall be amortised over a period, not exceeding the useful life of the equipment.

Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal. Where materials are accounted at standard cost, the price variances related to materials shall be treated as part of material cost.

The material cost of normal scrap or defectives which are rejects shall be included in the material cost of goods manufactured. The material cost of actual scrap or defectives, not exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap or objectives shall not be included in material cost but treated as loss after giving credit to the realisable value of such scrap or defectives.

Material costs shall be directly traced to a cost object to the extent it is economically feasible or shall be assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per above principles. Where the material costs are not directly traceable to the cost object, the same shall be assigned on a suitable basis like technical estimates.

Where a material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing or manufacturing charges payable to the third party shall be treated as part of the material cost.

(ii) Employee Cost- Proper records shall be maintained in respect of employee costs in whole such a manner as to enable the company to book these expenses cost centre wise or department wise with reference to goods or services under reference and to furnish necessary particulars. Where the employees work in such a manner that it is not possible to identify them with any specific cost centre or service centre or department, the employees cost shall be apportioned to the cost centre or service centres or departments on equitable and reasonable basis and applied consistently.

Employee cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.

Bonus whether payable as a statutory minimum or on a sharing of surplus shall be treated as part of employee cost. Ex-gratia payable in lieu of or in addition to bonus shall also be treated as part of the employee cost.

Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute shall be considered as part of the employee cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits. Remuneration paid to non-executive directors shall not form part of employee cost but shall form part of administrative overheads.

Where employee cost is accounted at standard cost, variances due to normal reasons related to employee cost shall be treated as part of employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.

Any recovery from the employee towards any benefit provided, namely, housing shall be reduced from the employee cost. Any change in the cost accounting principles applied for the determination of the employee cost shall be made only if it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.

Where the employee services are traceable to a cost object, such employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged or other related basis or similar identifiable measure. While determining whether a particular employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.

Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime. Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

(iii) Utilities- Proper records shall be maintained showing the quantity and cost of each major utility such as power, water, steam, effluent treatment and other related utilities produced and consumed by the different cost centres in such detail as to have particulars for each utility separately.

Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.

Cost of self-generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads. In case of utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as above. Cost of utilities generated for the intercompany transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.

Any subsidy or grant or incentive or any such payment received or receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.

(iv) Direct Expenses- Proper records shall be maintained in respect of direct expenses in such a manner as to enable the company to book these expenses cost centre wise or cost object or department wise with reference to goods or services under reference and to furnish necessary particulars.

Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited. Other direct expenses shall be determined on the basis of amount incurred on connection therewith.

(v) Repairs and Maintenance- Proper records showing the expenditure incurred by the workshop, tool room and on repairs and maintenance in the various cost centres or departments shall be maintained under different heads.

Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other Identifiable resources consumed in such activity. Indirect cost shall include the cost of resources common to various repairs and maintenance activities such as manpower, equipment usage and other costs allocable to such activities.

Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.

Cost of repairs and maintenance activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.

Each type of repairs and maintenance shall be treated as a distinct activity, in material and identifiable. Cost of repairs and maintenance activity shall be measured for each major asset category separately.

Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.

Where the repairs and maintenance cost is not directly traceable to cost object, it shall be assigned based on either of the following the principles of (1) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and (2) Benefits received - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them. If the repairs and maintenance cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects.

(vi) Fixed Assets and depreciation- Proper and adequate records shall be maintained for assets used for production of goods or rendering of services under reference n respect of which depreciation has to be provided for. These records shall, *inter-alia*, indicate grouping of assets under each good or service, the cost of acquisition of each item of asset including installation charges, date of acquisition and rate of depreciation.

The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.

Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.

Cost of small assets shall be written off in the period in which they were purchased as per the accounting policy of the entity.

(vii) Overheads- Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited.

Overheads other than those referred to above shall be determined on the basis of cost incurred in connection therewith. Any abnormal cost where it is material and quantifiable shall not form part of the overheads.

Finance costs incurred in connection with procured or self-generated resources shall not form part of overheads. Marketing overheads that can be identified to a product or service shall be assigned to that product or service.

(viii) Administrative Overheads- Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.

In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

The cost of software (developed in house, purchased, licensed or customised), including up-gradation cost shall be amortised over its estimated useful life.

The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.

Any subsidy or grant or incentive or any amount of similar nature received or receivable with respect to any administrative overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related. Administrative overheads shall not include any abnormal administrative cost.

Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.

(ix) Transportation Cost- Proper records shall be maintained for recording the actual cost of transportation showing each element of cost such as freight, cartage, transit insurance and others after adjustment for recovery or transportation cost. Abnormal costs relating to transportation, if any, are to be identified and recorded for exclusion of computation of average transportation cost.

In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant grease, amortized cost of tyres and battery, repairs and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled and transported to the depot.

In case of hired transport charges incurred for despatch of goods, complete details shall be recorded as to date of despatch, type of transport used, description of the goods, destination of buyer, name of consignee, challan number, quantity of goods in terms of weight or volume, distance involved, amount paid and other related details.

(x) Royalty and Technical Know-how- Adequate records shall be maintained showing royalty or technical know-how fee including other recurring or non-recurring payments of similar nature, if any, made for the goods or services under reference to collaborators or technology suppliers in terms of agreements entered into with them.

Royalty and technical know-how fee paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from the related asset. Amortisation of the amount of royalty or technical know-how fee paid for which the benefit is ensued in the current or future periods shall be determined based on the production or service volumes estimated for the period over which the asset is expected to benefit the entity.

Amount of the royalty and technical know-how fee shall not include finance costs and imputed costs. Any subsidy or grant or incentive or any such payment received or receivable with respect to amount of royalty and technical know-how fee shall be reduced to measure the amount of royalty and technical know-how fee.

(xi) Research and Development Expenses- Research and development costs shall include all the costs that are directly traceable to research or development activities or that can be assigned to research and development activities strictly on the basis of (a) cause and effect or (b) benefits received.

(xii) Quality control expenses- Adequate records shall be maintained to indicate the expenses incurred in respect of quality control department or cost centre or service centre for goods or services under reference. Where these services are also utilized for other goods or services of the company, the basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.

(xiii) Pollution control expenses- Adequate records shall be maintained to indicate the expenses incurred in respect of pollution control. The basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.

Pollution control costs shall be the aggregate of direct and indirect cost relating to pollution control activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing and certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others. Indirect cost shall include the cost of resources common to various pollution control activities such as pollution control registration and such like expenses.

(xiv) Service department expenses- Proper records shall be maintained in respect of service departments, that is, cost centres which primarily provide auxiliary services across the enterprise, to indicate expenses incurred in respect of each such service cost centre like engineering, work shop, designing, laboratory, safety, transport, computer cell, welfare and other related centres.

Each identifiable service cost centre shall be treated as a distinct cost object for measurement of the cost of services subject to the principle of materiality.

Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre. Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service. Cost of other resources shall include related overheads. Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.

(xv) Packing expenses- Proper records shall be maintained separately for domestic and export packing showing the quantity and cost of various packing materials and other expenses incurred on primary or secondary packing indicating the basis of valuation.

The packing material receipts shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified at the time of acquisition.

Finance costs directly incurred in connection with the acquisition of packing material shall not form part of packing material cost.

Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.

(xvi) Interest and financing charges- Interest and financing charges are costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non-equity fund.

Interest and financing charges incurred shall be identified for-

(I) acquisition or construction or production of qualifying assets including fixed assets; and

(II) other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.

Interest and financing charges directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset. The charges shall not include imputed costs.

Subsidy or grant or incentive or amount of similar nature received or receivable with respect to interest and financing Charges, if any, shall be reduced to ascertain the net interest and financing charges.

(xvii) Any other item of cost- Proper records shall be maintained for any other item of cost being indispensable and considered necessary for inclusion in cost records for calculating cost of production of goods or rendering of services, cost of sales, margin in total and per unit of the goods or services under reference.

(xviii) Capacity determination- Capacity shall be determined in terms of units of production or equivalent machine or man hours.

Installed capacity is determined based on-

(I) manufacturers' technical specifications;

(II) capacities of individual or interrelated production centres;

(III) operational constraints or capacity of critical machines; or

(IV) number of shifts.

In case manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity. In case any production facility is added or discarded the installed capacity shall be reassessed from the date of such addition or discard. In case the same is reassessed as per direction of the Government, it shall be in accordance with the principles laid down in the said directives. In case of improvement in the production process, the installed capacity shall be reassessed from the date of such improvement.

Normal capacity shall be determined *vis-a-vis* installed capacity after carrying out adjustments for-

(I) holidays, normal shut down days and normal idle time;

(II) normal time lost in batch change over;

(III) time lost due to preventive maintenance and normal break downs of equipments;

(IV) losing efficiency due to ageing of the equipment; or

(V) number of shifts;

Capacity utilization is actual production measured as a percentage of installed capacity.

(xix) Work-in-progress and finished stock- The method followed for determining the cost of work-in-progress and finished stock of the goods and for services under delivery or in-process shall be appropriate and shall be indicated in the cost records so as to reveal the cost element that have been taken into account in such computation. All conversion costs incurred in bringing the inventories to their present location and condition shall be taken into account while computing the cost of work-in-progress and finished stock. The method adopted for determining the cost of work in progress and finished goods shall be followed consistently.

(xx) Captive consumption- If the goods or services under reference are used for captive consumption, proper records shall be maintained showing the quantity and cost of each such goods or services transferred to other departments or cost centres or units of the company for self-consumption and sold to outside parties separately.

(xxi) By-Products and Joint Products- Proper records shall be maintained for each item of by-product, if any, produced showing the receipt, issues and balances, both in quantity and value. The basis adopted for valuation of by-product for giving credit to the respective process shall be equitable and consistent and shall be indicated in cost records. Records showing the expenses incurred on further processing, if any, and actual sales realisation of by-product shall be maintained. The proper records shall be maintained in respect of credits or recoveries from the disposal of by-products.

Proper records shall be maintained the cost up to the point of separation of products or services shall be apportioned to joint products or services on reasonable and equitable basis and shall be applied consistently. The basis on which such joint costs are apportioned to different products or services arising from the process shall be indicated in the cost records. Proper records shall be maintained in respect credits or recoveries from the disposal of joint products or services.

(xxii) Adjustment of cost variances- Where the company maintains cost records on any basis other than actual such as standard costing, the records shall indicate the procedure followed by the company in working out the cost of the goods or services under such system. The cost variances shall be shown against separate heads and analyzed into material, labour, overheads and further segregated into quantity, price and efficiency variances. The method followed for adjusting the cost variances in determining the actual cost of the goods or services shall be indicated clearly in the cost records. The reasons for the variances shall be duly explained in the cost records and statements.

(xxiii) Reconciliation of cost and financial accounts- The cost statements shall be reconciled with the financial statements for the financial year specifically indicating the expenses or incomes not considered in the cost records or statements so as to ensure accuracy and to adjust the profit of the goods or services under reference with the overall profit of the Company. The variations, if any, shall be clearly indicated and explained.

(xxiv) Related party transactions- Related Party means related party as defined under clause (76) of section 2 of the Companies Act 2013.

'Normal' price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged in the sole consideration of sale and such sale is not made to a related party. Normal price can be construed to be a price at which two unrelated and non-desperate parties would agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and free from influence though the parties may have shared interest.

In respect of related party transactions or supplies made or services rendered by a company to a company termed 'related party relationship' and vice-a-versa, records shall be maintained showing contracts entered into, agreements or understanding reached in respect of-

(I) purchase and sale of raw materials, finished goods, rendering of services, process materials and rejected goods including scraps and other related materials;

(II) utilisation of plant facilities and technical know-how;

(III) supply of utilities and any other services;

(IV) administrative, technical, managerial or any other consultancy services;

(V) purchase and sale of capital goods including plant and machinery; and

(VI) any other payment related to the production of goods or rendering of services under reference.

(xxv) Expenses or incentives on exports- Proper records showing the expenses incurred on the export sales, if any, of the goods or services under reference shall be separately maintained so that the cost of export sales can be determined correctly. Separate cost statements shall be prepared for goods or services exported giving details of export expenses incurred or incentive earned.

Proper records shall be maintained giving the details of export commitments license-wise and the fulfillment of these commitments giving the reasons for non-compliance, if any. In case, duty free imports are made, the cost statements shall reflect this fact. If the duty free imports have been made after actual production, the statement shall reflect this fact also.

(xxvi) Production Records- Quantitative records of all finished goods (packed or unpacked) or services rendered showing production, issues for sales and balances of different type of the goods or services under reference, shall be maintained. The quantitative details of production of goods or services rendered shall be maintained separately for self-produced, third party on job work, loan license basis etc.

(xxvii) Sales records- Separate details of sales shall be maintained for domestic sales at control price, domestic sales at market price, export sales under advance license, export sales under other obligations, export sales at market price, and sales to related party or inter unit transfer. In case of services details of domestic delivery or sales at control price, domestic delivery or sales at market price, export delivery or sales under advance license, export delivery or sales under other obligations, export delivery or sales at market price, and delivery or sales to related party or inter unit transfer. Such details shall be maintained separately for each plant or unit wise or service center wise for total as well as per unit sales realization.

(xxviii) Cost statements- Cost statements (monthly, quarterly and annually) showing quantitative information in respect of each good or service under reference shall be prepared showing details of available capacity, actual production, production as per excise records, capacity utilization (in-house), stock purchased for trading, stock and other adjustments, quantity available for sale, wastage and actual sale during current financial year and previous year.

Such statements shall also include details in respect of all major items of costs constituting cost of production of goods or services, cost of sales of goods or services and margin in total as well as per unit of the goods or services. The goods or services emerging from a process, which forms raw material or an input material or service for a subsequent process, shall be valued at the cost of production or cost of service up to the previous stage.

Cost Statements in respect of reconciliation of indirect taxes showing details of total clearances of goods or services, assessable value, duties or taxes paid, CENVAT or VAT or Service Tax credit utilized, duties or taxes recovered and interest or penalty paid.

If the company is operating more than one plant, factory or service centre, separate cost statements as specified above shall be prepared in respect of each plant, factory or service centre.

(xxix) Statistical Records- The records regarding available machine hours or direct labour hours in different production departments and actually utilized shall be maintained for production of goods or rendering of services under reference and shortfall suitably analyzed. Suitable records for computation of idle time of machines or labour shall also be maintained and analyzed.

Proper records shall be maintained to enable the company to identify the capital employed, net fixed assets and working capital separately for the production of goods or rendering of services under reference and other goods or services to the extent such elements are separately identifiable. Non-identifiable items shall be allocated on a suitable and reasonable basis to different goods or services. Fresh investments on fixed assets for production of goods or rendering of services under reference that have not contributed to the production of goods or rendering of services during the relevant period or year shall be indicated in the cost records. The records shall, in addition, show assets added as replacement and those added for increasing existing capacity.

(xxx) Records of Physical Verification- Records of physical verification may be maintained in respect of all items held in the stock such as raw materials, process materials, packing materials, consumables stores, machinery spares, chemicals, fuels, finished goods and fixed assets etc. Reasons for shortages or surplus arising out of such verifications and the method followed for adjusting the same in the cost of the goods or services shall be indicated in the records.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Standards on Auditing, Statements and Guidance Notes

1. (a) CA Jack, a recently qualified practicing Chartered Accountant got his first audit assignment of Futura (P) Ltd. for the financial year 2014-15. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA Jack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting ₹ 150 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA Jack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment.

   (b) M/s Sureshchandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2014-15. CA Suresh, one of the partners of M/s Sureshchandra &

Co., completed entire routine audit work by 29th May, 2015. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA Chandra, another partner of M/s Sureshchandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA Suresh. State with reasons whether CA Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor.

2. (a) Ferry Ltd. is a leading employee friendly company operating in India. The company outsourced the most critical function of its HR Department i.e. the actuarial services to Ms. Preeti, a renowned practicing actuary, for ascertaining its employee cost, gratuity and leave encashment liabilities.

As the auditor of Ferry Ltd., you would like to use the report submitted by the actuary as an audit evidence. How would you evaluate the work of the actuary?

(b) CA Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Kishor, the statutory auditor of the Company, for his view and reporting. Can CA Kishor rely on such report?

Audit Strategy, Planning and Programming

3. xLoud, a movie theater complex, is the foremost theater located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe shops, pubs etc. located in the complex. Its ‘other income’ includes advertisements exhibited within/outside the premises such as hoarding, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.

xLoud appointed your firm as the auditor of the entity. Being the head of the audit team, you are therefore required to draw an audit programme initially in respect of its revenue and expenditure considering the above mentioned facts along with other relevant points related to a complex.

Risk Assessment and Internal Control

4. (a) You are the auditor of Max Ltd., a distributor of automotive components, and have been provided with the following description of the sales order processing system.

Order entry

Sales orders are taken over the telephone and entered into the computer by a sales order clerk *via* a terminal in the sales office while the customer is on the line. On entry the order details are read back to the customer for confirmation. The computer checks that there are sufficient inventories to meet the order and that the customer’s credit limit is not exceeded.

If the goods are unavailable, the customer is asked if he wants the order to be recorded as a 'backorder' which will be fulfilled when there is sufficient inventory. Once accepted, the order is automatically given an order number which is relayed to the customer.

Orders which take a customer over his credit limit are referred to the credit controller who decides, in consultation with the chief accountants, whether or not the customer should be allowed to exceed the credit limit or have the credit limit raised. Any adjustments in respect of overrides of, or increase in, credit limits are input *via* a terminal in the accounts department by the credit controller. Printouts of these amendments are not generated and no other review of credit limits is undertaken.

New customers are referred to the credit controller who obtains credit ratings and references and on the oral authority of the chief accountant, enters the customer account details on to the sales.

Dispatch of goods

Sequentially-numbered packing notes in respect of accepted orders are printed out in the warehouse and the goods are selected, packed and checked by warehouse staff. Confirmations of packing and any notifications of short falls are entered into the computer *via* a terminal in the warehouse by the warehouse supervisor. Two copies of the sequentially numbered delivery advice are printed in the warehouse and sent with the goods to the customer who is required to sign a copy which is returned by the driver to the accounts department. All dispatches are checked at the gate house to ensure that they are accompanied by the appropriate documentation. The packing notes are filed in numerical order in the warehouse and the sequence is checked for completeness on a daily basis by the warehouse supervisor.

The system does not automatically generate purchase orders with manufacturers when a customer's order cannot be fulfilled.

Computer system

All users of the system are required to log on using identification codes and individual passwords which control their level of access to the system. All passwords are changed every 90 days and when employees leave. System's support is provided by a supplier where the service agreement provides for availability of a back–up system within 72 hours of a systems failure.

Requirements

(i) Identify the objectives of exercising internal controls over sales order processing ignoring sales invoicing or ledger processing. For each objective discuss the extent to which the procedures exercised by Max Ltd. achieve the objective.

(ii) Set out, in a manner suitable for inclusion in a report to management, any weaknesses in the system described above. For each weakness you should include the possible consequence of the weakness and a recommendation to remedy the weakness.

(b) "Corporate accountability and civil and criminal penalties for white collar crimes." Comment on the major provisions of Sarbanes Oxley Act.

Audit under CIS Environment

5. Techno Ltd., for the first time, is considering computerizing its manner of maintaining documentation. This change will have a significant effect on the organization control, flow of document information processing and so on. This will also require the auditor of the company to gain knowledge about computer environment (Hardware, software etc.) and keep pace with rapidly changing technology even to the extent of using sophisticated Audit software.

   You, being an expert of audit under CIS environment are required to guide the auditor of the company by explaining -

   (a) The risks and internal control characteristics in an audit conducted in Computer Information Systems (CIS) environment.

   (b) Whether the use of audit software would increase the probability of detecting frauds.

The Company Audit & Audit Report

6. (a) CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of ₹ 6,00,000 as on 01.04.2015. However, CA Adroit having come to know that he might be appointed as auditor of the company, he squared up the amount on 10.7.2015. Later on, he was appointed as an auditor of the company for the year ended 31.3.2016 at the Annual General Meeting held on 16.07.2015.

   Subsequently, one of the shareholders complains that the appointment of CA Adroit as an auditor is invalid because he incurred disqualification under section 141 of the Companies Act, 2013. Comment.

   (b) While auditing Y Ltd., CA Max, the statutory auditor of Y Ltd. encounters exceptional circumstances that bring into question his ability to continue performing the audit. Considering it appropriate, CA Max resigned from the office of auditor of Y Ltd. Due to the resignation of the existing auditor, the Board of Directors of Y Ltd. itself appointed CA Mini, a practicing Chartered Accountant, as the statutory auditor till the conclusion of 6th meeting.

   You are required to state the provisions related to filling of casual vacancy as per the Companies Act, 2013 and comment upon the validity of appointment made by the Board.

   (c) Malta Pvt. Ltd., a newly incorporated company dated 01.07.2015 is engaged in the manufacturing business of Cotton Shirts. On 30.07.2015, the Managing Director of Malta Pvt. Ltd. himself appointed CA Rajnath, his daughter's husband, as the first auditor of the company.

You are required to –

(i) state the provisions of the Companies Act, 2013 relating to appointment of first auditor.

(ii) comment on the action of the Managing Director.

(d) Carroty Ltd. appointed M/s CROSS as the sole statutory auditor for financial year 2015-16 where till last year M/s WORD was also one of the joint auditors along with M/s CROSS. Mention the steps that should be taken by M/s CROSS before commencing the audit work.

7. Comment on the following situations:

(a) The Board of Directors of Polite Ltd. made an aggregate of online contribution of ₹ 37.5 lakhs to a National Defence Fund for the financial year ending on 31st March, 2016. All the contribution of the fund is used for the welfare of the members of the Armed Forces and their dependents. The average net profit of the company during the three immediately preceding financial years was ₹ 476 lakhs.

The manager of the company is of the view that the maximum contribution that can be made to a National Defence Fund is ₹ 35.7 lakhs and, therefore, the company is violating the provisions of the Companies Act, 2013.

(b) Pirana Ltd. issued 10,000 shares of face value of ₹ 10 each at a premium of ₹ 490 each in May, 2015. The company received the stated minimum amount in the prospectus and transferred a sum equal to the aggregate amount of the premium received on shares (i.e. ₹ 49 lakhs) to the 'Securities Premium Account'.

Unfortunately, in the month of July, the godown of the company caught fire and stock worth ₹ 45 lakhs burnt to ashes.

Now, the management desires to adjust the loss due to fire against the said premium account.

(c) Axel Ltd., a newly incorporated company in India, commenced its business from 1st April, 2014. The Company purchased a machinery costing ₹ 4,000 lakhs on 01.04.2014 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in 4 annual equal installments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 43.00 as on 01-04-2014 and 31-03-2015 respectively. The company worked out foreign exchange loss as per AS 11 at ₹ 300 Lakhs and expensed the entire amount in the statement of profit and loss. The Managing Director of the company was worried about this heavy revenue loss and asked the accountant not to follow AS 11 issued by the ICAI for this particular transaction. The accountant of the company followed the instruction of the Managing Director and removed exchange loss from the statement of profit and loss but then he added the entire exchange loss to the value of machinery and computed the depreciation thereon.

(d) Forex Pvt. Ltd. started stock broking activities in May, 2014. For this purpose, it acquired membership of a stock exchange for ₹ 150 lakhs. While finalizing the accounts for the financial year ending March, 2015, 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 thinking that the rights would enable the company to perpetually carry on its business.

8. (a) E-Tech Pvt. Ltd., which has an aggregate outstanding loan of ₹ 20 lakhs from Banks and ₹ 30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies (Auditor's Report) Order, 2015 is not applicable.

You are required to state the list of companies to which CARO is applicable and state how would you deal with the given situation as an auditor of the company.

(b) Zig Pvt. Ltd. has granted a loan of ₹ 20 crores to its associate Zag Pvt. Ltd. at the beginning of the financial year and it remain outstanding at the year end. How the auditor should report the fact?

(c) During the course of audit of Visionary Ltd. it is noticed that out of ₹ 12 lakhs of provident fund contribution accounted in the books, only ₹ 5 lakhs has been remitted to the authorities during the year. On enquiry, the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as and when the position improves. As a Statutory Auditor, how would you deal?

(d) You have been appointed as an auditor of Giant Ltd. The company closed one of its main manufacturing units and sold all its fixed assets during the financial year ended 31st March, 2015. However, it intends to continue its operations as a trading company. In respect of other fixed assets, the company carried out a physical verification as at the end of 31st March, 2015 and found a material discrepancy to the tune of ₹ 80,000, which was written off and is disclosed separately in the Statement of Profit and Loss. How are you supposed to incorporate the above in your audit report?

Liabilities of Auditor

9. (a) Cloud Ltd. appointed an auditor for the financial year 2015-16. While going through the audit procedure, the auditor observed that the management has entered into certain transactions which are irregular in nature and the management is personally benefited from such transactions.

Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.

(b) 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).

Audit Committee and Corporate Governance

10. (a) A leading corporate in India approached Mr. Watson, a renowned and experienced

Chartered Accountant at international level, to join its Board and also as a Chairman of its Audit Committee for reviewing the annual financial statements of the entity. Mr. Watson expressed his consternation that he is not having the requisite experience regarding the responsibilities of an Audit Committee.

Mr. Watson seeks your advice on the responsibility of Audit Committee *vis-a-vis* the review of Financial Statements.

(b) State the main features of the Qualified and Independent Audit Committee set up under clause 49 of the listing agreement.

Audit of Consolidated Financial Statements

11. Hold Ltd. has two subsidiaries and one associate. While doing the audit of Consolidated Financial Statements (CFS) of Hold Ltd., you have come to know that the associate entity had made a provision for proposed dividend in its financial statements. Hold Ltd. computed its share of the results of operations of the associate after taking into account the proposed dividend. Comment.

Audit of Banks

12. (a) Your firm has been appointed as central statutory auditors of Rustic Bank, a nationalised bank of India. In the course of audit, you observed that the accountant has classified an advance as NPA due to non-receipt of latest stock statement. You further observed that there are many other wrong classification of assets to NPA without considering RBI norms issued in this perspective.

You are therefore required to guide him by stating the exceptions to the general rule of treating advances as Non-performing Assets (NPAs).

(b) As the concurrent auditor of Unity Bank, you are requested by its management to draft an internal control policy in respect of loans and advances. What factors would you consider as important while drafting such a policy?

Audit of General Insurance Companies

13. 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?

Audit under Fiscal Laws

14. (a) Ploy Ltd., engaged in the leasing of goods carriage, appointed you as the tax auditor for the financial year 2015-16. How would you deal with the following matters in your tax audit report:

(i) Payments of 6 invoices of ₹ 5,000 each made in cash to Mr. X on 4th July, 2015.

(ii) Payments of 2 invoices of ₹ 18,000 each made in cash to Mr. Y on

5th July, 2015 and 6th July, 2015 respectively.

(iii) Payment of ₹ 40,000 made in cash to Mr. Z on 7th July, 2015 against an invoice for expenses booked in 2014-15.

(b) 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 2015-16.

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.

As a tax auditor, how would you deal with the matter?

(c) Nadir India (P) Ltd. appointed a tax auditor under the value added tax system to conduct its VAT audit for the financial year 2015-16. You are required to state the approach to be adopted and the major areas to be tested by the tax auditor while conducting the tax audit under VAT laws.

Cost Audit

15. Mithas Ltd. is a top sugar manufacturer and exporter in India operating from Noida Specific Economic Zone, Uttar Pradesh. Its revenue from sale/export for the current year is given below:

Sale within India	₹ 153 lakhs
Sale outside India (Export)	₹ 357 lakhs
Total Revenue	₹ 510 lakhs

Mr. X, the statutory auditor of Mithas Ltd., is of the view that the company is mandatorily required to include cost records in their books of account and consequently conduct cost audit. He also suggested the name of his friend, who is a Cost Accountant in Practice, for the purpose of such cost audit. However, the management is of the view that the company neither required including cost records in their books of account nor conduct cost audit.

Being an expert in cost records and audit rules, you are required to guide the management in this regard.

Audit of Public Sector Undertakings

16. (a) While planning a performance audit, the auditor should define the audit's objectives and the scope and methodology to achieve those objectives. What are the other

factors the auditor needs to consider while planning such audit?

(b) What is a comprehensive audit of public enterprises? Discuss some of the areas to be examined therein.

Internal Audit, Management and Operational Audit

17. (a) UV Ltd. appointed CA Manan, a recently qualified CA, for conducting internal audit for the financial year 2015-16. CA Manan seeks your advice in drafting a good quality internal audit report. You are, therefore, required to guide him by elaborating essential features of a good internal audit report.

(b) 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.

In this perspective, state the following -

(i) Need of operational auditing.

(ii) Major differences between Financial and Operational Auditing.

Investigation and Due Diligence

18. (a) A departmental store has a very large turnover in cash sales of all kinds of items such as groceries, foodstuffs, sweets, chocolates, and other related items. One day, the accountant of the store stole all the cash receipts and cleverly misguided the management about the embezzlement.

The management appointed you to investigate the suspected embezzlement of cash receipts in the departmental store. What are the steps you would take in this regard?

(b) A nationalised 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 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 investing accountant would involve in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank.

Professional Ethics

19. Comment on the following with reference to the Chartered Accountants Act, 1949, and Schedules thereto:

(a) CA Brilliant is a leading income tax practitioner and consultant for derivative products. He resides in Mumbai near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day he invests most of his time to settle the commodity transactions though he has not obtained any permission from the Institute for conducting such business.

(b) 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.

(c) Mr. Hopeful, an aspiring student of ICAI, approached Mr. Witty, a practicing Chartered Accountant, for the purpose of articleship. Mr. Witty, the principal, offered him stipend at the rate of ₹ 2,000 per month to be paid every sixth month along with interest at the rate of 10% per annum compounded monthly to compensate such late payment on plea that cycle of professional receipts from clients is six months. Mr. Hopeful agreed for such late payment in the hope of getting extra stipend in the form of interest.

Mr. Witty, however, used to disburse salary to all of his employees on time.

(d) 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 assignments comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI.

Other Miscellaneous Chapters

20. Write short notes on the following:

(a) Focus of a Peer review.

(b) Statistical and Non-Statistical Sampling.

(c) Purpose of appointing Inspecting officer of a Depository.

(d) Restrictions on investments of funds of a central co-operative society.

(e) Special points that may be covered in the audit of equipment leasing finance company.

SUGGESTED ANSWERS / HINTS

1. (a) Verification of Accounts Receivable: As per SA 510 "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

(i) Opening balances contain misstatements that materially affect the current period's financial statements; and

(ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

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

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

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

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

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

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

(b) **Relying on Work Performed by Another Auditor:** As per SA 220 "Quality Control for an Audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed; the work performed supports the conclusions reached and is appropriately documented; the evidence obtained is sufficient and appropriate to support the auditor's report; and the objectives of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.

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

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA Suresh. However, the report could not be signed by him due to his unfortunate death. Later on, CA Chandra signed the report relying on the work performed by CA Suresh. Here, CA Chandra is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA Suresh provided he further exercises adequate skill and due care and review the work performed by him.

2. (a) **Evaluating the Work of Management's Expert:** As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes,-

(i) Evaluate the competence, capabilities and objectivity of that expert;

(ii) Obtain an understanding of the work of that expert; and

(iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert;

discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

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

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

(i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;

(ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

(iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

(b) **Using the Work of Internal Auditor:** As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors is likely to be adequate for the purpose of the audit, the external auditor shall evaluate-

(i) the objectivity of the internal audit function;

(ii) technical competence of the internal auditors;

(iii) whether the work of the internal auditors is likely to be carried out with due professional care; and

(iv) whether there is likely to be effective communication between the internal auditors and the external auditor.

To determine the adequacy of specific work performed by the internal auditors for the external auditor's purposes, the external auditor shall evaluate whether the internal auditors have adequate technical training and proficiency; work was properly supervised, reviewed and documented; any reports prepared are consistent with the results of the work performed etc.

In the instant case, CA Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check few items and he can also observe the procedures performed by the internal auditors.

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

3. Audit Programme of a Complex:

(i) Peruse the Memorandum of Association and Articles of Association of the entity.

(ii) Ensure the object clause permits the entity to engage in this type of business.

(iii) In the case of income from sale of tickets:

(1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.

(2) Verify the system of relating to online booking of various shows and the system of realization of money.

(3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.

(iv) Verify the internal control system and its effectiveness relating to the income from cafe shops, pubs etc., located within the multiplex.

(v) Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.

(vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.

(vii) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.

(viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.

(ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.

4. (a) (i) Internal Controls over Sales Order Processing

Objectives	Extent to which achieved by Max Ltd's procedures
➢ To ensure that goods are available for all orders accepted.	➢ The availability of inventories is checked on the computer system while the customer is on the line. ➢ This will be effective only where the system is continuously updated for new orders and deliveries of inventories.
➢ To ensure that existing customers are within	➢ The computer system automatically checks that the

their credit limits (including the current order being taken).	customer is within his current credit limit. ➢ Adjustments to credit limits are carried out by the credit controller but no review of any amendments is carried out.
➢ To ensure that new customers are credit worthy before	➢ The credit controller carries out credit checks but details are amended on the terminal in the accounts department only after oral authority from the chief accountant, and no subsequent review of new customers is performed.
➢ To ensure that changes to credit limits are valid.	➢ As above.
➢ To ensure that the correct goods are dispatched to each customer.	➢ Order details are read back to the customer to confirm their accuracy. ➢ Packing notes are produced in the warehouse giving the details of the order. However, there is no responsibility assigned in respect of dealing with shortfalls of inventories and ensuring that the customer ultimately receives all of the goods ordered.
➢ To ensure that goods are dispatched for all orders accepted	➢ Packing notes are sequentially numbered and a completeness check is carried out on a daily basis.
➢ To ensure that all goods leaving the premises are in respect of valid orders.	➢ All goods leaving the warehouse are checked at the gate house to ensure that they are accompanied by a valid delivery advice.
➢ To ensure that back orders are fulfilled when inventories become available.	➢ There are no procedures in place to ensure that, one goods are received by Max Ltd., back orders are fulfilled.

(ii) Points for inclusion in a report to management

Weakness	Consequence	Recommendation
➢ There is no review of amendments to credit limits once these have been processed on the system.	➢ Invalid amendments could be made, leading to supply of goods to non-credit worthy customers.	➢ An exception report should be produced on a weekly basis detailing all changes made to credit limits. This should be reviewed by the chief accountant, and evidenced by his signature, to ensure that all amendments are for valid business reasons.
➢ Authority to enter new customers on to the system is only given orally with no review of the credit ratings and references obtained.	➢ Invalid entries of new customers could be made without detection until non-payment of invoices arises.	➢ The chief accountant should review the credit ratings and references obtained before giving authority to accept the new customer.
➢ There is no responsibility assigned for dealing with shortfalls in orders when they are being selected in the warehouse.	➢ Delivery of part-complete orders and non-delivery of parts of orders will lead to loss of customer goodwill and subsequent loss of revenue.	➢ A daily printout of unprocessed orders should be produced and followed up by the warehouse supervisor.
➢ There are no procedures to ensure that back orders are fulfilled when the goods become available.	➢ Delay in fulfilling customer orders will again lead to loss of customer goodwill.	➢ The system should produce a daily list of items that have come into inventory for which there are current backorders. The sales ledger clerk should contact

		the customer to ensure that the goods are still required and then process the order in the normal manner.
➢ When back orders are accepted the goods which are unavailable are not immediately reordered.	➢ There may be significant delays in fulfilling these orders.	➢ The computer should automatically generate purchase requisitions on a daily basis for items which have been requested but are unavailable. A supervisor should review these purchase requisitions and raise a purchase order where the goods have not already been ordered.

Additional notes:

- Credit control procedures do not take the age of the debt into consideration; this could result in goods being dispatched to slow payers.
- In respect of the failure to review credit limits on a regular basis, limits may be unrealistically low for customers with a good payment history, resulting in loss of business.
- Response time in respect of systems support is too slow; this could result in delayed and lost orders.

(b) Major Provisions of Sarbanes Oxley Act: The Sarbanes Oxley Act of 2002 established corporate accountability and civil and criminal penalties for white – collar crimes. This Act also known as the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called SOX or Sarbox; is a United States federal law passed in response to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, and WorldCom. These scandals resulted in a decline of public trust in accounting and reporting practices.

This Act provides regulatory bodies and courts to take various actions – civil and criminal proceedings in connection of misstatements amounting to accounting scandals and fraudulent financial reports, other frauds on securities matters, obstruction of justice and retaliating against corporate whistleblowers. The Act also enforce tougher civil and criminal penalties for fraud and accounting scandals, securities fraud and certain other forms of obstruction of justice. The Act further protect employer against corporate whistle blowers (person who provide evidence of fraud in the company).

Some of the major provisions of Sarbanes-Oxley Act of 2002 are:

(i) Creation of the Public Company Accounting Oversight Board (PCAOB);

(ii) A requirement that public companies evaluate and disclose the effectiveness of their internal controls as they relate to financial reporting, and that independent auditors for such companies "attest" (i.e., agree, or qualify) to such disclosure;

(iii) Certification of financial reports by chief executive officers and chief financial officers;

(iv) Auditor independence, including outright bans on certain types of work for audit clients and pre-certification by the company's Audit Committee of all other non-audit work;

(v) Ban on most personal loans to any executive officer or director;

(vi) Accelerated reporting of insider trading;

(vii) Prohibition on insider trades during pension fund blackout periods;

(viii) Enhanced criminal and civil penalties for violations of securities law;

(ix) A requirement that companies listed on stock exchanges have fully independent audit committees that oversee the relationship between the company and its auditor;

(x) Additional disclosure;

(xi) Significantly longer maximum jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements, although maximum sentences are largely irrelevant because judges generally follow the Federal Sentencing Guidelines in setting actual sentences;

(xii) Employee protections allowing those corporate fraud whistleblowers who file complaints with OSHA within 90 days to win reinstatement, back pay and benefits, compensatory damages, and congressional page abatement orders, and reasonable attorney fees and costs.

5. (a) The Risks and Internal Control Characteristics in CIS Environment include the following:

(i) **Lack of transaction trails:** Some computer information systems are designed so that a complete transaction trail that is useful for audit purposes might exist for only a short period of time or only in computer readable form. Where a complex application system performs a large number of processing steps, there may not be a complete trail. Accordingly, errors embedded in an application's program logic may be difficult to detect on a timely basis by manual (user) procedures.

(ii) **Uniform processing of transactions:** Computer processing uniformly processes like transactions with the same processing instructions. Thus, the clerical errors ordinarily associated with manual processing are virtually eliminated. Conversely, programming errors (or other systemic errors in hardware or software) will ordinarily result in all transactions being processed incorrectly.

(iii) **Lack of segregation of functions:** Many control procedures that would ordinarily be performed by separate individuals in manual systems may become concentrated in a CIS environment. Thus, an individual who has access to computer programs, processing or data may be in a position to perform incompatible functions.

(iv) **Potential for errors and irregularities:** The potential for human error in the development, maintenance and execution of computer information systems may be greater than in manual systems, partially because of the level of detail inherent in these activities. Also, the potential for individuals to gain unauthorised access to data or to alter data without visible evidence may be greater in CIS than in manual systems.

In addition, decreased human involvement in handling transactions processed by computer information systems can reduce the potential for observing errors and irregularities. Errors or irregularities occurring during the design or modification of application programs or systems software can remain undetected for long periods of time.

(v) **Initiation or execution of transactions:** Computer information systems may include the capability to initiate or cause the execution of certain types of transactions, automatically. The authorisation of these transactions or procedures may not be documented in the same way as that in a manual system, and management's authorisation of these transactions may be implicit in its acceptance of the design of the computer information systems and subsequent modification.

(vi) **Dependence of other controls over computer processing:** Computer processing may produce reports and other output that are used in performing manual control procedures. The effectiveness of these manual control procedures can be dependent on the effectiveness of controls over the completeness and accuracy of computer processing. In turn, the effectiveness and consistent operation of transaction processing controls in computer applications is often dependent on the effectiveness of general computer information systems controls.

(vii) **Potential for increased management supervision:** Computer information systems can offer management a variety of analytical tools that may be used to review and supervise the operations of the entity. The availability of these analytical tools, if used, may serve to enhance the entire internal control structure.

(viii) **Potential for the use of computer-assisted audit techniques:** The case of processing and analysing large quantities of data using computers may require the auditor to apply general or specialised computer audit techniques and tools in the execution of audit tests.

(b) Use of Audit Software: CAATs allow the auditor to give access to data without dependence on the client, test the reliability of client software and perform audit tests more efficiently. CAATs are used to perform various audit procedures like-

(i) Tests of details of transactions and balances e.g. use of audits software to test all or a few transactions in a computer file.

(ii) Analytical review procedures e.g. use of audit software to identify unusual fluctuations or items.

(iii) Compliance tests of IT application controls e.g. use of test data to test the functioning of a programmed procedure.

However, the methods of applying audit procedures to gather evidence may be influenced by the methods of computer processing. Sometimes, in some accounting systems that use of computer for processing significant applications, it may difficult or impossible for an auditor to obtain certain data for inspection, inquiry or confirmation without computer assistance.

CAAT in Fraud Detection: In a CIS Environment, the Auditor is required to plan his work by exercising reasonable care and skill in such a manner that there is reasonable expectation of detecting material misstatements in the financial information resulting from fraud or error.

Use of the CAAT/ audit software systems will help the auditor to identify errors and frauds in the accounting and internal control system.

Conclusion: Frauds are intentional. Auditing through the computer with adequate knowledge of computer systems may highlight some frauds, but there is no empirical evidence to prove the assertion that the use of audit software systems has unearthed well concealed frauds.

Thus, it cannot be conclusively said that use of audit software systems increases the probability of detection of fraud.

6. (a) **Indebtness 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.

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, CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of ₹ 6,00,000 as on 01.04.2015. He was appointed as an auditor of the company for the year ended 31.03.2016 at the Annual General Meeting held on 16.07.2015. He also repaid the loan amount fully to the company on 10.7.2015 i.e. before the date of his appointment.

Hence, the appointment of CA Adroit as an auditor is valid and the shareholder's complaint is not acceptable.

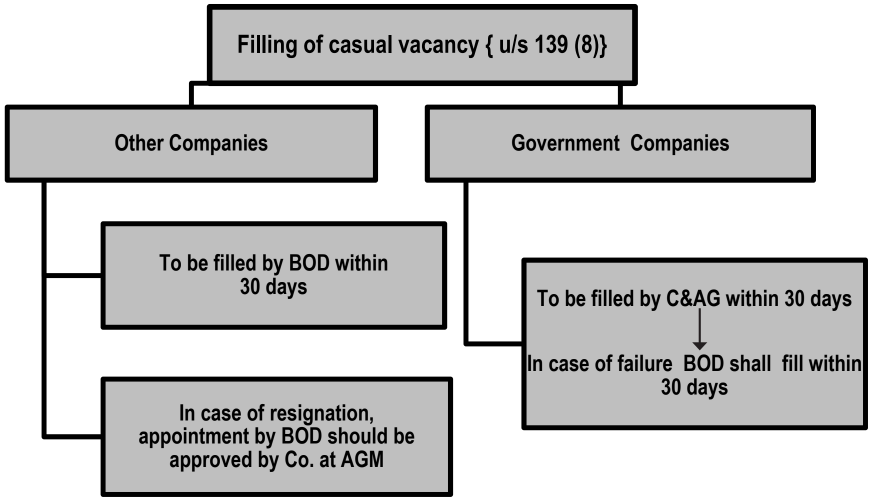
(b) **Filling of Casual Vacancy:** According to section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-

(i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within he said period the Board of Directors shall fill the vacancy within next 30 days.



In the given case, CA Max, the statutory auditor of Y Ltd. has resigned from the office of auditor. Therefore, such casual vacancy can be filled by the Board of Directors subject to approval by the company at a general meeting convened within 3 months of the recommendation of the Board.

Thus, the appointment of CA Mini made by the Board of Directors without the approval of the company at a general meeting is invalid.

Further, if appointment is approved by the company, CA Mini cannot hold the office of auditor till the conclusion of 6th meeting i.e. the appointment cannot be made for five years. The auditor can hold office only till the conclusion of the next AGM.

(c) (i) Appointment of First Auditor: Provisions of the Companies Act, 2013 relating to appointment of first auditor are stated below-

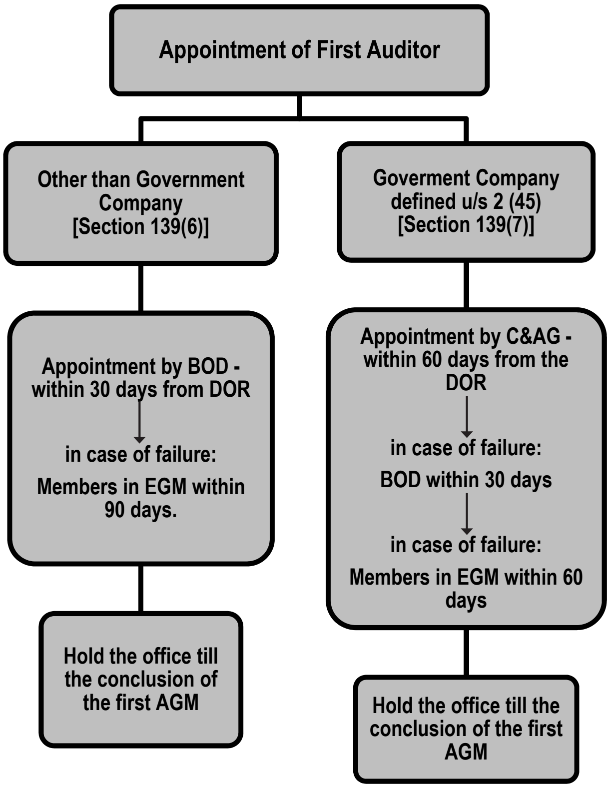
(1) Appointment of First Auditor in the case of a company, other than a Government Company- As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

(2) Appointment of First Auditor in the case of Government Company- Section 139(7) provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.



(ii) Appointment of First Auditor by the Managing Director: Apparently, there are two issues arising out of the situation given in the question, viz., first one relates to appointment of first auditor by the Managing Director; and second pertains to relation of such an auditor with the Managing Director. Regarding the first issue relating to appointment of auditor, particularly, in this case relating to appointment of first auditor, it may be noted that as per the provisions of section 139(6) of the Companies Act, 2013, the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

As per the facts given in the case, the appointment of CA Rajnath as first auditor by the Managing Director of Malta Pvt. Ltd. by himself is in violation of section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within one month of registration of the company.

Thus, the appointment of CA Rajnath is not valid. Under the circumstances, the second issue relating to relationship of auditor with Managing Director becomes redundant.

(d) Steps before commencing the Audit Work: When one of the joint auditors of the previous year is considered for ratification by the members as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. The provisions of section 140 of the Companies Act, 2013 (hereinafter referred as the Act) relating to non-reappointment of the retiring auditor need to be considered. As per sub-section 4 of section 140 of the Act, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139 of the Act.

The following steps should be taken care of by M/s CROSS before commencing the audit:

(i) Ascertain that special notice under section 140(4) of the Act was duly received by the company from such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice, not earlier than three months but at least 14 days before the AGM date as per section 115 of the Act read with the Companies (Management and Administration) Rules, 2014.

(ii) Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per section 115 of the Act.

(iii) Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.

(iv) Verify that the said notice is also sent to the retiring auditor as per section 140(4)(ii) of the Act.

(v) Verify whether any representation received from the retiring auditor was sent to the members of the company to whom notice of the meeting was sent as per section 140(4)(iii) of the Act.

(vi) Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.

(vii) Examine that proposed resolution was properly passed.

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 Sections 224 and 225 of the Companies Act, 1956 (now Section 139 and 140 read with section 141 of the Companies Act, 2013), in respect of such appointment have been duly complied with.

Therefore, M/s CROSS is required to comply with all the above mentioned provisions provided under Companies Act and Chartered Accountants Act before commencing the audit.

7. (a) Contribution to National Defence Fund: Section 183 of the Companies Act, 2013 deals with the power of Board and other persons to make contributions to National Defence Fund, etc. This section permits the Board and other person to make contributions to the National Defence Fund or any other Fund approved by the Central Government for the purpose of National Defence to any extent as it thinks fit.

In the given case, the board of Polite Ltd. has made an aggregate of online contribution of ₹ 37.5 lakhs to a National Defence Fund. However, according to the manager of Polite Ltd., the maximum contribution that can be made to the Fund is ₹ 35.7 lakhs.

In this context, it may be noted that there is no such restriction imposed on contributions to National Defence Fund. The board is free to contribute such amount as it thinks fit.

Therefore, the view of the manager of Polite Ltd. is not appropriate and, thus, there is no such violation of the provisions of section 183 of the Companies Act, 2013. The data on average net profit of the company given in question is of no relevance here.

(b) Application of Securities Premium Account: Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. The said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to an account called "Securities Premium Account" and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company.

However, as per section 52, the securities premium account may be applied for the following purposes:

(i) towards the issue of fully paid bonus shares;

(ii) in writing off the preliminary expenses;

(iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures;

(iv) in providing for the premium payable on the redemption of any redeemable preference shares or debentures; or

(v) for the purchase of its own shares or other securities under section 68 of the Companies Act, 2013.

In the given case, the management of Pirana Ltd. desires to adjust the loss due to fire against the securities premium account.

In view of the above provisions of the Companies Act, 2013, it may be noted that the company is not permitted to adjust its loss against the securities premium account.

(c) Treatment of Changes in Foreign Exchange Rates: As per Para 46A(1) of Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates'', the exchange differences arising on reporting of long-term foreign currency monetary items in so far as they relate to the acquisition of a depreciable capital asset, in respect of accounting periods commencing on or after the 1st April, 2011, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, it can be accumulated in a ''Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods.

In the given case, the accountant of Axel Ltd. has added the exchange loss to the value of machinery and computed the depreciation thereon.

In this context, it may be noted that Axel Ltd. has the choice to avail this option. However, the company should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.

(d) Stock Exchange Membership Rights: Forex Pvt. Ltd. has paid ₹ 150 lakhs for acquiring membership of stock exchange. Such membership rights provide exclusive right to Forex Pvt. Ltd. for carrying out stock broking activities. Thus, Stock Exchange Membership Rights are controlled by Forex 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 Forex 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.

8. (a) Applicability of Companies (Auditor's Report) Order, 2015 [CARO, 2015]: The CARO, 2015 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013.

The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined under the Insurance Act,1938;

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;

(v) a small company as defined under clause (85) of section 2 of the Companies Act; and

(vi) a private limited company with a paid up capital and reserves not more than ₹ 50 lakh and which does not have loan outstanding exceeding ₹ 25 lakh from any bank or financial institution and does not have a turnover exceeding ₹ 5 crore at any point of time during the financial year.

In the given case, E-Tech Pvt. Ltd. has outstanding loan of ₹ 50 lakhs (₹ 20 lakhs + ₹ 30 lakhs) from Banks and Financial Institutions together, which is exceeding the limit prescribed under Order for applicability of exemption.

Therefore, CARO, 2015 will be applicable to E-Tech Pvt. Ltd. Thus, the period and amount of default need to be reported for default in repayment of dues to bank or financial institution under clause (ix) of Para 3 of CARO, 2015.

(b) Reporting of "Loan to Related Party": As per AS 18 "Related Party Disclosures", related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged. According to this AS, in the case of related party transactions, the reporting enterprise should disclose the following-

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

Additionally, the auditor is required to report on certain matters specified in Para 3 of CARO, 2015 under section 143(11) of the Companies Act, 2013. As per clause (iii) of Para 3 of CARO, 2015, if the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act, 2013, the auditor is required to report-

(a) whether receipt of the principal amount and interest are also regular; and

(b) if overdue amount is more than ₹ 1 lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest.

In the instant case, Zig Pvt. Ltd. has granted a loan of ₹ 20 crores to its associate Zag Pvt. Ltd. and it remain outstanding at the year end. The case is squarely covered by AS 18.

Further, SA 550 on "Related Parties" also prescribes the auditor's responsibilities and audit procedures regarding related party transactions.

Therefore, the auditor should insist to make proper disclosure as per the AS and report as per CARO, 2015. If management refuses, the auditor shall have to modify his report.

(c) Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management with the oversight of those charged with governance to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, as per section 128 of the Companies Act, 2013, a company has to maintain proper books of account on accrual basis and according to the double entry system of accounting.

Additionally, as per Section 43B of the Income Tax Act, 1961, there are certain expenses, which includes any sum payable by the assessee as an employer by way of contribution to any provident fund, which are allowed only on its actual payment.

The auditor is, therefore, required to report under clause (vii)(a) of Para 3 of CARO, 2015 whether the company is regular in depositing undisputed statutory dues including provident fund with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, out of ₹ 12 lakhs of provident fund contribution accounted in the books, only ₹ 5 lakhs has been remitted to the authorities due to financial problems during the year. Hence, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of ₹ 7 lakhs in his report.

(d) Disclosure in Audit Report: As per SA 570 "Going Concern", when the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements-

(i) 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

(ii) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

The auditor is further required to specifically include certain matters as per CARO, 2015 under section 143(11) of the Companies Act, 2013. According to clause (i)(b) of Para 3 of CARO, the auditor has to comment whether the fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

In the given case, Giant Ltd. has sold out its manufacturing fixed assets during the year. However, it intends to continue its operations as a trading company. Therefore, selling of manufacturing fixed assets does not affect the going concern assumption of the company. Additionally, while carrying out physical verification of other fixed assets, a material discrepancy to the tune of ₹ 80,000 was found which was written off and disclosed separately in the Statement of Profit and Loss. Hence, this fact needs to be disclosed in the Audit Report as follows:

Para in the Audit Report-

We have made our view point from the facts of the case and on the basis of guidance drawn from AS 1. We report as under-

As per Accounting Standard (AS) 1, "Disclosure of Accounting Policies", "the enterprise is normally viewed as a going concern that is as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations." Although the company has disposed off its manufacturing fixed assets during the financial year ending on 31-03-2015, it is still a going concern in the form of a trading company. We also report that on physical verification of other fixed assets, a material discrepancy to the tune of ₹ 80,000 was noticed and that the same has been properly dealt with in the books of account.

9. (a) Duties & Responsibilities of an Auditor in case of Material Misstatement resulting from Management Fraud: As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Further, an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

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

Auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance, hence in an audit, the auditor does not guarantee that material misstatements will be detected.

In addition, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

The auditor is also required to report as per clause (xii) of Paragraph 3 of CARO, 2015, if there is any fraud on or by the company has been noticed or reported during the year. The nature and the amount involved are to be indicated.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

(i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and

(iii) If the auditor withdraws:

    (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

    (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

(b) Liability of Auditor under section 35 of the Companies Act, 2013: Under section 35 of the Companies Act, 2013, 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-

(i) is a director of the company at the time of the issue of the prospectus;

(ii) 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;

(iii) is a promoter of the company;

(iv) has authorised the issue of the prospectus; and

(v) is an expert referred to in sub-section (5) of section 26,

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.

No person shall be liable under sub-section (1) of section 35, if he proves— (i) 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 (ii) 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.

It may be noted that 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) of section 35 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.

10. (a) Responsibility of Audit Committee *vis-a-vis* review of Financial Statements: The responsibility of the audit committee while reviewing the annual financial statements with management before submission to the Board, focuses primarily on-

(i) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013.

(ii) Changes, if any, in accounting policies and practices and reasons for the same.

(iii) Major accounting entries involving estimates based on the exercise of judgment by management.

(iv) Significant adjustments made in the financial statements arising out of audit findings.

(v) Compliance with listing and other legal requirements relating to financial statements.

(vi) Disclosure of any related party transactions.

(vii) Qualifications in the draft audit report.

(b) Features of Qualified and Independent Audit Committee: The main features of a qualified and independent audit committee to be set up under clause 49 of listing agreement are as follows-

(1) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;

(2) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

Explanation (i): The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(3) The Chairman of the Audit Committee shall be an independent director;

(4) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

(5) The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;

(6) The Company Secretary shall act as the secretary to the committee.

11. Accounting for Investments in Associate: As per Accounting Standard 23 on "Accounting for Investments in Associates in Consolidated Financial Statements", adjustments to the carrying amount of investment in an investee arising from changes in the investee's equity that have not been included in the statement of profit and loss of the investee are directly made in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit/credit is made in the relevant head of the equity interest in the consolidated balance sheet. For example, in case the adjustment arises because of revaluation of fixed assets by the investee, apart from adjusting the carrying amount of investment to the extent of proportionate share of the investor in the revalued amount, the corresponding amount of revaluation reserve is shown in the consolidated balance sheet.

In case an associate has made a provision for proposed dividend in its financial statements, the investor's share of the results of operations of the associate is computed without taking in to consideration the proposed dividend.

Applying the above provisions to the given problem, Hold Ltd. should have computed its share of the results of operations of the associate without taking into consideration the proposed dividend. Therefore, treatment made by Hold Ltd. is not correct.

12. (a) Non-Performing Assets: RBI has laid down norms for classification of assets and provisioning norms for NPAs. However, certain exceptions to these norms are discussed below-

(i) **Temporary Deficiencies**, e.g., non availability of current drawing power due to non-receipt of latest stock statement, temporary delay in renewals of limits on due date, etc.

(ii) **Natural Calamities:** Where, in the wake of natural calamities, short-term agricultural loans are converted into term loans or there is rescheduling of repayment period or fresh short-term loans are sanctioned, the term loan as well as fresh short term loan may be treated as current dues and need not be classified as NPA.

(iiii) **Facilities backed by Central Government Guarantees:** Credit facilities backed by guarantee of the Central Government though overdue should be treated as NPA only when the government repudiates its guarantee when invoked (this exemption is only for the purpose of asset classification and provisioning and not for the purpose of recognition of income).

(iv) **Advances to "On Lending" arrangements** are also exempted under this category.

(b) Drafting of Internal Control Policy for Loans and Advances: The following are the important factors to be considered while drafting internal control policy in respect of loans and advances of Unity Bank-

(i) 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.

(ii) All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.

(iii) Sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or for particular accounts.

(iv) All the securities should be received and returned by responsible officer. They should be kept in the Joint custody of two such officers.

(v) 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.

(vi) In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipts. The godowns should be regularly and frequently inspected by a responsible officer of the branch concerned, in addition by the inspectors of the bank.

(vii) Surprise checks should be made in respect of hypothecated goods not in the possession of the bank.

(viii) Market value of goods should be checked by officers of the bank by personal enquiry in addition to the invoice value given by the borrowers.

(ix) As soon as any increase or decrease takes place in the value of securities proper entries should be made in the Drawing Power Book and Daily Balance Book. These entries should be checked by an officer.

(x) All accounts should be kept within both the drawing power and the sanctioned limit at all times.

(xi) 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.

(xii) The operation in each advance should be reviewed at least once every year.

(xiii) Post disbursement supervision and follow-up should be proper, such as receipt of stock statements, instalments, renewal of limits, etc.

(xiv) There should not be any mis-utilisation of the loans and instances indicative of diversion of funds should be checked.

(xv) Letters of credit issued by the branch should be within the delegated power and should be for genuine trade transactions.

(xvi) Bank guarantees issued, should be properly worded and recorded in the register of the bank. They should be promptly renewed on the due dates.

(xvii) Proper follow-up should be made for overdue bills of exchange.

(xviii) The classification of advances should be done as per RBI guidelines.

(xix) The submission of claims to DICGC and ECGC should be on time.

(xx) Instances of exceeding delegated powers should be promptly reported to controlling/Head Office by the branch and should be got confirmed or ratified at the required level.

13. **Commission Paid to Insurance Agents:** It is a well-known fact that insurance business is solicited by insurance agents. The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured through them and is debited to Commission on Direct Business Account. There is a separate head for commission on reinsurance accepted which usually arise in case of Head Office. It may be noted that under section 40 of Insurance Act, 1938, no commission can be paid to a person who is not an agent or intermediary of the insurance company.

    The auditor should, *inter alia*, do the following for verification of commission-

    (i) Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.

    (ii) Check whether the vouchers are authorised by the officers-in–charge as per rules in force and income tax is deducted at source, as applicable.

    (iii) Test check correctness of amounts of commission allowed.

    (iv) Scrutinise 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.

    (v) Check whether commission outgo for the period under audit been duly accounted.

14. (a) **Reporting of Payments Exceeding ₹ 35,000 in Cash:** 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 ₹ 20,000. However, in case of payment made for plying, hiring or leasing of goods carriage, limit is ₹ 35,000 instead of ₹ 20,000.

    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 ₹ 20,000 (₹ 35,000 in case of plying, hiring or leasing of goods carriages).

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

    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.

Therefore, as per the provisions and explanations discussed above, the given cases are dealt as under-

(i) Payments of 6 invoices of ₹ 5,000 each aggregating ₹ 30,000 made in cash on 4th July, 2015 need not be reported as the aggregate of payments do not exceed ₹ 35,000.

(ii) Payments of 2 invoices of ₹ 18,000 each made in cash on 5th July, 2015 and 6th July, 2015 respectively aggregating ₹ 36,000 need not be reported as the payment do not exceed ₹ 35,000 in a day.

(iii) Payment of ₹ 40,000 made in cash against an invoice for expenses booked in 2014-15 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 needs to be furnished under clause 21(d)(B) of Form 3CD.

(b) Reporting Requirement for Disqualifications in Cost Audit Report: 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.

In the given case, the cost auditor of Beam Ltd. has reported certain disqualifications in Form CRA-3 of the cost audit report.

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.

(c) Approach to Tax Audit under VAT Law: The audit approach of the tax auditor under the value added tax system will be more or less similar to the approach, which is adopted by the auditor while conducting the tax audit under the provisions of section 44AB of the Income-tax Act, 1961. However, the reporting requirements vary to a considerable extent.

While the auditor has to apply the basic principles of audit he has to keep in mind that the requirements of VAT audit are different and accordingly he should design his audit programme.

While designing the audit program the auditor has to ensure that the program includes the performance of such audit checks as would generate the information which would enable him to ensure the following and also to draw his audit reports.

The auditor has to take a judgement of his own regarding the adequacy and appropriateness of the audit checks to be applied and the areas where the tests are to be applied, so as to give him all the information needed to form a view not only on the authenticity of the books of account, correctness of the returns filed but also in the quantification of tax liability.

Major areas to be tested: The following are only the major areas which are to be tested by the auditor while conducting the tax audit under VAT laws-

(i) The turnover of sales/purchases of goods has been properly determined keeping in view not only the generally accepted accounting policies but the definition of turnover of sales in the relevant VAT law. The sales turnover arrived at by applying the generally accepted accounting policies may not be the same as required under the VAT law. To take an example, the sale proceeds of a fixed asset will not form a part of turnover or sales as per the generally accepted accounting policies but will form a part of turnover or sales for the purpose of VAT law. Similarly the price of goods returned is deducted from the turnover or sales even if the returns are from the sales effected in the previous years, while under VAT law, the goods returned are to be deducted only if they are made within the prescribed time, say six months from the date of sale. Thus, the results of the audit procedure adopted by the auditor should be such as will give him a reasonable assurance regarding the figures of sales reported in the returns. Not only that, he should also be able to get the exact quantum of the sales under reported or over reported duly classified for different tax rates and its impact on overall tax liability. The sales as per the financial statements may include the turnover or sales effected by all the branches, but for the purposes of VAT law the turnover or sales of only those branches will be included which are included in one registration certificate.

(ii) The turnover of purchases should be tested by applying audit checks as will enable the auditor to get the purchases eligible for grant of input tax credit segregated from other purchases. Further, the purchases on which the input tax credit is available in full and the purchases on which it is available partially should also be ascertained correctly. Thereafter, the auditor should get the exact amount of input tax credit available; compare the same with the credit claimed in the returns and report on the excess/short claim of the credit in the returns filed.

(iii) The auditor is also required to comment on the timely filing of the returns under the VAT law. For this purpose the auditor is expected to list out the due dates of filing of returns and find out the reasons for delay in filing the returns if any.

(iv) The auditor is also required to give his report on the composition scheme. He should apply such compliance tests as will be enable him to ascertain that the auditee is eligible for composition, it has paid the requisite composition fee and all the procedural formalities in relation thereto have been complied with.

(v) The auditor has to give his report on the TDS. Therefore, such tests are to be applied as will enable him to report on the applicability of TDS provisions, the accuracy of the amount deducted and paid, timely issue of TDS certificate and filing of TDS returns.

(vi) The auditor is also expected to check the consolidation of the returns filed for all the periods covered in the year under audit, both under the State-Level VAT law and the Central Sales-tax Act. These returns are to be compared with the books of account and the documentary evidences available. The auditor is expected to apply such substantive steps as would enable him to judge whether all the transactions relating to sale and purchase are entered in the books of account and have been taken into consideration while filing the returns. In case of any inconsistency, a proper reconciliation of book figures and the returned figures should be made and also the correct quantification of tax liability is to be done.

15. Applicability of Provisions related to Cost Records and Audit: The provisions relating to cost records and audit are governed by section 148 of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2014.The audit conducted under this section shall be in addition to the audit conducted under section 143.

Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account. The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Company belonging to sugar industry is one of the types of companies prescribed under the regulated sectors.

However, the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(1) whose revenue from exports, in foreign exchange, exceeds 75 per cent of its total revenue; or

(2) which is operating from a special economic zone.

In the given case, Mithas Ltd., a sugar manufacturer and exporter in India, is operating from Noida Specific Economic Zone, Uttar Pradesh.

Therefore, Mithas Ltd. is required to include cost records in their books of account in accordance with Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. However, the company is not required to conduct cost audit as it is operating from a special economic zone. The facts given on revenue are not relevant here.

16. (a) **Factors to be considered while planning the Performance Audit:** While planning a performance audit, the auditors should take care of certain factors which are listed below-

(i) to consider significance and the needs of potential users of the audit report.

(ii) to obtain an understanding of the program to be audited.

(iii) to consider legal and regulatory requirements.

(iv) to consider management controls.

(v) to identify criteria needed to evaluate matters subject to audit.

(vi) to identify significant findings and recommendations from previous audits that could affect the current audit objectives. Auditors should determine if management has corrected the conditions causing those findings and implemented those recommendations.

(vii) to identify potential sources of data that could be used as audit evidence and consider the validity and reliability of these data, including data collected by the audited entity, data generated by the auditors, or data provided by third parties.

(viii) to consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.

(ix) to provide sufficient staff and other resources to do the audit.

(x) to prepare a written audit plan.

(b) **Comprehensive Audit of Public Enterprises:** The scope and extent of audit of public sector enterprises is determined by the Comptroller and Auditor General of India. Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfill their objectives and goals. Another aspect of such audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Comprehensive audit involves assessing efficiency and effectiveness of public enterprises in its entirety to be conducted on the basis of certain standards and criterion. Public enterprises have been set-up with socio-objectives. An objective assessment with reference to such objectives' fulfillment would require comprehensive audit.

The starting point of a comprehensive audit of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers. These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis and criteria, the data required for such analysis and the sources of such data, the extent of the audit analysis including the test checks to be applied and the instructions to the audit parties assigned to the work.

Areas to be examined: The areas covered by comprehensive audit are those of investment decisions, project formulation and management, organisation, delegation of powers and management information systems, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, development of complementary ancillary small scale industries, materials management, sales and credit control, budgetary and internal control systems, etc. The areas covered in comprehensive audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below-

- Comparison of overall capital cost of the project with the approved planned costs.
- Production or operational outputs *vis-à-vis* under-utilisation of the installed capacity.
- Systems of project formulation and implementation.
- Planned rate of return.
- Cost control measures.
- Research and development programmes.
- System of repairs and maintenance.
- adequate purchase policies.
- Effective and economical procedures.
- Project planning.
- Undue waste, unproductive time for men and machines, wasteful utilisation or even non-utilisation of resources.

17. (a) Essential Features of a Good Internal Audit Report: The contents of an internal audit report are influenced by various factors such as the nature of internal auditing function in the organisation, level of reporting, degree of management support and capabilities of internal audit staff. However, for preparing a good internal audit report, the following general rules may be observed-

(i) **Objectivity -** To maintain the credibility of internal audit function the comments and opinions expressed in the report should be as objective and unbiased as possible.

(ii) **Clarity -** The language used should be simple and straight-forward. As far as practicable, use of technical terms and jargon should be avoided. Each draft of the report should be reviewed by a senior who should attempt to read it from the point of view of the users of the report.

(iii) **Accuracy -** The information contained in the report, whether quantified or otherwise, should be accurate. Where approximation or assumptions have been made the fact should be clearly stated along with reasons, if material.

(iv) **Conciseness -** Brevity is vital subject, of course, to the condition that important information should not be omitted.

(v) **Constructiveness -** Destructive criticism should carefully be avoided in the report. The report should clearly demonstrate that the internal auditor is trying to assist the auditor in an effective discharge of his responsibilities.

(vi) **Readability -** The reader's interest should be captured and retained throughout. For this, appropriate paragraph heading may be used.

(vii) **Timeliness -** The report should be submitted promptly because if the time lag between the occurrence of an event and its reporting is considerable, the opportunity for taking action may be lost or a wrong decision may be taken in the absence of the information.

(viii) **Findings and conclusions -** 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 conclusion and opinion should normally follow the findings. Tables or graphs may be used for the presentation of statistical data in appendices.

(ix) **Recommendations -** An internal audit report usually includes recommendations for potential improvements. In order to enable the management to accept and implement the recommendations, the internal auditor should be able to convince the management that the conclusions are logical and valid and the recommendations represent effective and feasible ways of taking action.

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

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

(xii) **Supporting information -** The internal auditor should supplement his report by such documents and data which adequately and convincingly support the conclusions. Supporting information may include the relevant standards or regulations.

(xiii) **Draft Report -** Before writing the final report, the internal auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his reports. It would also indicate whether there is any superfluous information or a gap in reasoning.

(xiv) **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 internal 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.

(b) (i) Need of Operational Auditing: The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company 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.

Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. 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.

(ii) Difference between Financial and Operational Auditing: The major differences between financial and operational auditing can be described as follows -

(1) **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.

(2) **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.

(3) **Reporting -** The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However the operational audit report is primarily for the management.

(4) **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.

The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements. Operational auditing is considered as specialized management information tool. Operational auditing is essentially a function of internal auditing staff. Operational auditing is a systematic process of evaluating an organisation's effectiveness, efficiency and economy of operations under management control and reporting to appropriate persons, the result of the evaluation along with recommendations for improvements. Operational audit 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 improvements in future. Operational auditing is not different from internal auditing; it is merely an extension of internal auditing into operational areas.

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. In financial auditing, an auditor is called upon to review the financial statements of an enterprise to ascertain whether they reflect true and fair view of its state of affairs and of its working results. He may analyse the operations of an enterprise to appraise their cost effectiveness and also he may seek evidence to review the managerial performances.

18. (a) Investigation of Suspected Embezzlement of Cash Receipts: While doing investigation of suspected embezzlement of cash receipts of a departmental store, an investigating accountant would like to take below mentioned steps-

(i) Before proceeding to investigate a suspected embezzlement, the investigating accountant should ascertain the exact duties of the person concerned who is suspected to have committed a fraud; his relationship to the general routine of the office, and the circumstances in which any known instances of defalcation have come to light. Such an enquiry would give a clue to promising avenues of investigation. Greater the authority of the individual suspected of a fraud, wider would be the field which would have to be covered by the investigation.

(ii) He should also examine the line of responsibility between the various members of the staff.

(iii) He should have a look at the system of internal control in operation for spotting out the weaknesses, if any, that may exist in it. Relying on the above study, he should direct his enquiry towards those aspects of the business where there has been excessive control in the hands of single persons, without any supervision by any other person or any other inherent weakness that may be in existence in the system.

(iv) On the assumption that cash may have been diverted before being entered in the books, evidence as regards income received from different sources should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices of travelling salesmen and counterfoils or receipts.

(v) Carbon copies of receipts marked 'duplicate', should be scrutinised to confirm that they are in fact copies of receipts issued earlier.

(vi) By recalling paying-in-slips from the bank the details of cash deposited on each day should be compared with those shown in the Cash Book.

(vii) The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., and other Government authorities should be examined for finding out if any of these amounts have been misappropriated.

(viii) Cash sales should be vouched in detail. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed.

(ix) All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book.

(b) Steps involved in the verification of Assets and Liabilities included in the Balance Sheet of the borrower company: The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below-

(i) **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.

(ii) **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.

(iii) **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:

(1) debts due in respect of which the period of credit has not expired;

(2) debts due within six months; and

(3) 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.

(iv) **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.

(v) **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.

(vi) **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.

(vii) **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.

(viii) **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.

(ix) **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.

(x) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

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.

19 (a) Engaging into a Business: As per 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.

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 Brilliant is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission. Further, he has not even obtained any permission from the Institute for conducting such business.

Hence, he will be deemed to be guilty of professional misconduct under clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(b) Posting Photograph on Website: A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct under clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

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.

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. Only display of passport size photograph is permitted.

Therefore, CA Intelligent is guilty of professional misconduct under clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(c) Contravening Provisions of the Act: A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct under clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, if he contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.

In the given case, Mr. Witty has failed to make the payments of stipend to articled assistant every month in accordance with Regulation 48. 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 six months is not acceptable as Mr. Witty has disbursed salary to all of his employees on time.

Therefore, Mr. Witty 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.

(d) **Charging Excess Fees:** 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.

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.

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.

20. **(a)** **Focus of a Peer review**: As per the Statement of Peer Review issued by the Institute of Chartered Accountants of India, Peer Review - means an examination and Review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the Technical, Professional and Ethical Standards and whether the same were consistently applied in the period under review.

The Review shall cover:

(i) Compliance with Technical, Professional and Ethical Standards.

(ii) Quality of reporting.

(iii) Systems and procedures for carrying out assurance services.

(iv) Training programmes for staff (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure.

(v) 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.

(vi) 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.

(b) Statistical and Non-statistical Sampling: Audit sampling means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

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

There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

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

(ii) **Non-statistical sampling:** Under this method, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor. This method has been in common application for many years because of its simplicity in operation. Traditionally, the auditor on the basis of his personal experience will determine the size of the sample and express it in terms that number of pages or personal accounts in the purchases or sales ledger to be checked. For example, March, June & September may be selected in year one and different months would be selected in the next year. An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check. It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined.

(c) Purpose of Appointing Inspecting Officer of a Depository: The SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the books of account, records, documents and infrastructure, systems and procedures or to investigate the affairs of a mutual fund, the trustees and asset Management Company for any of the following purposes, namely-

(i) To ensure that the books of accounts are maintained in the names specified in the regulations;

(ii) To look into the complaints received from depositors' participant, beneficial owners or other persons;

(iii) To ascertain whether the provisions of the Act, bye-laws agreements and these regulations are being complied;

(iv) To ascertain whether the systems, procedures and safeguards are being followed in the interests and to secure the market;

(v) To ensure that the affairs are being conducted in the interest of the Investors / Securities markets.

(d) Restrictions on Investment of Funds of a Central Co-operative Society: Provisions of the Central Act put some restrictions on investments of funds of a Central Cooperative Society. According to Section 32 of the Central Act, a Central Cooperative Society may invest its funds only in any one or more of the following-

(i) In the Central or State Co-operative Bank.

(ii) In any of the securities specified in Section 20 of the Indian Trusts Act, 1882.

(iii) In the shares, securities, bonds or debentures of any other society with limited liability.

(iv) In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.

(v) In any other moneys permitted by the Central or State Government.

The principal provision relating to the investments of funds of a co-operative society, the Central as well as State Acts does not mention anything about the investment of reserve fund outside the business specifically.

(e) Special Points in the Audit of Equipment Leasing Finance Company: The auditor should-

(i) Ascertain whether the Non Banking Financial Companies (NBFC) has an adequate appraisal system for extending equipment leasing finance.

(ii) Verify whether there is an adequate system in place for ensuring installation of assets and their periodical physical verification. In some major transactions, 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.

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

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

(v) Verify whether the Accounting Standard issued by the Institute of Chartered Accountants of India in respect of "Accounting for Lease" has been compulsorily followed.