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**SUGGESTED SOLUTION**  
**FINAL NOVEMBER 2018 EXAM**  
**SUBJECT- ADVANCE AUDITING**  
**Test Code - FNJ 7030 N**  
**BRANCH - () (Date :)**

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**Answer 1:**

**(A)**

**External Confirmation:**

This is a case of external confirmation, covered by SA 505 "External Confirmations". The identities of trade payables are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation.

The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members.

**(B)**

According to **SA 450 "Evaluation of Misstatements identified during the Audit"**, the following are the sources of misstatements arising from other than fraud -

- (i) An inaccuracy in gathering or processing data from which the financial statements are prepared;
- (ii) An omission of an amount or disclosure;
- (iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and
- (iv) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

**(C)**

**Projected Financial Statements:**

As per SAE 3400, "The Examination of Prospective Financial Information", the answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

- (i) Acceptance of Engagement: As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:
  - (1) the intended use of the information;
  - (2) whether the information will be for general or limited distribution;
  - (3) the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
  - (4) the elements to be included in the information; and
  - (5) the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

- (ii) **Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

- (1) the sources of information,
- (2) basis of forecasts,
- (3) the assumptions made in arriving the forecasts,
- (4) hypothetical assumptions, evidence supporting the assumptions,
- (5) management representations regarding the intended use and distribution of the information, completeness of material assumptions,
- (6) management's acceptance of its responsibility for the information,
- (7) audit plan,
- (8) the nature, timing and extent of examination procedures performed, and,
- (9) in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

**(D)**

As per **SA 810**, "Engagement to Report on Summary Financial Statements", the auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

- (i) Evaluate whether the summary financial statements adequately disclose their summarised nature and identify the audited financial statements.

When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

- (1) From whom or where the audited financial statements are available; or
  - (2) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.
- (ii) Evaluate whether the summary financial statements adequately disclose the applied criteria.
- (iii) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.
- (iv) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
- (v) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
- (vi) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements.

(E)

As per **SA 510 “Initial Audit Engagements—Opening Balances”**, in 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.

Being new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. For example, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

**Answer 2:**

(A)

There are numerous situations where regulatory authorities like SEBI, ROC, Income Tax, Central Board of Excise and Customs (CBEC), Reserve Bank of India etc. requires a professional accounting firm or the statutory auditor of the organization to provide opinion on certain specific matters which are provided by the organisation as part of statutory requirements.

	<b>Authorities</b>	<b>Examples of Various types of Certificates</b>
	Reserve Bank of India	Certificate of unhedged foreign currency exposure as at year end ✍ Certificate for adherence to guidelines as per RBI circular ✍ Annual activity certificate for branch office, Liaison office, Project office etc. ✍ Certificate of probable exposure

	Companies Act, 2013	Certificate pursuant to proviso to Section 230(7) of the Companies Act, 2013 in relating to accounting treatment prescribed under the Scheme of Arrangement.
	Income Tax Act, 1961	Reporting on Expenditure incurred on R&D Centre approved under Section 35(2AB)
	SEBI	Certificate for accounting treatment in case of a merger of two entities or reorganization, Income Tax authorities requires auditor to certify amount eligible Minimum Alternative tax under Section 115JB of Income tax Act, 1961
	Others	<ul style="list-style-type: none"> <li>☞ Certificate for net worth required for a tender document</li> <li>☞ Certificate for value of fixed assets in a particular location required by a regulatory agency to process tax incentives</li> <li>☞ Certificate of service tax refund or VAT refund</li> </ul>

(B)

**Permission for Providing Private Tutorship:**

As per Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

Further, regulation 190A of the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same there is no specific permission from the council would be necessary in the case of private tutorship.

In the given case, CA. Ram has started providing private tutorship to Mr. Ratan along with some other aspirants, without obtaining specific or prior approval of the Council.

On this context, it may be noted that the Council has provided general permission for providing such private tutorship. Therefore, CA. Ram would not be held guilty of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(C)

**Applicability of Provisions of Internal Audit:**

As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

- (A) every listed company;
- (B) every unlisted public company having-
  - (1) paid up share capital of fifty crore rupees or more during the preceding financial year; or
  - (2) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (3) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - (4) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (C) every private company having-
  - (1) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, WWF Ltd. is a public company. The company borrowed a loan from a public financial institution of Rs. 110 crores during the previous year. At the year end, the loan outstanding after being squared up is Rs. 90 crores (Rs. 110 crores - Rs. 20 crores) which is less than the minimum prescribed limit of Rs. 100 crores for applicability of internal audit. Although, the outstanding loan at previous year end is Rs. 90, it was Rs. 110 crores at some point of time which is the requirement of the section (refer Rule 13(B)(3) as mentioned above).

Hence, WWF Ltd. has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit. Consequently, the contention of the management of the company is not tenable.

(D)

**Various Stages involved in the Conduct of the Quality Review Assignments are:**

- ☛ Selection of Audit Firm and Technical Reviewer to conduct Quality Review and sending Offer Letter of Engagement to the Technical Reviewer.
- ☛ Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
- ☛ Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
- ☛ Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.
- ☛ Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
- ☛ Technical Reviewer to send the preliminary report to Audit firm.
- ☛ Audit firm to submit representation on the preliminary report to the Technical Reviewer.
- ☛ Technical Reviewer to submit final report along with a copy of Annual report of the

company/entity for the year, to the Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.

- ✎ Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions there on to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon along with their final comments in the specified format
- ✎ Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
- ✎ Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

### Answer 3:

(A)

#### **Reporting for Default in Repayment of Dues:**

As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in eachcase.

Further, as per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2016-17 which remain outstanding as at March 31, 2017. However, the company has settled the total outstanding dues including interest in April, 2017 but, the dues were outstanding as at March 31, 2017. Therefore, it needs to be reported in the notes to accounts.

#### **The draft report for above matter is as under:**

*"The company has taken a loan during the year, from a financial institution amounting to Rs. XXXX @ X% p.a. which is repayable by monthly installment of Rs. XXXX for XX months.*

*The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2015-16 amounting to Rs. XXXX which remained outstanding as at March 31, 2017. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2017."*

(B)

#### **Types of Audit under GST Law by Chartered Accountants:**

Contention of Rajul Rani & Associates, a firm of Chartered Accountants is not correct. GST envisages two types of Audit by Chartered Accountants i.e.

(1) Audit of accounts [Section 35(5) read alongwith section 44(2) and rule 80].

(2) Special Audit wherein the registered person can be directed to get his records including books of account examined and audited by a chartered accountant or a cost accountant during any stage of scrutiny, inquiry, investigation or any other proceedings; depending upon the complexity of the case. [Section 66 and rule 102].

1. **Audit of Accounts [Section 35(5) read along with section 44(2) and rule 80] :**

As per sub-section 5 of section 35 read along with section 44(2) and rule 80 of the CGST Rules, 2017 stipulates as follows:

Every registered person must get his accounts audited by a Chartered Accountant or a Cost Accountant if his aggregate turnover during a FY exceeds Rs. 2 crores.	Such registered person is required to furnish electronically through the common portal along with Annual Return a copy of: <input type="checkbox"/> Audited annual accounts <input type="checkbox"/> A Reconciliation Statement, duly certified, in prescribed FORM GSTR-9C.
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**Reconciliation Statement** will reconcile the value of supplies declared in the return furnished for the financial year with the audited annual financial statement and such other particulars, as may be prescribed.

2. **Special Audit under section 66:**

Availing the services of experts is an age old practice of due process of law. These experts have done yeoman service to the process of delivering justice. One such facility extended by the Act is in Section 66 where an officer not below the rank of Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer considering the nature & complexity of the business and in the interest of revenue is of the opinion that:

- ✎ Value has not been correctly declared; or
- ✎ Credit availed is not within the normal limits.

It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determines what is the normal limit of input credit availed.

(C)

**Corporate Responsibility under Sarbanes Oxley Act of 2002:**

The Sarbanes– Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 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. The act contains eleven titles and establishes corporate accountability and civil and criminal penalties for white – collar crimes. The title three deals with the Corporate Responsibility which is as follows:

- (i) The audit committee to be more independent through enhancement of their oversight responsibilities and one of the Audit committee members to be financial expert.
- (ii) Requires CEO& CFO to issue certification of the quarterly financial results and annual reports to SEC as past of compliance with Form 10K.
- (iii) Provides rules of conduct for companies managerial and their officers regarding Pension matters.
- (iv) To Comply with SEC rules requiring attorneys to report violation of securities to the company's CEO or chief legal counsel & to Audit Committee if no action is taken.

(D)

**In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:**

- (i) **Trend:** Whether in the past, sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
- (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

**Answer 4:**

(A)

**Maintenance of Books of Account by a CA in Practice:**

Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of accounts including the following-

- (i) a Cash Book
- (ii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA. Elegant does not maintain proper books of accounts and writes the fees received from various clients in notes in his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Elegant, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

(B)

**Classification of Frauds by NBFC: In order to have uniformity in reporting, frauds have been classified as under -**

- (i) Misappropriation and criminal breach of trust.
- (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (iii) Unauthorised credit facilities extended for reward or for illegal gratification.
- (iv) Negligence and cash shortages.
- (v) Cheating and forgery.
- (vi) Irregularities in foreign exchange transactions.
- (vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (iv) and (v) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not

suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

- (i) cases of cash shortages more than Rs. 10,000/- and
- (ii) cases of cash shortages more than Rs. 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

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

(C)

**Risk Assessment -**

The auditor in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", should make an assessment of inherent and control risk for material financial statement assertions.

In a CIS environment the risk of a Material financial statement ascertain being erroneously stated could arise from the deficiencies in the following case as-

- (i) Program Development and maintenance.
- (ii) System software support.
- (iii) Operations including processing of data.
- (iv) Physical CIS security.
- (v) Control over access to specialized utility program.

These deficiencies would tend to have a negative impact on all application systems that are processed through the computer.

(D)

**Ceiling Limit for Holding Company Audits:**

As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs. 100 crore.

In the instant case, KSY & Co. is an audit firm having two partners, namely, CA. K and CA. Y. The total number of company audits that can be accepted by the firm is 40 (2 partners x 20 companies each partner). However, the firm is already holding appointment as auditors of 36 public companies. Thus, the remaining number of audits that can be accepted by the firm is of 4 more companies.

In the given situation, KSY & Co. has been offered appointment as auditors of 7 private limited companies out of which 1 is a private limited company with paid-up share capital of Rs. 150 crores, 5 are 'small companies' and 1 is 'dormant company'.

In view of above discussed provisions and explanations, KSY & Co. can hold appointment as an auditor in 5 'small companies' and 1 'dormant company' as these are excluded from the ceiling limit of company audits.

In addition, the firm can also accept appointment as auditor of 1 private limited company with paid-up share capital of Rs. 150 crores which will be within the maximum ceiling limit of 40

company audits.

Therefore, KSY & Co. can accept appointment for all the 7 private limited companies as asked in question.

- (E) **Corporate Governance** : Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies. A number of reports and codes of corporate governance have been published internationally.

The Securities and Exchange Board of India (SEBI) issued a circular dated April 17, 2014 to all recognized stock exchanges, making amendments to Clauses 35B and Clause 49 of the Equity Listing Agreement, with the intent to align the Listing Agreement with the provisions of the Companies Act, 2013, to make the corporate governance framework more effective and to adopt best practices on corporate governance. Further amendments were made to Clause 49 of the Listing Agreement vide circular dated September 15, 2014.

Since a listing agreement is a statutorily mandated contract between the listed entity and the stock exchange where it is listed, it does not have the authority of law behind it. Hence, on September 2, 2015, SEBI issued the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"), with the objective of streamlining and consolidating the provisions of various listing agreements in operation for different segments of the capital markets, such as equity shares, preference shares, debt instruments, units of mutual funds, Indian depository receipts, securitized debt instruments and any other securities that the SEBI may specify.

The LODR Regulations are divided into two parts – the substantive provisions are incorporated in the main body while the procedural requirements are incorporated in the form of schedules. The LODR Regulations also capture the corporate governance principles found in Clause 49 of SEBI's Model Listing Agreement. It may be noted that the LODR Regulations deal with only post – listing requirements and exclude all pre – listing requirements. Needless to add, the above – mentioned circulars stand rescinded.

**Answer 5:**

(A)

**Related Party Disclosures:**

As per definition given in the AS 18 "Related Party Disclosures" parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In the instant case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid Rs. 3 lakhs as job work charges. The managing director is having a substantial holding in XYZ Ltd. The case is squarely covered by AS 18. According to AS-18, 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.”

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

The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also it has to be seen whether section 184 of the Companies Act, 2013 regarding disclosure of interest by director has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

**(B)**

As per the Clause 7 of Part 1 of the First Schedule, if any Chartered Accountant advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognized by the Central Government or a title indicating membership of the ICAI of any other institution that has been recognized by the Central Government or may be recognized by the council, will be guilty of professional misconduct.

Here A Chartered Accountant empanelled as IP (Insolvency Professional) can mention 'Insolvency Professional' on his visiting cards, Letter heads and other communication, as this is a title recognized by the Central Government in terms of Clause-7 of Part-1 of First Schedule to the Chartered Accountants Act, 1949. Thus, complaint of neighbor is not enforceable /valid.

**(C)**

**Audit Procedures –**

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

Area of Focus	Suggested Audit Procedures
<b>Evaluation of Internal Controls over Advances</b>	<ul style="list-style-type: none"> <li>• Examine loan documentation;</li> <li>• Examine the validity of the recorded amounts;</li> <li>• Examine the existence, enforceability and valuation of the security;</li> <li>• Ensure compliance with the terms of sanction and end use of funds.</li> <li>• Ensure compliance with Loan Policy of Bank as well as RBI norms including appropriate classification and provisioning</li> <li>• Review the operation of the accounts;</li> </ul>

<b>Substantive Audit Procedures</b>	<ul style="list-style-type: none"> <li>• Check that amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet.</li> <li>• Check that advances represent amount due to the bank.</li> <li>• Verify that amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.</li> <li>• Ensure there are no unrecorded advances.</li> <li>• Check that the stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognized in their valuation.</li> <li>• Verify that the advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements.</li> <li>• Check that appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.</li> <li>• Examine all large advances while other advances may be examined on a sample basis</li> <li>• Verify completeness and accuracy of interest being charged</li> </ul>
<b>Recoverability of Advances</b>	<ul style="list-style-type: none"> <li>• Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions.</li> <li>• Review latest financial statements of borrowers.</li> <li>• Review reports on inspection of security.</li> <li>• Review Auditors' reports in the case of borrowers enjoying aggregate credit limits of Rupees 10 lakh or above for working capital from the banking system.</li> </ul>

(D)

The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

- (i) **Criminal liability for Misstatement in Prospectus** - As per Section 34 of the Companies Act, 2013, where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

- (ii) **Punishment for false statement** - According to Section 448 of the Companies Act, 2013 if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement —

- (a) which is false in any material particulars, knowing it to be false; or  
(b) which omits any material fact, knowing it to be material, he shall be liable under section 447.

**Punishment for Fraud- As per Section 447 of the Companies Act, 2013**, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

**Answer 6:**

**(A)**

**Importance of KYC Requirements for a Chartered Accountant's Practice:**

The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI recommended such norms to be observed by the members of the profession who are in practice. These Know Your Client (KYC) Norms are also important in order to ensure a healthy growth of the profession and an equitable flow of professional work among the members.

The self-regulatory measures are recommendatory. However, considering the spirit underlying these measures, it is expected that every Chartered Accountant carrying out attest function is encouraged to follow them and implementation of these measures would go a long way in ensuring equitable flow of work among the members and would also further enhance the prestige of the profession in the society.

**(B)**

**Reporting under CARO, 2016**

- (i) Utilisation of Term Loans:** According to clause (ix) of Para 3 of CARO, 2016, the auditor is required to report "whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable".

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car for the use of the director who was involved in the R&D activities.

Car though used by R&D Director does not fall within the meaning of R&D equipment. The auditor is required to state the fact in his report as per Paragraph 3 clause ix of the CARO 2016, that out of the term loan taken for R&D equipment, Rs. 15 lakh was not utilised for the purpose of acquiring R&D equipment.

- (ii) Non-cash Transactions with Relative of Director:** As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report "whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with".

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is an arrangement by which RPS Ltd. is in process to acquire assets for consideration other than cash and falls within the meaning of section 192 of Companies Act, 2013.

The reporting has to be two fold. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

In the given situation, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below.

*According to the information and explanations given to us, the Company has entered into non-cash transactions with Mr. Rahul, son of one of the directors during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.*

(C)

#### **Verification of Premiums:**

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

- (i) Before commencing verification of premium income, the auditor should look into the internal controls and compliance thereof as laid down for collection and recording of the premiums.

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

- (ii) The auditor should ensure that premium in respect of risks incepting during the relevant accounting year has been accounted as premium income of that year on the basis of premium revenue recognition. The auditor, as part of his audit procedures, should make an assessment of the reasonability of the risk pattern established by the management. The auditor should also see whether the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' and has been disclosed separately. Normally, such instances relate to the issue of cover notes and certificates at the end of the accounting year relating to risks commencing in the next accounting period. Generally, there is a column in the Premium Register called "Commencement of Risk", indicating the date and time from which the risk under the policy issued has commenced. The auditor should verify that policy documents have not been issued, or where issued, the company was not at risk, in case:
  - (a) premium had not been collected at all;

- (b) premium had been collected but the relevant cheques have been dishonoured;
  - (c) premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);
  - (d) premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
  - (e) instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 per cent of the total premium payable by instalments).
- (iii) The auditor should examine whether the reinsurance company is not under a risk in respect of amount lying at credit and outstanding as at the year-end in the following accounts:
- (a) Deposit Premium Account;
  - (b) Premium Received in Advance Account;
  - (c) Inspectors' Deposits Account; and
  - (d) Agent's Premium Accounts.
- (iv) The auditor should verify the collections lodged by agents after the balance sheet date to see whether any collection pertains to risk commencing for the year under audit. The auditor should also check that the premium has been recorded originally at the gross figure, i.e., without providing for unexpired risks and reinsurances.
- (v) In case of co-insurance business, where the company is not the leader, because of the non-availability of the relevant information in many cases the premium is not booked even though the risk has commenced during the relevant accounting year. The auditor should see that the company's share of the premium has been accounted for on the basis of the available information on nature of risk and the provisional premium charged by the leading insurer. The auditor should examine the communications issued to the company by the leading insurers advising them of the company's share of premium income. Such communications should be seen even in respect of the post-audit period. Where the company is the leader, the auditor should obtain a reasonable assurance that only the company's own share of premium has been shown as income and accounts of the other companies have been credited with their share of the premium collected.
- (vi) The auditor should check whether Premium Registers have been maintained chronologically, for each underwriting department, giving full particulars including service tax charged as per acceptance advice on a day-to-day basis. The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger.
- (vii) Where policies have been issued with a provision to collect premium periodically (i.e., under instalment clause, special declaration policy or periodical declaration under open policies in marine insurance), the auditor should check whether premium are collected as and when they become due.
- (viii) The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit. Also examine whether instalments of premium falling due in the subsequent year have not been recognised in the accounts as outstanding premium.

- (ix) The auditor should verify the year end transactions to check that amounts received during the year in respect of risks commencing/ instalments falling due on or after the first day of next financial year are not credited to premium account but credited to Premium Received in Advance Account.
- (x) The auditor should verify the collections remitted by agents immediately after the cut-off date to verify the risk assumed during the year under audit on those collections.
- (xi) The auditor should also check that in case of cancellation of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.
- (xii) Where premium originally received has been refunded, the auditor should verify whether the agency commission paid on such premium has been recovered.
- (xiii) The auditor should verify whether service tax has been charged from the insured, at the rates in force, on the total premium for all classes of business other than those exempted under service tax laws. Check whether service tax so collected is disclosed under 'Current Liabilities' to the extent not deposited in Government's Account.
- (xiv) In the case of co-insurance business, the auditor should verify whether service tax at the rates in force on the whole premium has been charged or collected from the insured by the company in case it is the leader.
- (xv) Check that service tax so collected on premium charged from the insured by the company has been regularly deposited in the Government's Account.

**{ Note : Students can write any 6 points }**

**(D)**

**Technical, Ethical and Professional Standards as per Statement on Peer Review:**

As per the Statement, Technical, Professional and Ethical Standards means-

1. Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India;
2. Standards issued by the Institute of Chartered Accountants of India including-
  - (i) Engagement standards
  - (ii) Statements
  - (iii) Guidance notes
  - (iv) Standards on Internal Audit
  - (v) Statements on Quality Control
  - (vi) Notifications / Directions / Announcements / Guidelines / Pronouncements/ Professional standards issued from time to time by the Council or any of its committees.
3. Framework for the Preparation and presentation of financial statements, framework of statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and framework for assurance engagements;
4. Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.