



INTER CA – NOVEMBER 2018

Sub: AUDIT

Topics : Nature, Objective and Scope of Audit,
Company Audit (without (Sec 128-138)

Test Code – N42

Branch: Multiple

Date:

(50 Marks)

Answer 1 (8 marks)

Basic Principles Governing an Audit: The basic principles which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried are described below:

(i) Integrity, objectivity and independence: The auditor should be straight forward, honest and sincere in his approach to his professional work. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever is actual effect, as being incompatible with integrity and objectivity.

(ii) Confidentiality: The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

(iii) Skills and Competence: The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing. The auditor requires specialised skills and competence along with a continuing awareness of developments including pronouncements of the ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

(iv) Work performed by others: When the auditor delegates work to assistants or uses work performed by other auditors and experts, he continues 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

(v) Documentation: The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

(vi) Planning: The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

(vii) Audit evidence: The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

(viii) Accounting system and Internal Control: The auditor should gain an understanding of the accounting system and related controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

(ix) Audit Conclusions and Reporting: The auditor should review and assess the conclusions drawn from the audit evidence obtained and from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information.

The audit report should contain a clear written opinion on the financial information and should comply the legal requirements. When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons therefore.

Answer 2(8 marks)

The objective of audit, naturally, should be to see that what the statements of account convey is true and fair, not misleading and that such errors and frauds do not exist as to distort what the accounts really should convey.

However, it should not be inferred that the detection of errors and frauds is no longer an audit objective; it is indeed an audit objective because statements of account drawn up from books containing serious mistakes and fraudulent entries cannot be considered as true and fair statement.

To establish whether the financial statements show a true and fair state of affairs, the auditors must carry out a process of examination and verification and, if errors and frauds exist they would come to his notice in the ordinary course of checking. But detection of errors and frauds is not the primary aim of audit; the primary aim is the establishment of a degree of reliability of the annual statements of account.

If there remains a deep laid fraud in the accounts, which in the normal course of examination of accounts may not come to light, it will not be construed as failure of audit, provided the auditor was not negligent in the carrying out his normal work. This principle was established as early as in 1896 in the leading case in Re-Kingston Cotton Mills Co.

The nature of audit objectives was also highlighted in the leading case Re The London and General Bank Ltd. [1895]. It was held that an auditor must ascertain that the books of account show the true financial position of the company. For the first time, the duties of the company auditor were spelled out in specific terms. Lord Justice Lindley observed, "It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans without security. It is nothing to him whether the business of company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit and his duty is confined to that."

Answer 3 (4 marks)

Filling of a Casual Vacancy

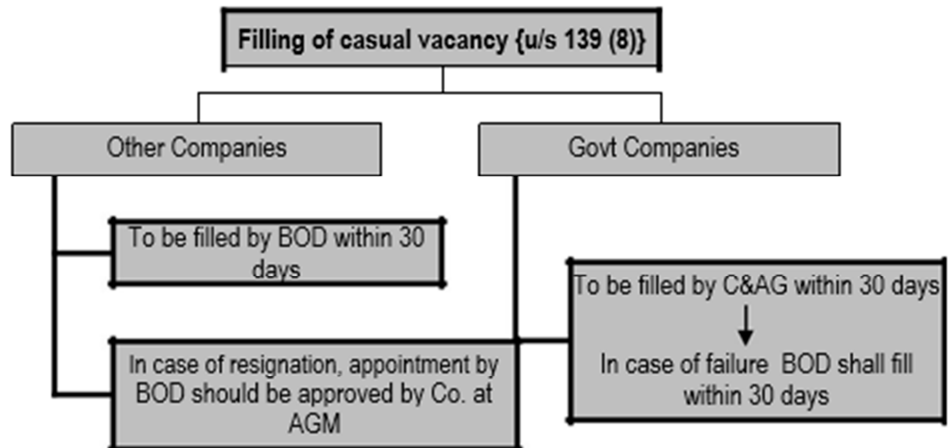
As per **Section 139(8)**, any casual vacancy in the office of an auditor shall -

- (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 three 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 the said period the Board of Directors shall fill the vacancy within next 30 days.



Casual Vacancy by Resignation: As per **section 140(2)** the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed **Form ADT-3** (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in **section 139(5)** i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor -General of India, indicating

the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per **section 140(3)**.

Answer 4 (6 marks)

Appointment of Sole Auditor:

When one of the joint auditors of the previous years 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

As per sub-section 4 of section 140 of the Companies Act, 2013, 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 said Act

Accordingly, provisions of the Companies Act, 2013 to be complied with are as under-

(i) Ascertain that special notice u/s 140(4) of the Companies Act, 2013 was 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 3 months but at least 14 days before the AGM date as per Section 115 of the Companies Act, 2013 read with rule 23(1) and 23(2) of 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 Companies Act, 2013 read with rule 23(3) of the Companies (Management and Administration) Rules, 2014.

(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) The notice is also sent to the retiring auditor as per Section 140(4)(ii) of the Companies Act, 2013.

(v) Verify whether any representation, received from the retiring auditor was sent to the members of the company.

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

Answer 5 (4 marks)

Tenure of Appointment:

i) Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

ii) But in this regard it is to be noted that the company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.

iv) In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded.

iv) Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting.

Answer 6 (5 marks)

Appointment of First Auditor of Company:

i) Section 139(6) of the Companies Act, 2013 lays down that the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company.

ii) In the instant case, the appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR 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 first auditor of the company within one month of registration of the company.

iii) In view of the above, the Managing Director of PQR Ltd. should be advised not to appoint the first auditor of the company.

Answer 7(5 marks)

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ` 1,00,000.

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M. Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of ` 50,000 only (5,000 shares x ` 10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditors of Enn Ltd. as the relative of CA. R (i.e. partner of M/s RM & Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

Answer 8 (5 marks)

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144. Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the investment banking service is specifically notified in the list of services not to be

rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

Answer 9 (5 marks)

Non-Provision of Losses:

i) As per AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

ii) Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

iii) As per SA 570 "Going Concern", there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event.

iv) When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

v) In the instant case, as per AS 29 the company should made provision. Further, proper disclosure explaining the loss incurred and the subsequent position relating to the situation should be made. In case of failure, the auditor may issue a qualified report.
