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CA FINAL ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

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CA. Sarthak Niraj Jain

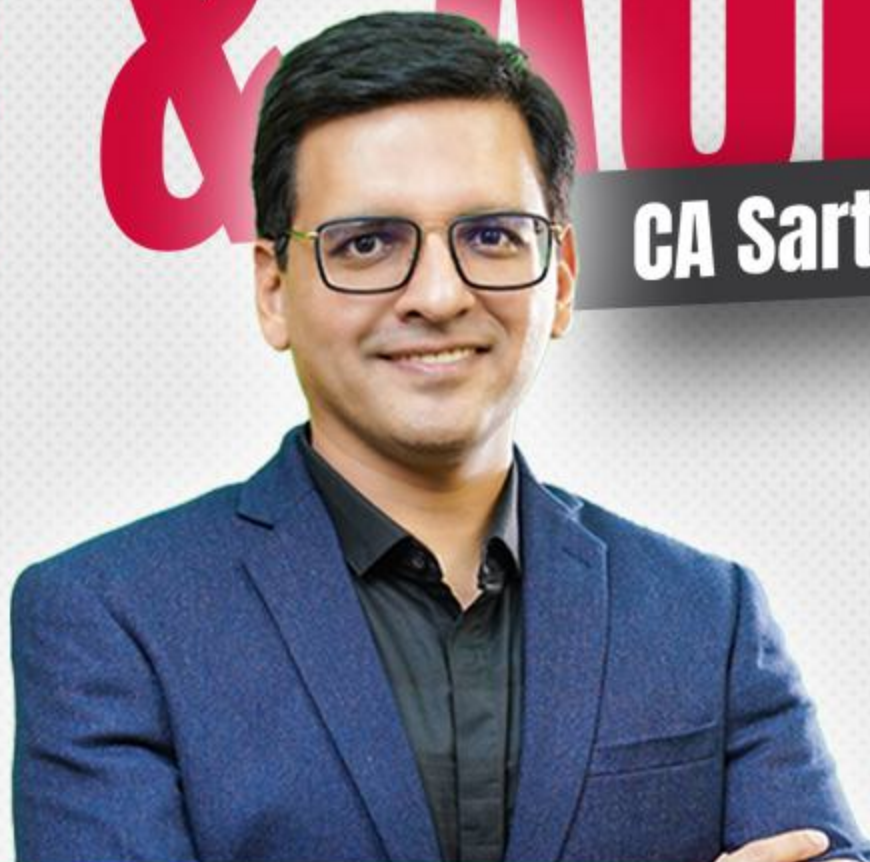
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Chapter 1

Quality Control

1. Continuance of Client Relationship

PQR Associates are the statutory auditors of a large un-listed company, which is engaged in manufacturing of auto components. Subsequent to re-appointment of auditors in the Annual General Meeting, the Company shared the appointment letter with PQR Associates, seeking acknowledgement and acceptance letter. CA. R is the engagement partner and is planning to issue the acceptance letter. During the current financial year, there was a search by the Income Tax authorities on the company, and certain accounting records were seized for verification. Based on the information available on social media, CA. R noted that the promoters' brother, is contemplating to contest in the ensuing elections, under the banner of a political party. One of the current senior engagement team manager, who has been doing the audit engagement till last year, has left PQR Associates and is planning to provide some accounting services to one of the associate companies. PQR Associates are yet to recruit another senior manager having adequate experience in the audits of clients engaged in automotive sector.

Elaborate the matters to be considered by PQR Associates with respect to acceptance & continuance of client relationships considering the above issues.

(May-2024, MTP-May-2025, SM)

Ans.



Acceptance and Continuance of Client Relationships:

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," a firm before accepting an engagement should **acquire vital information** about the client. Such an information should help firm **to decide about:** -

- **Integrity of Client, promoters, and key managerial personnel.**
- **Competence (including capabilities, time, and resources) to perform engagement.**
- **Compliance with ethical requirements.**

The firm should **obtain such information as it considers necessary** in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. **Where issues** have been **identified**, and the firm decides to accept or continue the client relationship or a specific engagement, it should **document how the issues were resolved**.

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall **form a conclusion on compliance with independence requirements** that apply to the audit engagement. In doing so, the engagement partner shall obtain relevant information from the firm and, where applicable, network firms, to **identify and evaluate circumstances and relationships that create threats to independence**.

In view of the above, PQR Associates should:

- ✓ **follow their firm's policies and procedures** for client acceptance and continuance. This includes **evaluating the integrity of the client, assessing potential risks** associated with the engagement, and **ensuring the firm has the necessary resources and expertise** to perform the engagement effectively. The engagement team, should assess, whether the company is involved in any funding activities, to the political parties, and if so enquire and assess the risks related to such transactions.
- ✓ **communicate clearly** with the client regarding the scope of the engagement, the responsibilities of both parties, and any limitations on the services to be provided. This helps manage expectations and ensures alignment between the firm and the client.
- ✓ **independence and objectivity throughout the engagement**. Any potential threats to independence, such as relationships with the client's affiliates or involvement in political activities by related parties, should be evaluated and mitigated appropriately. Since the senior manager who was on this engagement is providing certain accounting services, to one of the group companies, the engagement partner, should assess, whether it would have any impact on the audit and examine the relevant ethical/independence requirements.
- ✓ **continually monitor the client relationship for any changes or developments** that may impact the

firm's ability to provide services effectively. This includes staying informed about significant events such as the income-tax search, changes in client management, or potential conflicts of interest. Since there was an income-tax raid on the organisation, the engagement partner should evaluate the risks of material misstatements, and non-disclosure of tax disputes and liabilities.

- ✓ **ensure that their engagement team possesses the necessary competence and capabilities to perform the audit effectively.** The departure of a senior manager and the need to recruit a replacement with specific industry experience should be addressed promptly to maintain audit quality. Since one of the senior engagement team members has left PQR Associates, the engagement partner should assess, whether he would be in a position to devote adequate time on the engagement or whether to recruit another resource, before commencement of the audit.

2. Independence of the firm

RST Ltd. is a company listed in India. The Company has appointed M/s R & Co. as auditors. CA. R has recently joined the firm and has been appointed as the engagement partner for the first time. During the audit planning, the engagement partner discovers that a relative of a team member holds a significant financial interest in RST Ltd. The team member had not reported this relationship earlier.

He understands that it is necessary to ensure compliance of independence for the audit team as per standard audit practices. But he could not find as such any policies and procedures available with the firm in documented form.

Why do you think that the firm should have policies and procedures to ensure the independence of the firm in every assignment? How does an engagement partner ensure the compliance of independence? Discuss with reference to relevant SAs

(MTP-Sept-2025)

Ans.



As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code.

Such policies and procedures should enable the firm to:

- (i) **Communicate its independence requirements** to its personnel and, where applicable, to others subject to them; and
- (ii) **Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action** to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

Further, **as per SA 220, "Quality Control for an Audit of Financial Statements"**, the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement.

In doing so, the engagement partner shall:

- (i) **Obtain relevant information from the firm and**, where applicable, **network firms**, to identify and evaluate circumstances and relationships that create threats to independence;
- (ii) **Evaluate information on identified breaches**, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- (iii) **Take appropriate action to eliminate such threats or reduce them to an acceptable level** by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

3. Acceptance in Audit Engagement

SDC & Associates, a medium-sized audit firm, is appointed as an auditor of Neuronix Ltd., a listed pharmaceutical company engaged in extensive R&D with complex global operations. CA Rashi an engagement partner of SDC & Associates is leading the audit team for the audit of the same. Neuronix Ltd. was earlier audited by a Big 4 firm that withdrew from the engagement citing scope limitations. During the audit planning, CA Rashi realises that while her team is skilled in standard manufacturing audits, they lack experience in pharma R&D and associated regulatory frameworks. The firm is under pressure to complete the audit in time to meet the listing obligations of Neuronix Ltd. The Managing Partner insists on continuing the audit and advises CA Rashi to rely on the firm's standard procedures to ensure timely delivery.

In light of SQC 1 and SA 220, analyse the quality control considerations CA Rashi must evaluate before continuing with the engagement. What actions should she take to uphold audit quality and professional standards? **(RTP-Sept-2025)**

Ans.



As per SQC 1, "Quality Control for firms that perform audits and reviews of historical financial information, and other assurance and related services engagements", CA Rashi, as the engagement partner, is required to evaluate whether the firm has the capabilities, competence, time and resources to undertake an engagement, following matters have to be taken into consideration: -

- Firm personnel have knowledge of relevant industries or subject matters;
- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
- The firm has sufficient personnel with the necessary capabilities and competence;
- Experts are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
- The firm would be able to complete the engagement within the reporting deadline.

Under SA 220, "Quality Control for an audit of financial statements", the responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC 1 which requires the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

Information like integrity of principal owners, competence of engagement team and consideration of necessary capabilities including time and resources, compliance with relevant ethical requirements and significant matters arisen during current or previous audit engagement and their implications assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate.

In the given case:

- SDC & Associates lacks experience in pharmaceutical R&D audits, a highly regulated and technical field.
- The previous auditor's withdrawal citing scope limitations is a warning sign that must be evaluated.
- The engagement team lacks relevant expertise, and there is pressure from the managing partner to proceed regardless.
- Proceeding without addressing these issues would violate the requirements of SQC 1 and SA 220.

CA Rashi must not proceed with the engagement unless satisfied that all conditions under SQC 1 and SA 220 are met. She should:

- Assess the firm's capability and consider engaging external experts.
- Understand the reason for previous auditor's withdrawal.

Ensure that a qualified EQCR reviewer is appointed and review is completed before issuing the audit report. This will help maintain audit quality, ensure compliance with professional standards, and protect the firm from regulatory repercussions.

4.

Familiarity Threat

XYZ and Associates, Chartered Accountants, is an audit firm, giving services to the various types of clients in the field of auditing, taxation and management consultancy. It has been doing statutory audit of B Ltd., a listed entity since last seven years. CA X who has been the engagement partner for the company since beginning has a complete idea about the strengths and weaknesses of the internal controls of the company. He maintains good relations with the management and those charged with the governance. Every year audit is completed in a cordial and healthy manner. During current year the quality control reviewer insisted to change the engagement partner for the company saying that continuation of same engagement partner poses certain audit risk and threats to the organization and advises to review the firm's policies and procedures in relation to the engagement partner. The management of the company does not wish to change the engagement partner. How do you view the above situation from the view point of quality control system in audit firm in terms of requirements of SQC 1 ? Guide the firm in establishing the policies and procedures in respect of an engagement

partner.

(May-2025)

Ans.



Quality control system in an audit firm (SQC 1): SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," lays special emphasis on familiarity threat. Using the same senior personnel on assurance engagements over a prolonged period may impair the quality of performance of the engagement.

Therefore, the firm should establish criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as

- (i) the nature of the engagement, including the extent to which it involves a matter of public interest, and
- (ii) the length of service of the senior personnel on the engagement.

- ◆ The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years (except in cases where audit of listed entities is conducted by a sole practitioner). However, to ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

In the given situation, XYZ and Associates, Chartered Accountants, has been conducting the statutory audit of B Ltd., a listed company, for the past seven years. CA X served as the engagement partner throughout this period. CA X has developed an in-depth understanding of the company's internal controls and maintains a strong, cordial relationship with the management and those charged with governance. However, during the current year, the firm's quality control reviewer raised concerns about the continued involvement of CA X, citing the continuation of the same engagement partner poses certain audit risk and threats to the organisation, and advised reviewing the firm's policies regarding engagement partner rotation.

In view of SQC 1, the continued involvement of the same engagement partner, CA. X with a listed entity for an extended period, i.e., more than 7 years, poses a familiarity threat, potentially impairing audit quality and independence. Therefore, the firm should implement a policy of mandatory partner rotation and review its quality control procedures to ensure compliance with professional standards and maintain the integrity of the audit process.

The firm should establish policies and procedures requiring that:

- (I) The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance;
- (II) The engagement partner has the appropriate capabilities, competence, authority, and time to perform the role; and

The responsibilities of the engagement partner are clearly defined and communicated to that partner.

5.

Withdrawal

SPS & Associates, Chartered Accountants, are statutory auditors of Grec Limited for the last two years. Grec Limited is engaged in the manufacturing and marketing of pharmaceutical goods in India. During the year 2023-24, the company has diversified and commenced providing software solutions in "e-commerce" in India as well as in certain African countries. SPS & Associates, while carrying out the audit, noticed that the company has expanded its operations into a new segment as well as in a new country. SPS & Associates does not possess the necessary expertise and infrastructure to carry out the audit of these diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw.

(Nov-2022, MTP-Nov-2024, SM)

Ans.



As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", the firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, SPS & Associates, Chartered Accountants, statutory auditors of Grec Limited for the last two years, came to know that the company has expanded its operations into a new segment as well as in new country. SPS & Associates does not possess the necessary expertise for the same, therefore, SPS & Associates wish to withdraw from the engagement and client relationship. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following: Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.

If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's

management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.

Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

Documenting significant issues, consultations, conclusions, and the basis for the conclusions.

SPS & Associates should address the above issues before deciding to withdraw.

6. Engagement Quality Control Reviewer & Differences of Opinion

CA Giri is a senior partner of M/s TSV Associates. M/s TSV Associates is a reputed firm of Chartered Accountants which has been in practice for more than five decades. The firm undertakes statutory audits of large listed companies across various industry sectors and has more than fifty qualified experienced professionals. CA Giri has been assigned as an Engagement Quality Control Reviewer for an audit engagement of a listed company. What are the aspects, which would be looked into by CA Giri as an EQCR in relation to the engagement?

Upon completion of the review, CA Giri has identified certain issues, with respect to revenue recognition and adequacy of provisions relating to onerous contracts. The views of CA Giri are not accepted by the Engagement Partner. Suggest the ways of resolving the differences of opinion between CA Giri and the engagement partner.

(May-2024, MTP-Jan-2026, SM)

Ans.

A 220, "Quality Control for an Audit of Financial Statements", for audits of financial statements of listed entities, CA. Giri, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

The engagement team's **evaluation of the firm's independence in relation to the audit engagement;**

Whether appropriate **consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions** arising from those consultations;

Whether **audit documentation selected for review** reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements,", there might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences.

In case, **recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved** to reviewer's satisfaction, the **matter should be resolved by following established procedures of firm** like by consulting with another practitioner or firm, or a professional or regulatory body.

In the given situation, under completion of review, **CA. Giri, Engagement Quality Control Reviewer has identified certain issues**. However, the view of CA Giri, **the EQCR are not accepted by the Engagement Partner**. This **difference of opinion** among the CA Giri and Engagement Partner **should be resolved with abovementioned manner as per SQC 1**.

7.

System of QC : Documentation

TPX & Co., Chartered Accountants is a large audit firm. It maintains audit documentation both electronically and in physical form (hard files). The physical files are neither scanned and incorporated into electronic files nor cross-referenced to the electronic files. Further, there are many instances where audit working papers do not contain details as to whether information was obtained from client or prepared by engagement team. How do you view above situation from point of view of quality control system in audit firm? Analyse.

(MTP-May-2024, RTP-Jan-2026, SM)

Ans.



In accordance with SQC 1," Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" the firm should establish policies and procedures designed to maintain confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

In the given situation,

- the physical files are **neither scanned and incorporated in the electronic files nor cross-referenced to the electronic files**.
- Inability to do so shows that **firm has not established policies and procedures to maintain integrity of engagement documentation**.
- Lack of ensuring the same makes it **difficult to demonstrate completeness of audit files and whether these were assembled within 60 days** timeframe stipulated in SQC 1.
- Where engagement documentation is in paper, electronic, or other media, the integrity, accessibility or **retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted** without the firm's knowledge, or if it could be **permanently lost or damaged**.
- One of the reasons for designing and implementing appropriate controls for engagement documentation in this regard is the protection of the integrity of information at all stages of engagement.

For the practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures requiring engagement teams to:

- Generate scanned copies** that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
- Integrate the scanned copies into the engagement files**, including indexing and signing off on the scanned copies as necessary; and
- Enable the scanned copies to be retrieved and printed** as necessary.

It has also been stated that there are many instances where audit **working papers do not contain details as to whether information was obtained from the client or prepared by the engagement team**. It is important to **identify the source of the document and** the information used as audit **evidence** to ensure its reliability. It could have potential risks of non-compliance with standards on auditing.

8. Quality Control System

MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputes one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a quid pro quo. **Is approach of Sudhanshu proper? How does it reflect upon quality control system of firm?**

Ans.



Approach of Sudhanshu is **not proper**. Such practices blatantly **violate code of ethics and its spirit**. It reflects poorly upon quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel. It shows that firm's **personnel are not properly sensitized regarding requirements of SQC 1**.

9. Engagement Performance, Consultation and Engagement Quality Control Review

M/s KRM & Associates, Chartered Accountants, is the statutory auditor of Velocity Engineering & Projects Ltd., a listed company engaged in execution of large-scale infrastructure projects under Engineering, Procurement and Construction (EPC) contracts across India and overseas.

The firm has an experienced partner designated as Engagement Quality Control Reviewer for listed entity audits.

During the audit for the year ended 31st March 2025, the engagement team noticed the following matters:

- Revenue of ₹ 1,250 crores recognised under long-term EPC contracts using percentage of completion method based on cost-to-cost input method under Ind AS 115. Significant variation claims and escalation clauses were included in transaction price based on management's assessment of "high probability of recovery".
- Impairment testing of investments in step-down foreign subsidiaries executing overseas EPC contracts, where cash flow projections were based on aggressive assumptions about future contract awards.
- Disagreement between the senior member of the audit team and the engagement partner regarding inclusion of variation claims as part of transaction price, with the senior member recommending external technical consultation.

- The firm did not have internal infrastructure specialists. However, external consultation was obtained, and the matter was resolved without formal documentation of consultation process.
- The Engagement Quality Control Reviewer was informed about the audit but:
 - o The review was conducted only at a summary level.
 - o Detailed evaluation of significant judgments relating to revenue recognition and impairment was not performed.
 - o The audit report was signed before completion of formal EQCR documentation.
 - o Differences of opinion, if any, were not formally documented or resolved.
- The working papers contain general review notes but no detailed documentation evidencing depth of consultation or completion of objective EQCR procedures prior to issuance of the audit report.

You are required to examine compliance with requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review as per SQC 1. **(RTP-May-2026)**

Ans.



In the given case, the auditor is required to examine compliance with requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review as per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" as follows:

Engagement Performance: Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

In the given case, though complex and high-risk areas such as revenue recognition under long-term EPC contracts and impairment of overseas investments were involved, adequate documentation and supervision procedures are not evidenced.

Consultation should take place in difficult or contentious matters pertaining to an engagement. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter. It helps to promote quality and improves the application of professional judgment. Consultation procedures require consultation with those having appropriate knowledge, seniority and experience within the firm (or outside the firm) on significant technical, ethical and other matters and appropriate documentation and implementation of conclusions resulting from consultations.

A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies. Complete and proper documentation should be maintained on issues involved and results of consultation.

In the given case, disagreement existed within the engagement team regarding inclusion of variation claims, and the firm lacked internal infrastructure specialists. In the absence of above, external consultation was obtained to resolve the matter. Though matter got resolved, no documentation for consultation process was maintained. This indicates non-compliance with consultation requirements.

Engagement Quality Control Review (EQCR): Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued.

The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.

Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

In the present case, although the firm had an Engagement Quality Control Reviewer, the review was not adequately performed, significant judgments were not objectively evaluated in depth, and the audit report was issued before completion of proper EQCR procedures. This indicates non-compliance with the

requirements relating to Engagement Quality Control Review.

Conclusion: In the given case, the audit involved significant judgments relating to revenue recognition under long-term EPC contracts and impairment of foreign investments, which constitute difficult and contentious matters requiring consultation at an appropriate professional level. Failure to document such consultation indicates non-compliance with engagement performance requirements.

Further, since Velocity Engineering & Projects Ltd. is a listed entity, Engagement Quality Control Review was mandatory. Though an Engagement Quality Control Reviewer existed in the firm, the review was not properly performed and was not completed before issuance of the audit report. Hence, the firm has failed to comply with the requirements relating to Engagement Performance, Consultation and Engagement Quality Control Review.

10. **Loyal & Co., a Chartered Accountant firm, has recently experienced significant growth and started auditing several large corporate entities. During a periodic internal assessment of the firm's quality control system, the following observations were made:**

- **Loyal & Co. often accept new audit engagements based on referrals from existing clients, without conducting a proper evaluation of the client's reputation, integrity of management, or potential risks associated with the engagement.**
- **The firm is following the same quality control policies for several years without updating them for recent changes in professional standards and regulatory requirements.**

Identify the elements of the system of quality control under SQC 1 that are affected in the above situation and briefly explain how these elements contribute to ensuring quality in audit engagements performed by the firm. (MTP-May-2026)

Ans.



As per SQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", a firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances.

In the given situation, the following specific elements of quality control are affected:

(i) Acceptance and continuance of client relationships and specific engagements: A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:

- Integrity of Client, promoters and key managerial personnel.
- Competence (including capabilities, time and resources) to perform engagement.
- Compliance with ethical requirements.

In the present case, Loyal & Co. often accepts new engagements based solely on referrals without proper evaluation, which is a clear deficiency in this element.

(ii) Monitoring: The firm should ensure that policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. In this case, the firm has been following the same quality control policies for several years without updating them for changes in professional standards and regulatory requirements, indicating a lapse in monitoring.

Therefore, accepting engagements without properly assessing client integrity and continuing with outdated quality control policies by Loyal & Co. highlights deficiencies in the acceptance and continuance of client relationships and monitoring elements of SQC 1. These elements are crucial to ensure that the firm undertakes only appropriate engagements and its quality control framework remains updated, effective, and compliant with professional and regulatory standards. Strengthening these areas will help the firm in maintaining consistent audit quality, especially in view of its recent growth and engagement with large corporate clients.

Chapter 2

GENERAL AUDITING PRINCIPLES AND AUDITOR'S RESPONSIBILITIES

SA-240 (& Section 143 (12) on Fraud Reporting)

The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements

11. Responsibility of Auditor relating to fraud

Arihant Limited was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2023-24. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ₹ 35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings. In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

(RTP-Nov-2022, MTP-May-2024, SM)

Ans.



(i) **As per SA 240-** "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" **and SA 315,** "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment",

- The auditor shall **identify and assess the risks of material misstatement due to fraud** at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.
- When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, **based on a presumption** that there are **risks of fraud** in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

(ii) **In accordance with SA 240,** "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" **and 330,** "The Auditor's Responses to Assessed Risks"

- The auditor shall determine **overall responses to address the assessed risks of material misstatement** due to fraud at the financial statement level and assertion level.
- The **presumption that there are risks of fraud** in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.
- However, **when there is a complex revenue structure** or when there is lack of controls on revenue recognition, then there is a **high probability of fraud risk** in revenue recognition.
- **Obtaining an understanding of the entity and its environment**, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

(iii) **In the current scenario:**

- The company was **earning revenue from multiple streams**. Also, it was identified that the controls are **not properly designed** to mitigate the risk of fraud and risk of improper revenue recognition.
- During the year it was **identified that the management did not account for revenue** from corporate hotel bookings **amounting to ₹ 35 crore**. These amounts were partially received **in the company's bank accounts** and partially received **in the CFO's personal account**. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

(iv) **Conclusion:**

- Therefore, the auditor while performing the **risk assessment procedures** should consider the **complexity and nature of the revenue** for determining the fraud risks in revenue recognition.
- Also, **there were no adequate controls** addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk.

Moreover, the **audit team should have recognised fraud risk** by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is **required to report all the frauds identified** during the course of the audit **involving amounts above ₹ 1 crore** within the prescribed time frame to the Central Government

12. **Response to assessed risk**

Alpha Manufacturing Ltd. (AML) is engaged in the production of specialty machinery for the automotive industry. The company operates in a competitive market and is under pressure to meet aggressive revenue and profitability targets to secure additional funding from the investors. The audit firm BETA LLP has been engaged to conduct AML's statutory audit for the financial year 2024-25. BETA LLP performed risk assessment procedures and related activities towards obtaining information in identifying risk of material misstatement due to fraud and also evaluated whether there is an indication that one or more fraud risk factors are present. Analytical procedures reveal unexpected relationships potentially indicating fraudulent activities, such as sales inflation by management to meet earnings targets. Management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. Guide BETA LLP to decide the course of action in determining overall responses to address the assessed risks of material misstatement due to fraud at the (i) Financial Statement Level and (ii) Assertion Level.

(May-2025, RTP-Jan-2026)

Ans.



(I) **Responses to the Assessed Risks of Material Misstatement due to Fraud at the Financial Statement**

Level: In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

- Assign and supervise personnel taking account of the knowledge, skill, and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement;
- Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and
- Incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures.

(II) **Audit Procedures Responsive to Assessed Risks of Material Misstatement due to Fraud at the Assertion Level:**

- (a) The auditor shall design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. In doing so, the auditor may change the nature, timing, and extent of audit procedures to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.
- (b) If the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery.
 - (i) In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms.
 - (ii) In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

13.

Reporting of Fraud committed by Management/Directors of the Company

You are appointed as Statutory Auditor of Supreme Ltd. and are in the midst of conducting Annual Audit for the financial year ending on 31st March, 2023. During the course of audit, you come across a situation involving recording of purchases amounting to ₹ 1.50 crores from a company incorporated on 18th March, 2023. Upon further inquiry, you discover that purchases have been booked at the instance of one of the directors. Further, despite this entry in books, no payment was made and there is lack of documentary or other evidence validating these purported purchases. How would you deal in the given situation? **(RTP-May-2024)**

Ans.



SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," emphasize that fraud can be perpetrated by management override of controls, such as the creation of fictitious journal entries, particularly towards the end of an accounting period, to manipulate operating results or achieve specific objectives.

In the case of Supreme Ltd., where purchases of ₹ 1.50 crore were recorded at year-end without supporting evidence, it became apparent during the investigation that the company had entered fictitious journal entries to manipulate the operating results.

Given this situation,

- the auditor would **align their approach based on the impact of the misstatement** resulting from such fictitious journal entries.
- **if**, due to fraud or suspected fraud, the auditor encounters exceptional circumstances that cast **doubt on their ability to continue the audit**, they must **assess the professional and legal responsibilities applicable**.
- This includes **considering reporting obligations** to those who appointed the auditor or, in some cases, to regulatory authorities. The **appropriateness of withdrawal** from the engagement is also a consideration, where legally permitted.

Furthermore, the auditor is **mandated to report in accordance with Section 143(12) of the Companies Act, 2013. According to Section 143(12) read with Rule 13 of Companies (Audit & Auditor's) Rules, 2014**, if the auditor, during the performance of their duties, has reason to believe that an offence of **fraud** involving an **amount of ₹1 crore or more** has been committed by the company's officers or employees, **reporting to the Central Government is required in the prescribed manner.**

Additionally,

- **reporting obligations extend to Clause (xi) of Paragraph 3 of Companies (Auditor's Report) Order, 2020.**
- the auditor is obligated to **disclose whether any fraud** by the company or against the company by its officers or employees has been **observed or reported during the year**. If affirmative, the nature and amount involved are to be indicated.

This comprehensive reporting framework **ensures transparency, adherence to legal requirements, and protection of stakeholders' interests** in the face of potential fraudulent activities.

- 14. Inability to continue engagement in case of suspected fraud**
MN & Associates are the statutory auditors of ABC Ltd. for the FY 2023-24. During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. How should the audit team deal with the situation? **(SM)**

Ans.



During the course of audit, the engagement partner, Mr. Manohar **notices a misstatement resulting from a suspected fraud** that brings into question the audit team's ability to continue performing the audit. In such a situation the audit team should:

- (a) **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;
- (b) Consider **whether** it is appropriate **to withdraw from the engagement**, where withdrawal from the engagement is legally permitted; and
- (c) **If the auditor withdraws: -**
 - (i) **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
 - (ii) **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.

SA-250

Consideration of Laws and Regulations in an Audit of Financial Statements

- 15. Scope**
AJ Private Limited is a company involved in the business of textile manufacturing and having its factory a NOIDA. The business of the company is spread across India. Due to the recent fire incidents, the local authority of NOIDA passed a regulation wherein it is compulsory for any organisation in its jurisdictional area to have a valid Fire No Objection Certificate (Fire NOC) issued by the regulatory authority. You are appointed as the statutory auditor of the company for the financial year 2024-25. During initial risk assessment phase, you observed that the company is not in possession of Fire NOC as stipulated by the regulatory authority. You approached those charged with governance regarding this matter and requested them to provide their justification on the same, They are of the opinion that obtaining Fire NCC is outside the purview of the financial statements; hence you are not required to look after this aspect. What are the auditor's responsibilities in relation to compliance with laws and regulations? **(Sept-2025)**

Ans.



SA 250, "Considerations of Laws and Regulations in an Audit of Financial Statements" distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:

- (i) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and labour laws; and
- (ii) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties. Non-Compliance with such laws and regulations may, therefore, have a material effect on the financial statements.

For the compliance with provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, the auditor's responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations.

For other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the business, the auditor's responsibility is limited to undertaking specified audit procedures to help identify

non-compliance with those laws and regulations that may have a material effect on the financial statements. Therefore, auditor should ensure as to whether any penal provisions will be there for non-compliance of such law and also whether the same has been duly disclosed by the company. If auditor concludes that such non-compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements by the company, he shall express an adverse or a qualified opinion on the financial statements.

SA-402

Audit Considerations Relating to an Entity Using a Service Organization

- 16. Using the services of a Service Organization**
- During the audit of Indo limited, CA Harish observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Indo Limited used a service organisation to record transactions and process related data. What factors should CA Harish consider regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk. Discuss with reference to the relevant Standards on Auditing. (MTP-Nov-2024, SM)

Ans.  **As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", when obtaining an understanding of the user entity in accordance with SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:**

- (i) The **nature of the services provided** by the service organisation and the **significance of those services** to the user entity, including the **effect thereof** on the user entity's internal control;
- (ii) The **nature and materiality of the transactions processed or accounts or financial reporting processes** affected by the service organisation;
- (iii) The **degree of interaction** between the activities of the service organisation and those of the user entity; and
- (iv) The **nature of the relationship between the user entity and the service organisation**, including the relevant contractual terms for the activities undertaken by the service organization.

Based on above, while conducting the audit, CA Harish will assess the effect on the audit risk and take necessary steps.

- 17. Audit Evidence**
- Key Ventures Limited is availing the services of Chipmetric Limited for processing of its accounting data including payroll operations. Payroll costs account for 75% of the total costs of Key Ventures Limited. CA Tej, the auditor of Key Ventures Limited wants to obtain an understanding of the nature and significance of the services provided by Chipmetric Limited and their effect on the user entity's internal control to identify and assess the risks of material misstatement. In this regard, he wants to use Type 1 or Type 2 report. What shall be the considerations of CA Tej in determining the sufficiency and appropriateness of the audit evidence? Suggest the procedures if he plans to use a Type 1 or Type 2 report as audit evidence to support the understanding about the design and implementation of controls at Chipmetric Limited as per relevant Standard on Auditing. (May-2025, MTP-Jan-2026)

Ans.  **Using A Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation:**

As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", in determining the sufficiency and appropriateness of the audit evidence provided by a Type 1 or Type 2 report, CA Tej, the user auditor shall be satisfied as to: -

- (i) The service auditor's professional competence (except where the service auditor is a member of the Institute of Chartered Accountants of India) and independence from the service organisation; and
- (ii) The adequacy of the standards under which the Type 1 or Type 2 report was issued.

If the user auditor plans to use a Type 1 or Type 2 report as audit evidence to support the user auditor's

understanding about the design and implementation of controls at the service organisation Chipmetric Ltd., CA Tez, the user auditor shall:

- (i) Evaluate whether the description and design of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (ii) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit; and

Determine whether the complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls.

NOTES:

[illegible]

**Chapter
3**
AUDIT PLANNING, STRATEGY & EXECUTION
SA-300
Planning an Audit of Financial Statements
18.
Changes in Audit Plan

Mr. S & Mr. J are a senior and junior articled assistant respectively, in a renowned audit firm. Both were assigned statutory audit of a manufacturing company. Mr. S instructed his junior to draft an audit plan by taking reference from a similar client (a partnership firm) who was engaged in the same business. Mr. J was confused as to how that reference could suit in this case, since the nature and extent of planning would vary for both clients. After few days, the audit work commenced. During the course of the audit, certain events took place, which made Mr. J to rethink about the audit plan initially designed. He approached Mr. S and enquired about when would an audit plan require a change. Comment about both the situations face by Mr. J in the above situation.

(MTP-Dec-2021)
Ans.


SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing” states that in order to achieve the **overall objectives** of the audit, the auditor shall use the objectives stated in relevant SAs in **planning and performing the audit**. Without a careful plan, the overall objective of an audit **may not be achieved**. The audit **planning is necessary** to conduct an effective audit, in an efficient and timely manner. So far as the nature of planning is concerned, it would vary according to-

- (i) Size and Complexity of the Auditee** - If the **size and complexity of organization** of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.
- (ii) Past Experience & Expertise** - The key engagement team members' **previous experience & expertise** also contributes towards variation in planning activities.
- (iii) Change in Circumstances** - Another factor contributing towards **variation in planning** activities is change in circumstances.

Changes to Audit Planning: The auditor should update and change the overall audit strategy and audit plan as necessary during the course of the audit. The auditor may need to modify the overall audit strategy and audit plan due to the factors such as:

- (i) result of unexpected events,**
- (ii) changes in conditions, or**
- (iii) the audit evidence obtained** from the results of audit procedures.

Further, the auditor would also have to **modify the nature, timing & extent of further audit procedures**, based on the revised considerations of assessed risks. This may be the case **when information coming to the auditor differs significantly** from the information when he planned the audit process. In addition to the above, **there may be possibilities of change in** - law, notifications, government policies, which warrants updation of **overall audit strategy and audit plan**.

SA-600
Using the Work of Another Auditor
19.
CFS Audit Scope

Venus Ltd. is a curtain manufacturing company having its corporate office in Punjab. The company is in the process of expansion and has acquired four companies during the year. Pradyuman & Co. is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted by Jha & Jha Associates. During the course of audit, CA Pradyuman, the engagement partner asked the management of Venus Ltd. at the corporate office that in order to conduct the audit of the consolidated financial statements, his audit firm is required to conduct audit of the financial statements of all the components also (Companies acquired during the year). To this, the management asked CA Pradyuman to

consider the audit reports of the component auditor already provided to his audit team and to communicate with the component auditor for any discussion they wish to have. CA Pradyuman contended that for the purpose of audit of consolidated financial statements either his firm is required to conduct an audit of all the component's financial statements or he needs the working papers of the component auditors. Is the contention of CA Pradyuman correct? **(SM)**

Ans.



As per SA 600, "Using the work of Another auditor",

- The **principal auditor** is normally **entitled to rely upon** the **work of component auditor unless there are special circumstances** to make it essential for him **to visit** the **component** and/or to **examine** the **books of account and other records** of the said component.
- The principal auditor might **discuss** with the other auditor the **audit procedures applied** or **review** a **written summary** of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.
- The principal auditor may also wish to visit the other auditor.
- The **nature, timing and extent of procedures** will **depend on** the **circumstances** of the **engagement** and the principal auditor's knowledge of the **professional competence of the other auditor**.
- The principal auditor should **consider** the **significant findings of the other auditor**.
- The principal auditor may consider it appropriate to **discuss** with the other auditor and the management of the component, the **audit findings or other matters affecting** the **financial information** of the components.
- He may also **decide** that **supplemental tests** of the records or the financial statements of the component **are necessary**. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.

Accordingly, CA Pradyuman, can perform the above-mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required.

So, the contention of CA Pradyuman that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements **is not correct**.

Further, **SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides** that,

- unless otherwise specified by law or regulation, **audit documentation** is the **property of the auditor**.
- He may **at his discretion, make portions of, or extracts from,** audit documentation **available to clients**, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Accordingly, it is the discretion of the component auditor as the **working papers with respect** to the **components examined** by the **component auditor** are the **property of the component auditor**.

So, the contention of CA Pradyuman is not correct.

20.

Work Summary of WP of Branch Auditor

Kukreja & Associates is the principal auditor of MN Ltd. The company is engaged in the manufacture of sports items and operates through its 14 branches all over India. With respect to the audit of branches, the company has appointed seven Chartered Accountant firms, each firm conducting the audit of two branches. The audit reports in respect of accounts of branches have already been sent to the principal auditor. While analysing the work of the branch auditors, CA Kukreja, the engagement partner, asked the branch auditors to share with him a summary of the audit procedures and findings in respect of the accounts of the ranches examined by them. CA Kukreja also asked one of the branch auditor to share his working paper with respect to the two branches examined by that branch auditor for his review and return. Is the principal auditor correct in asking the branch auditors for sharing the summary and the working papers for his review. **(SM)**

Ans.

In terms of SA 600 "Using the Work of Another auditor",

- where **another auditor** has been **appointed for** the **component**, the **principal auditor** would normally



be **entitled to rely upon** the work of such auditor unless there are special circumstances to make it essential for him **to visit** the component and/or to **examine the books of account and other records** of the said component.

- When planning to use the work of another auditor, the principal auditor should **consider** the **professional competence** of the **other auditor** in the context of specific assignment **if the other auditor is not a member of the Institute of Chartered Accountants of India**.
- The principal auditor should **perform procedures to obtain sufficient appropriate audit evidence**, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.
- The principal auditor might **discuss with the other auditor** the **audit procedures applied or review a written summary** of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.

Accordingly, CA Kukreja is correct in asking the branch auditors to share with him the summary of their audit procedures and findings in respect of the accounts of the branches examined by them.

Further, CA Kukreja has asked one of the branch auditors to share with him the working papers with respect to the branches examined by such branch auditor for the former's review and return.

SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that,

- unless otherwise specified by law or regulation, **audit documentation** is the **property of the auditor**.
- He may **at his discretion, make portions of, or extracts from,** audit documentation **available to clients**, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Accordingly, it is the discretion of the branch auditor as the **working papers with respect to the branches examined** by the **branch auditor** are the **property of the branch auditor**. So, **CA Kukreja is not correct** in asking the branch auditor to share with him the working papers with respect to the branches examined by the branch auditor.

21.

Using the work of other auditors – Audit Procedures & Documentation

MK Electronics Limited is a listed company with eight subsidiaries spread across various states, The financial statements of MK Electronics Ltd are audited by CA Amar, the principal auditor, CA Amar relies on the work of other auditors for auditing the financial statements of subsidiaries. You are required to :

- Explain the procedures that CA Amar will perform to obtain sufficient appropriate audit evidence to ensure that the work of other auditors is adequate for his purpose.
- Explain how he will document the working papers with respect to the subsidiaries audited by other auditors. What matters need to be documented if the other auditor's report is modified. **(Nov-2024)**

Ans.



- The principal auditor CA. Amar should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor's purposes. When using the work of another auditor, CA. Amar the principal auditor should ordinarily perform the procedures given below:
 - advise the other auditor regarding use of his (other auditor) work and report and make sufficient arrangements for co-ordination at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit;
 - advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.
- CA Amar should document in his working papers, the components whose financial information audited by other auditors. CA Amar should also document the procedures performed and the conclusions reached. For example, the auditor would document the results of discussions with the other auditor and

review of the written summary of the other auditor's procedures.

Where the other auditor's report is other than unmodified, the principal auditor should also document how he has dealt with the qualifications or adverse remarks contained in the other auditor's report in framing his own report.

22.

Responsibilities of Auditor

CA Subhadra, an engagement partner in SRT & Associates, is conducting the statutory audit of MBI Ltd., an unlisted manufacturing company with 96 production and sales units spread across the country. These units are audited by different branch auditors. In respect of one major unit audited by a branch auditor, there were significant inventory valuation errors and misstatements in cost allocations, which were not reported by the branch auditor. The branch auditor submitted a NIL report without suggesting any modifications.

During overall review of financial statements of Company by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection reports etc. of above branch as part of overall review procedures. However, these reports did not point towards any concern or irregularities in the inventory or costing practices. Would the statutory auditor of the Company be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?

(MTP-Sept-2025)

Ans.



SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/ subsidiaries or other components audited by other auditors.

In the given situation, nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore, he would not be responsible for work performed by branch auditor.

Further, it should be clearly stated in the report that 96 production and sales units of company have been audited by branch auditors.

SA-610

Using the Work of Internal Auditors

23.

Direct Assistance

Rajveer & Associates have been the statutory auditors of Ish and Vish Ltd., a listed company. CA Vishav, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These assertions were not examined by him in previous years due to materiality or risk considerations.

Mr. Yug leads the internal audit department of the company and reports to the company's audit committee. During the audit, a senior member of the engagement team decides to engage Mr. Yug to provide direct assistance in performing the above substantive procedures. Comment with respect to the relevant Standards on Auditing.

Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance.

(MTP-May-2025)

Ans.



As per SA 610, "Using the Work of Internal Auditors", prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

- (i) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
- (ii) Obtain written agreement from the internal auditors that they will keep confidential specific matters as

instructed by the external auditor and inform the external auditor of any threat to their objectivity.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor shall not use an internal auditor to provide direct assistance if:

- (a) There are significant threats to the objectivity of the internal auditor; or
- (b) The internal auditor lacks sufficient competence to perform the proposed work.

In the current scenario, Rajveer & Associates are the statutory auditors of Ish and Vish Ltd., a listed company. CA. Vishav, the engagement partner, designed certain substantive procedures on some selected assertions in response to the assessed risks of material misstatements for the year, which were not previously examined. Mr. Yug, head of the internal audit department, reports to the audit committee. A senior audit team member decides to involve Mr. Yug in performing these substantive procedures.

As a result, the Rajveer & Associates is required to obtain written agreements from both the entity and the internal auditors regarding their cooperation and confidentiality. Further, using an internal auditor to provide direct assistance could prove to be counter-productive and defeat the very purpose of designing such substantive procedures. Hence, the decision of senior engagement team member to use Mr. Yug to provide direct assistance on above said matters is not in order as it is not in accordance with SA 610.

24.

Using Direct Assistance of Internal Auditor & Use in External Confirmation Procedure

Mr. A is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

- (a) Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
- (b) Will your answer be different, if Mr. A ask direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

(RTP-May-2020)

Ans.



(i) Provision:- As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) **shall not use internal auditors** to provide **direct assistance to perform procedures that:**

- Involve making **significant judgments** in the audit;

Significant judgments include the following:

- Assessing the **risks of material misstatement**;
- Evaluating the **sufficiency of tests performed**;
- Evaluating the appropriateness of management's use of the **going concern assumption**;
- Evaluating **significant accounting estimates**; and
- Evaluating the **adequacy of disclosures in the financial statements**, and other matters affecting the auditor's report
- Relate to **higher assessed risks of material misstatement** where the judgment required in performing the **relevant audit procedures** or **evaluating the audit evidence** gathered is more than limited;
- Relate to work with which the **internal auditors have been involved** and which has **already** been, or will be, **reported to management or TCWG** by the internal audit function; or
- Relate to **decisions the external auditor makes** in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

(ii) In the present case:- Mr. A asked internal auditor to provide **direct assistance regarding evaluating significant accounting estimates** and assessing the **risk of material misstatements**.

- (iii) **Conclusion:-** Evaluation of Accounting estimates and assessing Risk of Material Misstatements involve **significant judgements**, hence **Mr. A should not insist for direct assistance in these areas.**
- Direct Assistance from Internal Auditor in case of External Confirmation Procedures:**
- **SA 610 “Using the Work of Internal Auditor”**, provide relevant guidance in determining the **nature and extent of work** that may be assigned to internal auditors.
In determining the **nature of work that may be assigned to internal auditors**, the external auditor is **careful to limit such work** to those areas that would be appropriate to be assigned.
 - In accordance with **SA 505, “External Confirmation”** the external auditor is required to **maintain control over external confirmation** requests and **evaluate the results of external confirmation** procedures, it would **not be appropriate to assign** these responsibilities to internal auditors.
- Conclusion:** It would not be appropriate to use **direct assistance w.r.t. obtaining external confirmation requests** and their evaluation. **Assistance may be used in assembling information** necessary for the external auditor to resolve exceptions in confirmation responses

25.

Direct assistance from internal auditors - matters included in Audit Documentation

UV Limited is a large multinational company with a global outreach. Due to the voluminous business, it has an in-house internal audit function to monitor the day-to-day operations of the company. LK and associates, Chartered Accountants have been engaged to conduct the statutory audit for the financial year 2023-24. Since the company has large scale operations and there is a limited time to perform statutory audit, CA L, the engagement partner decides to take direct assistance from the internal auditors for certain areas of audit. CA L assigns the audit documentation part to one of his audit assistants and instructs him to do the requisite documentation of working papers. Further he tells his audit assistant not to document the working papers prepared by the internal auditors who directly assisted them, as it does not form part of statutory audit. Is CA L right in excluding the working papers prepared by internal auditor from the audit documentation? Guide him as to the matters to be included in the Audit Documentation in this scenario. **(Nov-2024)**

Ans.



As per SA 610, Using the Work of an Internal Auditor, if the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:

- The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance.
- The basis for the decision regarding the nature and extent of the work performed by the internal auditors.
- Who reviewed the work performed and the date and extent of that review in accordance with SA 230 Audit Documentation.
- The written agreements obtained from an authorized representative of the entity and the internal auditors; and
- The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

In the given situation, CA L the engagement partner decided to take direct assistance from the internal auditor for certain areas of audit and he assigned his audit assistant to do the requisite documentation of working papers. However, he instructed them not to document the working papers prepared by the internal auditors who directly assisted them as those documents do not form part of statutory audit.

In view of the above, the auditor is required to document the working papers prepared by the internal auditor in case of direct assistance, thus, contention of CA. L in excluding the working papers prepared by internal auditor from the audit documentation is not correct.

SA-620
Using the Work of an Auditor's Expert

26.

Evaluation of Objectivity of Auditor's Expert

Mr. Atharv, while conducting the audit of Black Mountain Mining Ltd., which is involved in phosphate mining, decided to engage an auditor's expert to assess environmental liabilities and site clean-up costs. Black Mountain Mining Ltd. re-appointed Mr. Aman as an independent expert for this task. For the past five years, the management has consistently re-appointed Mr. Aman. He calculated the environmental liabilities for both completed mining sites and sites scheduled for closure in the near future, including provisions for clean-up costs. Management accepted his assessment.

Mr. Atharv, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Aman or on his work performed for the company. However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert. Guide the audit partner and Mr. Atharv with respect to requirements pertaining to evaluating the objectivity of the management expert. **(MTP-Nov-2024, SM)**

Ans.



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, have regard to the significance of that expert's work for the auditor's purposes evaluate the competence, capabilities and objectivity of that expert.

A broad range of **circumstances may threaten objectivity, for example**, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures). Although **safeguards cannot eliminate all threats** to a management expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

When evaluating the objectivity of an expert engaged by the entity, it may be relevant to **discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity and any applicable safeguards**, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats **may include**:

- **Financial interests.**
- **Business and personal relationships.**
- **Provision of other services.**

In the current case, Red Rock & Silver Sand Limited re-appointed Mr. Sheetal for this engagement as an independent expert. The **audit team was of the view that the objectivity of the independent expert cannot be questioned** just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Conclusion: Hence, the audit team should **evaluate the objectivity** of an **expert** engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An **expert appointed by the entity** cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. As a result, audit partner is correct in his view.

27.

Agreement with Auditor's Expert

X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise. **(MTP-May-2021, SM, MTP-May-2019, RTP-May-2019, MTP-Nov-2018)**

Ans.



(i) As per SA 620 "Using work of Auditor's Expert"

The auditor shall agree, in writing when appropriate, on **the following matters with the auditor's expert**:

- **Nature, scope & objectives** of Auditor's Expert work (may include relevant technical standards or other professional and industry requirements).

- Respective **roles & responsibilities** of auditors & Auditor Expert.
- **Nature, timing & extent of communication**, including **form of report**.
- Need for Auditor Expert to **observe confidentiality requirements** under ethical requirements or Law and regulation.

- (ii) **In the instant case:-** X Ltd. had various **derivative contracts – options, forward contracts, interest rate swaps etc.** which were required to be **fair valued** for which company got the fair valuation done through an **external third party**. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives.
- (iii) **Conclusion:** Considering the **complexity involved in the valuation** and **volume of derivatives** and also due to the fact that the **auditor and auditor's expert** were new to each other, auditor should have **signed a formal agreement/ engagement letter** with the auditor's expert in respect of the work assigned to him in **accordance with SA 620**.

28.

Auditor's Expert and Joint Auditors

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2021-22. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

(SM, MTP-May-2023)

Ans.


(i) As per SA 620 "Using the Work of an Auditor's Expert"

- **The expertise of an expert** may be required in the **actuarial calculation of liabilities** associated with **insurance contracts or employee benefit plans etc.**, however, the auditor has **sole responsibility** for the audit opinion expressed, and that responsibility is **not reduced** by the auditor's use of the work of an auditor's expert.
- **The auditor shall evaluate the adequacy** of the **auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness** of that expert's findings or conclusions, and their consistency with other **audit evidence as per SA 500**.
- **Further, in view of SA 620**, if the expert's work involves **use of significant assumptions and methods**, then the **relevance and reasonableness** of those assumptions and methods must be **ensured by the auditor** and
- **If the expert's work involves the use of source data** that is significant to that expert's work, the **relevance, completeness, and accuracy** of that source data in the circumstances must be **verified by the auditor**.

(ii) In the instant case:

Mr. X, Mr. Y and Mr. Z, jointly appointed **as an auditor of KRP Ltd.**, referred their **own known Actuaries** for **valuation of gratuity scheme**. Actuaries are an auditor's expert **as per SA 620**. **Mr. Y's referred actuary** has provided the gratuity valuation report, **which later on found faulty**. Further, Mr. Z is **not agreed with this report** therefore he submitted a **separate audit report** specifically for such gratuity valuation.

(iii) Duty of Joint Auditors

- In such situation, **it was duty of Mr. X, Mr. Y and Mr. Z**, before using the **gratuity valuation report** of Actuary, to ensure the **relevance and reasonableness** of assumptions and methods used.
- **They were also required to examine** the relevance, completeness and accuracy of **source data used** for such report before expressing their opinion.

(iv) Conclusion:

- **Mr. X and Mr. Y will be held responsible for grossly negligence** and using such **faulty report** without examining the **adequacy of expert actuary's work** whereas
- **Mr. Z will not be held liable** for the same due to **separate opinion** expressed by him.

29.

Using Auditor Expert Work and Reference in Auditors Report

HAM Ltd. is engaged in the business of manufacturing electronic components, including sensors, microchips, and lithium-ion battery cells. The production process requires raw materials such as rare earth metals, semiconductor wafers, and chemical electrolytes. The company maintains a large stock of raw materials, the nature of which is technically complex and requires expert knowledge for physical verification. Therefore, management hired their experts to assist in the stock verification process. Simultaneously, auditors also hired their own expert to evaluate the inventory.

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

Though the auditor was aware that he has not obtained sufficient appropriate audit evidence and it would be right to express a modified opinion in the auditor's report. However, he was reluctant in doing so, thus, expressed an unmodified opinion and included the name of the expert in his report to reduce his responsibility for the audit opinion expressed. Comment with respect to the relevant Standard on Auditing relating to the action of the auditor of issuing unmodified audit report. **(MTP-Sept-2025)**

Ans.



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

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

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

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

SA-520

Analytical Procedures

30.

Analytical Procedures as Substantive Procedures (Additional Question for Practice)

You have been appointed as an auditor of M/s Excellent Hotels Ltd. As a senior partner, you want to use analytical procedures in respect of room rentals as well as payroll expenses. Discuss. **(May-2019)**

Ans.



(i) Analytical Procedures:

- SA 520 "Analytical Procedures" deals with the **auditor's use of analytical procedures as substantive procedures** and as procedures near the **end of the audit** that assist the auditor when **forming an overall conclusion** on the financial statements.
- in some cases, even an **unsophisticated predictive model may be effective** as an analytical procedure.

(ii) Analytical Procedures in case of Payroll cost:

- Where an entity has a **known number of employees at fixed rates of pay** throughout the period, it may be possible for the **auditor to use this data** to estimate the **total payroll costs for the period** with a **high degree of accuracy**,
- Thereby providing **audit evidence for a significant item** in the financial statements and **reducing the need to perform tests of details** on the payroll.

(iii) Analytical Procedures in case of Room Rental Income of Hotel-

- Different **types of analytical procedures** provide **different levels of assurance**.
- **Analytical procedures** involving the prediction of **total rental income** in case of Hotel taking the **room tariff rates, the number of rooms and vacancy rates** into consideration, can provide **persuasive evidence** and may eliminate the need for **further verification** by means of **tests of details**, provided the elements are appropriately verified.

SA-540
Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
31.
Accounting Assumptions & Estimates - Written Representations

Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing. **(SM, Nov-2019)**

Ans.

(i) Provision:- As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures",

- The auditor shall obtain **written representations** from **management** and, where appropriate, **TCWG**
- **Whether they believe significant assumptions** used in making **accounting estimates are reasonable**.

(ii) SA 580, "Written Representations" discusses the use of written representations.

- **Depending on the nature, materiality and extent of estimation uncertainty**, written representations about accounting estimates **recognised or disclosed in the financial statements may include representations**:
 - a) **About the appropriateness of the measurement processes**, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
 - b) That the **assumptions appropriately reflect management's intent and ability to carry out specific courses of action** on behalf of the entity, where relevant to the accounting estimates and disclosures.
 - c) That disclosure related to accounting estimates are **complete and appropriate** under the **applicable financial reporting framework**.

That **no subsequent event requires adjustment** to the accounting estimates and disclosures included in the financial statements.

32.
Review of Outcome of Accounting Estimates

Surya Pvt. Ltd., engaged in the business of real estate, appointed CA Amit as the auditor for F.Y. 2023-24. During the audit, CA Amit requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc.) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise. **(MTP-May-2025)**

Ans.

(i) Provision:- As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"

- The auditor shall review the **outcome of accounting estimates** included in the prior period financial statements, or, where applicable, their **subsequent re - estimation** for the purpose of the current period.
- **The nature and extent of the auditor's review** takes account of the **nature of the accounting estimates**, and whether the information obtained from the review would be relevant to **identifying and assessing risks of material misstatement** of accounting estimates made in the current period

financial statements.

- (ii) The **outcome of an accounting estimate** will often differ from the **accounting estimate recognised in the prior period** financial statements.

By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

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

- (iii) **The review of prior period accounting estimates may also assist the auditor**

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

In the given case:- The management is **not correct in refusing the relevant information to the auditor**.

33.

Using the Work of Other Auditor – Division of Responsibility:

CA. Sourabh is engagement partner conducting statutory audit of BBI Bank for SBT & Associates. The bank has 1034 branches spread all over the country which are audited by branch auditors. In respect of one large branch audited by a branch auditor, there were errors in NPA classification of many advances which were not pointed out by branch auditor in his report through memorandum of changes and NIL memorandum of changes was reported electronically.

During overall review of financial statements of bank by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection report and concurrent audit reports of above branch as part of overall review procedures. However, these reports did not point towards any irregularities in such accounts.

Would statutory auditor of bank be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?

Ans.



SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors. In the given situation, **nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore, he would not be responsible for work performed by branch auditor.**

Further, it should be clearly stated in the report that 1034 branches of bank have been audited by branch auditors.

Chapter 4

MATERIALITY, RISK ASSESSMENT AND INTERNAL CONTROL

34. Deficiencies in ICS & General Conditions pertaining to Internal Check

Navjeevan Hospital is a multi-specialty hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basic system control has been violated? Also list down the other general conditions pertaining to such system which needs to be maintained and checked by the management. (RTP-May-2020)

Ans.



Basic system of Control:

- **Internal Checks and Internal Audit** are important constituents of **Accounting Controls**. Internal check system implies organization of the **overall system of book-keeping** and arrangement of **Staff duties** in such a way that no one person can carry through a transaction and record every aspect thereof.
- **In the given case of New Life Hospital:-** The **person-in-charge of inventory** inflow and outflow from the store house is **also responsible** for purchases and maintaining inventory records.
- Thus, **one of the basic system of control** i.e. internal check which includes **segregation of duties or maker and checker** has been violated where transaction processing are allocated to different persons in such a manner that **no one person can carry through the completion of a transaction** from start to finish or the work of one person is made complimentary to the work of another person.
- **General Conditions pertaining to internal check:**
 - a) **No single person** should **have an independent control** over any important aspect of the business operation. **Every employee's action** should come under the review of another person.
 - b) **Staff duties** should be **rotated from time to time** so that members **do not perform the same function** for a considerable length of time.
 - c) **Every member of the staff** should be encouraged to **go on leave** at least once in a year.
 - d) **Persons having physical custody of assets** must not be permitted to have **access to the books of account**.
 - e) There should **exist an accounting control** in respect of each class of assets, in addition, there should be **periodical inspection** so as to establish their **physical condition**.
 - f) **Mechanical devices** should be used, where ever practicable to **prevent loss or misappropriation** of cash.
 - g) **Budgetary control** would enable the management to **review from time to time** the progress of trading activities.
 - h) For inventory taking, at the close of the year, **trading activities should, if possible be suspended**, and it should be done by staff belonging to several sections of the organization.
 - i) The **financial and administrative powers** should be distributed **very judiciously among different officers** and the manner in which those are actually exercised should be reviewed periodically. Procedures should be laid down for **periodical verification and testing** of different sections of accounting records to ensure that they are accurate.

35. Letter of Weaknesses-Drafting

During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

(SM, RTP-May-2020, MTP-May-2020)

Ans.

Points to be considered while drafting letter of weaknesses:

- (i) As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management" The auditor shall include in the written communication of significant



deficiencies in internal control –

- A **description of the deficiencies** and an **explanation of their potential effects**; and
- **Sufficient information** to enable those charged with governance and management to **understand the context of the communication**.

This communication should be, preferably, in writing through a letter of weakness.

(ii) Important points with regard to such a letter are as follows:

- It lists down the **area of weaknesses** in the internal control system and recommends suggestions for improvement.
- It should **clearly indicate** that this letter covers only weaknesses **which have come to the attention of the auditor** during his evaluation of internal control for the purpose of determining nature, timing and extent of further audit procedures.
- Letter should clearly indicate that his examination of internal control has **not been designed to determine the adequacy of internal control** for management.
- This letter serves as a significant means for management and governing body for the purpose of **improving the system and its strict implementation**.
- The letter may also serve to **minimize legal liability** in the event of a major defalcation or other loss resulting from a weakness in internal control.

36.

Benchmark

CA Kavya has been appointed as the statutory auditor of XYR InfraTech Ltd. for the financial year 2024-25. The company operates in two business segments:

- a consumer electronics division that manufactures smart televisions and earns stable profits; and
- an infrastructure development division engaged in metro rail projects under government contracts. The infrastructure division has reported operating losses in the past two years due to delays and cost overruns.

While planning the audit, CA Kavya needs to determine materiality for the financial statements as a whole. She seeks guidance on the factors that may affect the identification of an appropriate benchmark and the benchmarks that may be applied to each division. **(RTP-Sept-2025)**

Ans.



As per SA 320, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the PER particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

In the case of XYR InfraTech Ltd.:

- Consumer Electronics Division:** Since Consumer Electronics division earns stable and regular profits, CA Kavya may consider using profit before tax (PBT) or earnings as the benchmark.
- Infrastructure Development Division (Loss-making):** The Infrastructure Development Division has reported losses due to external factors (delays, overruns). In such cases, profit-related benchmarks may not be appropriate. Instead revenue or gross profit may be used as benchmarks.

Alternatively, considering its public utility nature, benchmarks like total cost or net cost (expenses less revenues) may be suitable. Where significant assets are involved, total assets may also be relevant.

37. Impact of uncorrected misstatements

While assessing the impact of uncorrected misstatements in the audit of Manhattan Constructions Private Limited, Mr. Sushil encountered a significant issue related to the calculation of materiality on Sales. The initial materiality calculation was based on estimated figures provided by the management. Notably, during the estimation of full-year sales, the management extrapolated from the actual amount of 11 months to derive the 12 months of sales. However, given the nature of Manhattan Constructions as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged.

The actual sales for the last month deviated significantly from the estimated sales due to an unforeseen increase in stamp duty rates imposed by the government in that region. As a result, the last month's actual sales represented only 25% of the estimated sales. Now, Mr. Sushil is confronted with a dilemma regarding the appropriate approach to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Sushil in the light of relevant Standards on Auditing. **(RTP-May-2024, MTP-Nov-2024, SM)**

Ans.



As per SA 450 "Evaluation of Misstatements Identified during the Audit", the auditor is required to reassess materiality, in accordance with SA 320 "Materiality in Planning and Performing an Audit", before evaluating the impact of uncorrected misstatements. This reassessment is crucial to confirm the ongoing appropriateness of materiality in light of the entity's actual financial results.

The determination of materiality under SA 320 often relies on estimates of the entity's financial results, given that the actual results may not be known during the early stages of the audit. Therefore, before the auditor proceeds to assess the effect of uncorrected misstatements, it becomes necessary to adjust the materiality calculated under SA 320 based on the now available actual financial results.

SA 320 outlines that, as the audit progresses, materiality may be revised for the financial statements as a whole or for specific classes of transactions, account balances, or disclosures. This revision is prompted by the auditor's awareness of information that would have led to a different initial determination. Typically, significant revisions occur before the evaluation of uncorrected misstatements. However, if the reassessment of materiality under SA 320 results in a lower amount, the auditor must reconsider performance materiality and the appropriateness of the audit procedures' nature, timing, and extent. This is crucial for obtaining sufficient and appropriate audit evidence on which to base the audit opinion.

In the present case involving Manhattan Constructions Private Limited, it has been identified that the materiality calculated at the beginning of the audit for Sales was based on estimates provided by the management. The management extrapolated sales for the full year using the actual amount of 11 months, but since the company experiences significant monthly variations in sales, the actual sales for the last month were only 25% of the estimated figure. This discrepancy arose due to an unexpected increase in stamp duty rates by the government in that region.

In this audit scenario, **Mr. Sushil, the auditor, must review and re-assess the materiality initially determined under SA 320 to ensure its continued validity in light of the actual financial results.** If the reassessed materiality is lower than the previously calculated amount, Mr. Sushil must reconsider performance materiality and the appropriateness of the nature, timing, and extent of further audit procedures. This meticulous approach is essential to gather sufficient and appropriate audit evidence, enabling Mr. Sushil to form an independent and objective opinion on the financial statements of Manhattan Constructions Private Limited.

38. Communication of Sign. Deficiencies

CA Q is the engagement partner for the statutory audit of LAL Ltd. While conducting the audit he has identified some deficiencies in the internal controls. On further verification of the internal controls of the company, he has some indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with the governance and also in few cases he observed the susceptibility to loss of an asset. He determines, on the basis of the audit work performed, that identified deficiencies constitute significant deficiencies. How and to whom CA Q shall communicate identified significant deficiencies in the internal control? Which matters shall be included by CA Q in such communication? **(Sept-2025)**

Ans.



Communicating Deficiencies in Internal Control: SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.

The auditor, CA Q shall communicate significant deficiencies in internal control identified during the audit to

those charged with governance on a timely basis in writing. CA Q shall also communicate to management at an appropriate level of responsibility on a timely basis.

The auditor shall include in the written communication of significant deficiencies in internal control:

- (1) A description of the deficiencies and an explanation of their potential effects; and
- (2) Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that:
 - (i) The purpose of the audit was for the auditor to express an opinion on the financial statements;
 - (ii) The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and

The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

39. Internal Check System

AMRO Ltd. is a manufacturing and trading Company of leather goods since last 10 years. You are the internal auditor of the company for the year 2023-24. In order to review internal controls of the company, you visited the departments and noticed:

- (1) The head of procurement, Mr. Amit, has complete control over purchasing, receiving goods, and approving payments to suppliers. His actions are not reviewed by any other person in the company.
- (2) The company's staff has been working in the same roles for over five years without any rotation. The finance manager, Mr. Sachin, in particular, has never had his duties rotated since joining the company.
- (3) The store manager, Mr. Gupta, who is responsible for maintaining the inventory, also keeps the inventory records.
 - (a) Briefly discuss the general conditions pertaining to the internal check system to be ensure by you as an auditor.
 - (b) Do you think that general conditions pertaining to the internal check system are violated in the given situation?

(RTP-Nov-2024, SM, MTP-Sept-2025)

Ans.



- (a) **Internal Check System:** The **general condition** pertaining to the **internal check system** may be summarized as under:
- (i) **no single person** should **have complete control** over any important aspect of the business operation. Every **employee's action** should **come under the review of another person**.
 - (ii) **Staff duties** should be **rotated** from time to time so that members do not perform the same function for a considerable length of time.
 - (iii) Every member of the **staff** should be **encouraged to go on leave** at least once a year.
 - (iv) **Persons having physical custody of assets** must **not** be **permitted to have access to the books** of accounts.
 - (v) There should exist an **accounting control** in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
 - (vi) **Mechanical devices** should be **used**, wherever practicable, to prevent loss or misappropriation of cash.
 - (vii) **Budgetary control** should be exercised, and wide deviations observed should be reconciled.
 - (viii) For inventory taking, **at the close of the year, trading activities** should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
 - (ix) The **financial and administrative powers** should be **distributed** very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
 - (x) Procedures should be laid down for **periodical verification and testing** of different sections of accounting records to ensure that they are accurate.

- (b) **Yes, in the given situation general conditions** pertaining to the internal check system are **violated** as follows:
- (i) The head of procurement, **Mr. Amit, having complete control over the procurement process without oversight** violates the principle that no single person should control any important aspect of the business operation.
 - (ii) The **lack of staff rotation** for over five years violates the principle that staff duties should be rotated periodically to prevent any single person from performing the same function for too long.
- (c) **Allowing Mr. Gupta, the store manager, to maintain inventory records while also having custody of the inventory** violates the principle that those with physical custody of assets should not have access to accounting records.

NOTES:

[illegible]

Chapter 5

AUDIT EVIDENCE

SA-500 Audit Evidence

40.

Evaluating the Work of Management's Expert

PDJ Ltd. has engaged an actuary to ascertain actuarial valuation of defined benefit obligations viz. Gratuity and Leave Encashment liabilities. As an auditor of PDJ Ltd. you would like to use the report of the actuary as audit evidence. How would you evaluate the work of the actuary? (Jan-2021)

Ans.



- 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-
 - (1) Evaluate the **competence, capabilities and objectivity** of that expert;
 - (2) Obtain an understanding of the **work of that expert**; and
 - (3) 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.

41.

Management Expert Work Evaluation

ABC Ltd. appointed Mr. Anand for the actuarial calculation of liabilities associated with insurance contracts and employee benefit plans. These calculations and valuations are then adopted by management in preparing the financial statements. Kindly guide Mr Sushil, the statutory auditor of ABC Ltd, on the use of information prepared by management's appointed expert as audit evidence. Also, explain Mr. Sushil the matters that can impact the nature, timing and extent of audit procedures regarding information to be used as audit evidence which has been prepared using the work of a management's expert. (MTP-Nov-2023)

Ans.



- As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management 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.
- Further, the **nature, timing and extent of audit procedures** in relation to the requirement relating to information to be used as audit evidence prepared using the work of a management's expert **may be affected by such matters as:**
- (i) The **nature and complexity of the matter** to which the management's expert relates.
 - (ii) The **risks of material misstatement** in the matter.

- (iii) The availability of **alternative sources of audit evidence**.
- (iv) The **nature, scope and objectives of the management's expert's work**.
- (v) **Whether the management's expert is employed by the entity or is a party engaged by it to provide relevant services.**
- (vi) The **extent to which management can exercise control or influence** over the work of the management's expert.
- (vii) **Whether the management's expert is subject to technical performance standards** or other professional or industry requirements.
- (viii) The **nature and extent of any controls within the entity** over the management's expert's work.

SA-501

Audit Evidence - Specific Considerations for Selected Items

42. Impracticable to Attend Physical Inventory Count

Coccyx Ltd. supplies navy uniforms across the country. The Company has 3 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. Coccyx Ltd. appointed M/s OPAQE & Co. to conduct its audit for the financial year 2021-22. Mr. P, partner of M/s OPAQE & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s OPAQE & Co.,

- (I) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?
- (II) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

(SM, RTP-May-2021, May-2018, RTP-May-2018, Nov-2023)

Ans.



(i) Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain **sufficient appropriate audit evidence** regarding the **existence and condition** of inventory by:

- (a) **Attendance at physical inventory counting**, unless impracticable, to:
 - Evaluate **management's instructions and procedures** for recording and controlling the results of the entity's physical inventory counting;
 - **Observe the performance** of management's count procedures;
 - **Inspect the inventory**; and
 - **Perform test counts**; and
- (b) **Performing audit procedures** over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(ii) Attendance at Physical Inventory Counting Not Practicable:

- **In some cases:-** Attendance at physical inventory counting may be impracticable. This may be due to **factors such as the nature and location** of the inventory,
- **For example:-** Where inventory is held in a location that **may pose threats to the safety** of the auditor. The matter of **general inconvenience** to the auditor, however, is **not sufficient to support a decision** by the auditor that attendance is impracticable.
- **As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing":** The matter of **difficulty, time, or cost involved** is not in itself a valid basis for the auditor to **omit an audit procedure** for which there is **no alternative** or to be satisfied with audit evidence that is **less than persuasive**.
- **Where attendance is impracticable:-** Alternative audit procedures, for example, inspection of documentation of the **subsequent sale of specific inventory** items acquired or purchased prior to the physical inventory counting, may provide **sufficient appropriate audit evidence** about the **existence and condition** of inventory.

	Reporting:-In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.
43.	Unable to Attend Physical Inventory Count RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31st March 2022, the company carried out a detailed physical verification of its inventory and property, plant and equipment. You are the auditor of RIM Private Ltd. The inventory as at the end of the year was ₹ 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order? (RTP-May-2020)
Ans. 	• SA 501 "Audit Evidence – Specific Considerations for Specific Items", requires from the auditor that when inventory is material to the financial statements, he shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable, to: ➤ Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting; ➤ Observe the performance of management's count procedures; ➤ Inspect the inventory; and ➤ Perform test counts. • When unable to present at the physical inventory count:-SA 501 provides that if the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and perform audit procedures on intervening transactions to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted and treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. • The auditor may also seek management's written representation on ➤ the completeness of information provided regarding the inventory, and ➤ assurance with regard to adherence to laid down procedures for physical inventory count. • Conclusion:- By following the above procedure it will be ensured that the physical verification conducted by the management was in order.
44.	Inventory under the Custody and Control of a Third Party Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2021-22. While verification of company's inventories as on 31st March 2022, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them? (RTP-Nov-2019)
Ans.	As per SA 501, "Audit Evidence—Specific Considerations for Selected Items" when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. Perform inspection or other audit procedures appropriate in the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include: • Attending, or arranging for another auditor to attend, the third party's physical

counting of inventory, if practicable.

- **Obtaining another auditor's report**, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is **properly counted and adequately safeguarded**.
- **Inspecting documentation regarding inventory held** by third parties, for example, **warehouse receipts**.
- **Requesting confirmation from other parties** when inventory has been **pledged as collateral**.

45. Inventory Counting at a Date other than the Date of the FSs

Moon Ltd. is a dealer in electronic appliances. The Company has a centralised warehouse at the outskirts of Mumbai. The Auditors of the company M/s JK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month. In the light of the above facts: Enumerate the audit procedures to be considered by M/s JK Associates, if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing. **(Nov-2020)**

Ans.

(i) As per SA 501 "Audit Evidence- Specific Considerations for Selected Items"

- When **inventory is material** to the financial statements, the auditor shall **obtain sufficient appropriate audit evidence** regarding the **existence and condition** of inventory.
- **For practical reasons**, the physical inventory counting **may be conducted at a date, or dates, other than the date** of the financial statements.
- (This may be done irrespective of **whether management determines** inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system.)
- **(In either case**, the effectiveness of the **design, implementation and maintenance** of controls over changes in inventory determines whether the **conduct of physical inventory** counting at a date, or dates, other than the date of the financial statements is **appropriate for audit purposes**.)

(ii) If physical inventory counting is conducted at a **date other than the date of the financial statements**, the auditor, JK Associates, **shall perform the following procedures**:

(A) Attendance at physical inventory counting, unless impracticable, to:

- Evaluate management's **instructions and procedures** for recording and controlling the results of the entity's physical inventory counting;
- **Observe the performance** of management's count procedures;
- **Inspect** the inventory; and
- **Perform** test counts; and

(B) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect **actual inventory count results**.

(iii) **Additional Audit Procedure:**

- In addition to above, auditor shall **also perform audit procedures to obtain audit evidence** about whether **changes in inventory** between the count date and the date of the financial statements are properly recorded.
 - **Relevant matters for consideration** when designing audit procedures to obtain audit evidence about whether changes in inventory amounts **between the count date, or dates, and the final inventory** records are properly recorded include:
 - Whether the perpetual inventory records are **properly adjusted**.
 - **Reliability** of the entity's perpetual inventory records.
- Reasons for significant differences** between the information obtained during the physical count and the perpetual inventory records.

46. Methods adopted by Management in determination of Segment Information

GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2022 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment

information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing. **(SM, Jan-2021)**

Ans.



- (i) The auditors, **GHK Associates** wanted to ensure and **obtain sufficient appropriate audit evidence** regarding the **presentation and disclosure of segment information** in accordance with the **applicable financial reporting framework** by obtaining an understanding of the **methods used by management** in determining segment information.
- (ii) **SA 501 guides in this regard:- As per SA 501- "Audit Evidence—Specific Considerations for Selected Items"**
- **Example of matters** that may be relevant when **obtaining an understanding of the methods used by management** in determining segment information and
 - Whether **such methods** are likely to **result in disclosure** in accordance with the **applicable financial reporting framework** include:
 - (a) **Sales, transfers and charges** between segments, and elimination of inter-segment amounts.
 - (b) **Comparisons with budgets** and other expected results, for example, operating profits as a percentage of sales.
 - (c) The **allocation of assets and costs** among segments.
 - (d) **Consistency with prior periods**, and the adequacy of the disclosures with respect to inconsistencies

47. Special Consideration with Regard to Inventory

The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period. As a result, the engagement Partner decided not to perform any physical count of inventory as it will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement. In the light of SA 501, evaluate whether the decision taken by the Engagement Partner is appropriate or not. **(MTP-Nov-2022, MTP-May-2025)**

Ans.



- (i) As per SA 501 "**Audit Evidence- Specific Considerations for Selected Items**", when inventory is material to the financial statements, the auditor shall obtain **sufficient appropriate audit evidence** regarding the **existence and condition** of inventory by:
- (a) **Attendance at physical inventory counting**, unless impracticable, to:
 - Evaluate **management's instructions and procedures** for recording and controlling the results of the entity's physical inventory counting;
 - **Observe the performance** of management's count procedures;
 - **Inspect the inventory**; and
 - **Perform test counts**; and
 - (b) **Performing audit procedures** over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
- (ii) **Attendance at Physical Inventory Counting involves:**
- **Inspecting the inventory** to ascertain its existence and evaluate its condition and perform test counts.
 - **Observing compliance** with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
 - **Obtaining audit evidence** as to the reliability of management's count procedures.
- (iii) **Reporting:- Hence in the given case**, the approach of Engagement Partner is **not appropriate as when inventory is material** to the financial statements, the auditor shall **obtain sufficient appropriate audit evidence** regarding the **existence and condition** of inventory. This should be done by **performing various audit procedures** which also includes attending physical count, observing the count, inspecting the inventory and reperforming physical counts.

48.

Inventory Count Procedures

While conducting the statutory audit of Tasty Foods Limited, CA. Careful has planned attendance at physical inventory count of the company from 29th March to 31st March 2024. The company is engaged in business of extracting rice from paddy grains and caters to domestic as well as international market particularly in Gulf region. It has its plant spread in area of about 20 acres located in National Capital Region (NCR). Paddy contained in jute bags of nearly standard sizes is purchased from dealers/agents. It is stored in heaps on pallets (kind of wooden structures) in open area covered by protective sheets and in steel silos (silos are huge steel containers with measuring strain gauges) in company's premises.

The company mainly produces three rice brands viz. "Raja" and "Shehzada" (both for the domestic market) and "Badshah" (for the international market). The process of obtaining rice from paddy consists of various steps like cleaning of paddy, removing outer husk layer from paddy grains to obtain brown rice, whitening, polishing, grading and sorting, packaging which is accomplished by means of various types of machineries installed in plant.

The company's management has prepared a set of instructions and procedures to be followed for recording and controlling results of company's physical inventory counting which are listed as under:-

- The physical inventory count process is to be supervised by a responsible officer of company responsible for storage functions.
 - There should be no disturbance to the routine process of receiving goods and dispatch during the counting time period.
 - Counting process is to be undertaken by constituting different teams of 3 members each for counting/verifying raw material, work in progress and finished goods.
 - Paddy in steel silos is to be estimated using their capacity.
 - Quantity of work in progress is to be estimated considering plant capacity as whole.
 - The responsible officer should ensure that stocks have been counted/verified in all areas.
- Before proceeding to attend physical inventory count process of company, evaluate management's instructions and procedures sent to CA. Careful as stated above. You may suggest modification, addition or removal of such instructions to ensure effective count process. **(MTP-May-2024, RTP-Jan-2026, SM)**

Ans.



The **set of instructions and procedures given in the case scenario are incomplete and not properly followed**, which are **discussed as under**:

- The **physical inventory count process should be supervised by a responsible officer** of the company, preferably **from finance department**. The **supervision** of the count process should **not be done by person responsible for storage function**. However, **storage in-charge** of each area **should be present** during inventory count process for co-ordination and facilitation.
- During inventory count process, **inward and outward movement of goods should not be allowed** as allowing such movement may distort the results or make it difficult to arrive at proper results.
- The **instruction** relating to the **constitution of teams** for counting process **does not specify** that **counting** shall be **undertaken by members drawn from departments not connected with storage function**. For example, these members may be from the finance department. Further, within each team, **duties** should be **fixed separately** for counting and recording on serially numbered count sheets. It is nowhere stated that once counting in an area is complete, certain distinctive marks or tags are required to be put.
- Count sheets should contain **description of products** in accordance with inventory records of company.
- The management's instructions are **silent about how team members would proceed with their work**. Team members should be provided with lay out plans for different sections/ storage areas so that all areas are covered.
- The management's instructions are **silent on how paddy lying in open is to be counted and verified**. Paddy in jute bags lying in open in heaps should be verified by counting number of bags in one heap. As each bag is of nearly standard size, the quantity of paddy can be determined by counting number of bags in a heap and correlating it with the weight of standard bag.
- **Paddy in steel silos should be determined using measuring strain gauges on silos**. Determining quantity

in silos based on silo capacity may lead to wrong results as paddy may have been used from such silos.

- Quantities of **work in progress** should be **estimated at each stage of production and** not for the plant as **a whole**. Estimating WIP inventories for plant as a whole would give inaccurate picture of work in progress inventories.
- Finished goods** inventories need to be **counted category wise**. Rice bags should be **verified by** checking the **name of brand**.
- There is **no instruction regarding damaged or obsolete stock items** particularly in the case of finished goods i.e. rice. Damaged/obsolete inventories should be counted and shifted to a separate area for assessment of their condition and to prevent mixup with other standard inventories.
- Count sheets** need to be **signed by each team member**.
- The responsible officer should **ensure that stocks have been counted/verified in all areas and distinctive marks are put** to confirm completion of counting.

SA -505

External Confirmations

49. Management Refusal to allow Auditor to Send Confirmation Request

Your firm has been appointed as the statutory auditors of AGM Private Limited for the financial year 2021-22. While verification of company's trade receivables as on 31st March 2022, accountant of AGM Ltd. has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are under dispute and the matter is pending in the Court. As a Statutory Auditor, how would you deal in this situation? **(RTP-May-2020)**

Ans.



SA 505 "External Confirmations", establishes standards on the auditor's **use of external confirmation** as a means of obtaining audit evidence. If the **management refuses** to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to **Management's reasons for the refusal**, and **seek audit evidence** as to their validity and reasonableness,
 - Evaluate the **implications of management's refusal** on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and
 - Perform **alternative audit procedures** designed to obtain relevant and reliable audit evidence.
- If the auditor concludes that **management's refusal to allow the auditor** to send a confirmation request is **unreasonable** or the auditor is **unable to obtain relevant and reliable audit evidence** from alternative audit procedures, the auditor shall communicate with **those in charge of governance** and also determine its **implication** for the audit and his opinion.

50. Negative Confirmation Requests

During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for the balances of trade payables outstanding in the balance sheet through external confirmation by "Negative Confirmation Request". In the list of trade payables, there are number of small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation. **(SM, Nov-2022, MTP-May-2025)**

Ans.



External Confirmation: As per SA 505, "**External Confirmation**", negative confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly **less persuasive audit evidence** than does a response to a positive confirmation request.

Confirming parties also may be **more likely to respond indicating their disagreement with a confirmation**

request when the information in the request is not in their favour, and less likely to respond otherwise.

In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 20 lakh has not sent the confirmation on the credit balance. **In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.** Further non-response for negative confirmation request does not mean that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.

51.

External Confirmation: Types of Responses

During the audit of the financial statements of Looks Limited for the year ended March 31, 2024, CA Suyash, the statutory auditor requested external confirmation for certain trade receivables and trade payables as part of audit procedures in accordance with SA 505:

- (i) CA Suyash sent a confirmation request to a debtor for balance of ₹15,50,000 which was outstanding for more than 6 months, insisting him to respond directly to the auditor, confirming whether they agree or disagree with the balance stated.
- (ii) He also sent a confirmation request to a creditor with an outstanding balance of ₹ 13,25,000 requesting a response only if there was a disagreement with the stated amount.

CA Suyash received responses from the aforementioned debtor and creditor in following manner:

- The debtor confirmed that, as per their records, they owed ₹ 14,90,000 to Looks Limited instead of ₹ 15,50,000 as per the company's books.
- The creditor did not respond to the confirmation request.

Identify and explain the type of confirmation request sent by the auditor to the debtor and creditor. Also, discuss the course of action the auditor should take for the discrepancy in the confirmation received from the debtor and non-receipt of confirmation from the creditor. **(RTP-May-2025)**

Ans.



Positive confirmation request: A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request or providing the requested information.

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

In the given situation, the auditor has sent the positive confirmation request for the amount of ₹ 15,50,000 to a debtor which was outstanding for more than 6 months, however, due to difference between information requested to be confirmed, or contained in the entity's records (i.e. ₹ 15,50,000), and information provided by the confirming party (i.e. ₹ 14,90,000) is forming situation of exception confirmation.

The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330 in case a response is indicating an exception.

The company should be asked to investigate and reconcile the discrepancy indicated by the confirming party.

Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees. In the given case, the auditor has sent the negative confirmation request for ₹ 13,25,000 to a creditor. Non-response by the creditor implies that creditor agrees with the amount. Thus, an auditor is not required to take any action in this case.

52.

Response to ECR

ABC Limited is in the business of manufacturing of iron ore and steel bars since last decade. The company is having its registered office in Mumbai and factory in Bhiwandi. M/s. R and Associates are appointed as the statutory auditors of the company for the financial year 2024-25. While going through the trial balance of the company, they observed that the company has 50 customers and 40 vendors. They requested the company to authorise them to send the external confirmation to few of its customers and vendors. The company

immediately provided them an authority letter to send the external confirmation to their customers and vendors. The auditor sent positive confirmation request to top 3 customers and top 3 vendors. After two days of sending positive confirmation request, the management of the company handed over to them the duly signed response received from the respective customers and vendors to whom they had sent the confirmation request. How would M/s. R and Associates proceed to deal with the situation as the auditor of the company?

(Sept-2025)

Ans.



Reliability of External Confirmation: SA 505, "External Confirmations", states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

SA 500, "Audit Evidence", indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium.

Factors that may indicate doubts about the reliability of a response include that it:

- was received by the auditor indirectly; or
- appeared not to come from the originally intended confirming party.

In the instant case, ABC Limited has 50 customers and 40 vendors in the year 2024-25. M/s R and associates sent positive confirmation letter to top 3 customers and top 3 vendors. However, after 2 days of sending request,

management of the company handed over duly signed response received from respective customers and vendors to auditor. Considering the fact that the response was received by the auditor indirectly, it raises questions on the reliability of responses received and indicates a fraud risk factor that requires evaluation.

In view of above, if the auditor has doubts regarding the reliability of these responses, it becomes necessary to obtain additional audit evidence to address those concerns. The auditor should also reassess the risk of material misstatement, including the possibility of fraud, and accordingly design further audit procedures.

SA-510

Initial Audit Engagements-Opening Balances

53.

Verification of Accounts Receivable

CA Pawan has been appointed as the statutory auditor of Vij Pvt. Ltd. for the financial year 2024-25. During the course of the audit, he obtained sufficient and appropriate audit evidence for items shown in the Statement of Profit and Loss. However, while auditing the Balance Sheet items, he left obtaining appropriate audit evidence, say, external confirmations, for outstanding accounts receivable amounting to ₹ 135 lakhs.

He continued as it is from last year, on the affirmation of management that there are no receipts and further credits during the year. CA Pawan, 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 the predecessor auditor.

What measures need to be taken by the auditor CA Pawan? Also, suggest the correct audit procedure in this regard.

(MTP-Sept-2025)

Ans.



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, (like external confirmations) 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 505, "External confirmations" the auditor can use external confirmation procedures to obtain audit evidence.

Further, 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 Vij Pvt. Ltd. has restrained CA Pawan, its auditor, from obtaining appropriate audit evidence for balances of accounts receivable outstanding as it is from the preceding year. CA Pawan, 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 Pawan 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.

54. **Opening Balances – Verification and Reporting**

CA. Zora has recently accepted engagement of the statutory audit of Segment Ltd. for the financial year 2024–25. While reviewing the trial balance and financial records, Zora identifies that the Opening Balances as on 1st April 2024 are carried forward from the previous year and were audited by another auditor, CA. Rohan. Zora wants to be satisfied regarding the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements.

- (i) Briefly mention the audit procedures Zora should perform to obtain sufficient and appropriate audit evidence regarding the Opening Balances, considering it is an initial audit engagement?
- (ii) Also suggest the approach to be followed by Zora if he is either unable to obtain adequate evidence about the Opening Balances or finds material misstatements therein.

(MTP-Sept-2025)

Ans.



(i) **Audit Procedures to be followed in case of initial audit engagement:** As per SA 510, "Initial Audit Engagements – Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- Determining whether the opening balances reflect the application of appropriate accounting policies; and
- Performing one or more of the following:
 - Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- Performing specific audit procedures to obtain evidence regarding the opening balances.

- (ii) **Approach to be followed if he is either unable to obtain adequate evidence about the Opening Balances or finds material misstatements therein:** If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

SA-550 Related Parties

55. Undisclosed Related Party Transactions

PQR Ltd. is engaged in the business of construction and real estate having various projects across the states. M/s ST & Co., Chartered Accountants have been appointed as statutory auditors. CA T, an engagement partner, who leads engagement team, during preliminary verification, identified a few agreements entered by PQR Ltd. for the provision of services to some parties under terms and conditions that are outside PQR Ltd.'s normal course of business, suggestive of the indications about existence of related party transactions that management has not previously disclosed to the auditor. Highlight the aspects that M/s ST & Co., shall consider on identification of previously undisclosed related party transactions with reference to the relevant standard on auditing. (Nov-2024)

Ans.



As per SA 550, "Related Parties," M/s ST & Co. should take the following steps upon identifying previously undisclosed related party transactions:

- Verify whether the circumstances substantiate the existence of such transactions.
- Ensure timely communication of the relevant information to all members of the engagement team.
- Confirm that appropriate substantive audit procedures have been conducted.
- Inquire why the entity's controls failed to identify or disclose the related party relationships or transactions.
- Carry out substantive audit procedures specifically for these newly identified related parties or significant related party transactions.
- Reassess risks associated with other related parties.
- Request management to identify all transactions involving the newly identified related parties.
- If it appears that management intentionally did not disclose such transactions, evaluate the implications for the audit.

56. Response : Positive Confirmation Requests

As auditor of Groom Limited, you have sent positive confirmation requests to 30 creditors of the company in March **2024**. All of the creditors in *the* informal sector are small concerns. You **selected** to send positive confirmation requests to all the above parties at their business addresses stated on respective bills after discussing the matter *the* CFO of the company. The CFO is cooperative and does not raise any hassles in the matter.

Responses to confirmation requests are received within a week's time. Your **article assistant** informs you that out of 30 creditors, GST registrations of 25 **creditors** have been cancelled during financial year **2023-24** itself by collating information from GST portal. He further informs you that there are no fresh registrations pertaining to PANs of these parties.

How **would you** proceed to deal with the situation as auditor of the company?

(MTP-Nov-2024, MTP-Jan-2026, SM)

Ans.



SA 505 states that if the auditor determines that a **response to a confirmation request is not reliable**, the auditor shall **evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.**

In the instant case, **GST registrations of 25 concerns have been cancelled** in the year **2023- 24**. It indicates

that businesses on those addresses were closed. Further, there are no fresh registrations pertaining to the PANs of these parties. However, the auditor sent external confirmation requests in March **2024**, which were duly responded. It raises questions on the reliability of responses received.

SA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include:

- Was received by the auditor indirectly or
- Appeared not to come from the originally intended confirming party.

Keeping in view the circumstances described in the case situation, **there is a risk that the response has not come from the originally intended confirming party. Unreliable responses may indicate a fraud risk factor that requires evaluation.**

57.

RPT - Outside the normal course of business

“Living Well Private Limited” is engaged in the manufacturing and export of floor coverings. Such products are labour-intensive and do not require much of capital investment in machinery. The company has no plans to diversify in other product lines. Its directors are also holding significant interest in another company “My Living Private Limited” engaged in manufacturing of blankets using capital intensive machinery. During the course of the audit of “My Living Private Limited”, it was noticed by you that the company has sold machinery of ₹ 1 crore to “Living Well Private Limited” during the year. The transaction has been done at **normal market rates** applicable to such used machinery. How do you view the above transaction as auditor of “My Living Private Limited”?

Ans.



In respect of **significant related party transactions outside the normal course of business of an entity**, it is the responsibility of the auditor, in accordance with **SA 550**, to **evaluate the business rationale** or lack thereof of transactions that may have been entered to indulge in fraudulent financial reporting or conceal misappropriation of assets.

The auditor has to seek to understand the business rationale of such a transaction from a related party's perspective. It would help him understand the economic reality of such a transaction and why it was carried out.

In the given situation, **there is no primary rationale for such a transaction.** Living Well Private Limited does not manufacture blankets, and the purchase of part of old machinery pertaining to blanket manufacturing has no rationale for it primarily. A **business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.**

Notes



Chapter 6

COMPLETION AND REVIEW

SA-560

Subsequent Events

58.

Audit Procedures on Subsequent Events

You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company needs to stock various non-perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view? **(Nov-2020, MTP-Sept-2025)**

Ans.



(i) Subsequent Events

- As per SA 560 “Subsequent Events”, the auditor shall perform **audit procedures designed** to obtain **sufficient appropriate** audit evidence that all **events occurring between the date of the financial statements** and the **date of the auditor’s report** that require **adjustment** of, or **disclosure** in, the financial statements have been identified.
- The auditor is not, however, expected to **perform additional audit procedures** on matters to which previously applied audit procedures have provided satisfactory conclusions.
- The auditor shall perform the procedures required in above paragraph so that they cover the period **from the date of the financial statements** to the **date of the auditor’s report**, or as near as **practicable** thereto.

(ii) **Audit Procedure:** Being the auditor of PQR Ltd, to **ensure that all subsequent events are considered** so that financial statements for the year ending 31.03.2020 represent true and fair view, the auditor shall take into account the **auditor’s risk assessment** in determining the **nature and extent of such audit procedures**, which shall include the following:

- a. **Obtaining an understanding of any procedures** management has established to ensure that subsequent events are identified.
- b. **Inquiring of management** and, where appropriate, **those charged with governance** as to whether any subsequent events have occurred which might affect the financial statements.
- c. **Reading minutes, if any, of the meetings**, of the entity’s owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- d. Reading the entity’s **latest subsequent interim financial statements**, if any.

When, **as a result of the procedures performed** as required above, the auditor identifies events that require **adjustment** of, or **disclosure** in, the financial statements, the auditor shall determine **whether each such event is appropriately reflected** in those financial statements.

59.

Facts Which Become Known to the Auditor After the Date of the Auditor’s Report but Before the Date the Financial Statements are Issued

Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2022. The Audit Report for that year was signed by the Auditors on 04/05/2022. The Annual General Meeting was decided to be held during the month of August 2022. On 06/05/2022, the Company had received a communication from the

Central Government that an amount of ₹ 5800 crore kept pending on account of incentives pertaining to Financial Year 2021-22 had been approved and the amount would be paid to the Company before the end of May 2022. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released' before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2022. On 08/05/2022, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2022. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

(SM, Nov-2018)

Ans.



(i) **Provision:**

- As per SA 560, “**Subsequent Events**”, the auditor has **no obligation to perform any audit procedures** regarding the financial statements **after the date of the auditor’s report**.
- However, **when, after the date of the auditor’s report** but before the **date the financial statements are issued**, a fact becomes **known** to the auditor that, had it been known to the auditor at the date of the **auditor’s report**, may have caused the auditor to **amend the auditor’s report**,
- The auditor shall
 - **Discuss the matter** with **management** and, where appropriate, **TCWG**.
 - Determine whether the **financial statements need amendment** and, if so,
 - Inquire how management **intends to address the matter** in the financial statements.

(ii) **Audit Procedure & New Audit Report:**

- If management amends the financial statements, the **auditor shall carry out the audit procedures necessary in the circumstances** on the amendment.
- Further, the **auditor shall extend the audit procedures** and provide a **new auditor’s report** on the amended financial statements.
- However, the **new auditor’s report shall not be dated** earlier than the **date of approval** of the amended financial statements.

(iii) **In the instant case:**

- **XYZ Company Ltd.** received an amount of **rupees 5800 crore** on account of incentives pertaining to **year 2021-22** in the month of **May 2022** i.e. after finalisation of financial statements and signing of audit report.
- **Board of Directors of XYZ Ltd. amended the accounts**, approved the same and **requested the Amudhan & Co. (auditor) to consider this event** and issue a **fresh audit report** on the financial statements for the year ended on 31.03.2022.

(iv) **Conclusion:-**After applying the conditions given in SA 560, **Amudhan & Co. can issue new audit report subject to date of audit report** which should not be **earlier than** the date of approval of the amended financial statements.

SA-570

Going Concern

60.

Circumstances affects Going Concern

Star Ltd. is a power generating company which uses coal as raw material for its power generating plant. The Company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2021-22, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Star Ltd. This happened in the month of December 2021 and as such entire power generation process of Star Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the Company. There were delays in the of payment of wages and salaries and the banks from whom the Company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of

the Company. Further, when discussed with the management, the statutory auditor understood that the Company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected in the financial statements of Star Ltd. What course of action should the statutory auditor of the Company consider in such situation? **(RTP-May-2021, SM)**

Ans.



- (i) **SA 570- "Going Concern"**:- Deals with the **auditor's responsibilities** in the audit of financial statements relating to **going concern** and the **implications for the auditor's report**.
- The **auditor's responsibilities** are to obtain **SAAE** regarding, and
 - Conclude on, the **appropriateness of management's use of the going concern** basis of accounting in the preparation of the FSs, and
 - To conclude, **based on the audit evidence** obtained, whether a **material uncertainty exists** about the entity's ability to **continue as a going concern**.
- (ii) **When the use of going concern basis of accounting is inappropriate:**
- If the financial statements have been **prepared using the going concern basis** of accounting but, in the **auditor's judgment**, management's use of the **going concern** basis of accounting in the preparation of the financial statements is **inappropriate**,
 - The auditor shall express an **adverse opinion**.
- (iii) **When adequate disclosure of a material uncertainty is not made in the FSs**
- The auditor shall express a **qualified opinion** or **adverse opinion**, as appropriate, in accordance with **SA 705 (Revised)**; and
 - **In the Basis for Qualified (Adverse) Opinion section** of the auditor's report, state that a **material uncertainty exists** that may cast **significant doubt** on the entity's ability to **continue as a going concern** and that the financial statements **do not adequately disclose this matter**.
- (iv) **In the present case:-** The following **circumstances indicate the inability of Star Ltd.** to continue as a going concern:
- Ban on the **allotment of coal blocks**
 - **Halt in power generation**
 - Key Managerial Personnel **leaving the Company**.
 - Banks decided **not to extend further finance** and not to fund the working capital requirements of the Company.
 - Non availability of **sound action plan** to mitigate such circumstances.
- (v) **Conclusion:-**Therefore, **considering the above factors** it is clear that the going concern basis is **inappropriate** for the Company. Further, such circumstances are **not reflected in the FSs** of the Company. **As such, the statutory auditor of Star Ltd. should:**
- **Express an adverse opinion** in accordance with SA 705 (Revised) and
 - In the **Basis of Opinion paragraph** of the auditor's report, The statutory auditor **should state that:**
 - a **material uncertainty exists** that may cast **significant doubt on the entity's ability to continue as a going concern** and that the financial statements **do not adequately disclose this matter**.

61.

GC Inappropriate

Fun Fiesta Ltd., an entertainment company that operates a traveling circus, has been facing a significant decline in popularity over the past few years, with attendance reportedly dropping by as much as 75% in the current financial year. The circus has also been continuously targeted by animal rights activists for its use of animals like elephants in performances. The CEO observed that audiences were shifting to other entertainment options, making the business model unsustainable due to the high costs of moving the show from city to city.

As a result, several key managerial personnel resigned, there were delays in the payment of wages and salaries, and the bank from which the company had obtained funds decided not to extend further financing or fund additional working capital requirements.

During discussions with management, the statutory auditor understood that Fun Fiesta Ltd. had no action plan to address these financial difficulties, making the use of the going concern assumption inappropriate. However, these critical circumstances were not disclosed in the company's financial statements.

What course of action should the statutory auditor take in the auditor's report in such situation? Discuss with reference to the applicable Standards on Auditing. (MTP-May-2025)

Ans.



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

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

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

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

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

- Losing popularity over the past few years.
- Animal Rights activists continuously targeting the circus.
- Audience abandoning the circus due to their expanding entertainment options.
- High Cost of moving the show from city to city making the business model untenable.
- Key Managerial Personnel leaving the Company.
- Banks decided not to extend further finance and not to fund the working capital requirements of the Company.
- Non availability of sound action plan to mitigate such circumstances.

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

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

- (1) Express an **adverse opinion in accordance with SA 705 (Revised)** and
- (2) In the **Basis of Adverse Opinion paragraph** of the auditor's report, the statutory auditor should state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

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

62.

Appropriateness of using Going Concern Assumption in case of Material Uncertainty Exists

OM Ltd. is a company engaged in the business of manufacture of spare parts. Shanti & Associates are the statutory auditors of the company for the FY 2021-22. During the course of audit, CA Shanti noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from

Korean Mart for the products of OM Ltd. ended for an unforeseeable time period. When discussed with the management, CA Shanti was told that the company is in the process of identifying new customers for their products. CA Shanti understands that though the use of going concern assumption is appropriate but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of OM Ltd. for the FY 2021-22. How should CA Shanti deal with this matter in the auditor's report for the FY 2021-22 in accordance with relevant Standard on Auditing? **(MTP-Dec-2021, MTP-Dec-2021, SM)**

Ans.



(i) As per SA 570, "Going Concern" - loss of a major market or a key customer is **one of the operating indicators** that may cast significant doubt on the **company's ability to continue as a going concern**.

(ii) In the present case:

- OM Ltd. has a **key customer in South Korea** from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea.
- Further, the company has **not yet identified new customers** and is in the process of doing the same.
- As such, the identification of **new customer is a material uncertainty** that cast a significant doubt on the company's ability to continue as a going concern.
- However, **this matter is duly disclosed by the management of OM Ltd.** in the financial statements for the year ended 31.03.2021.
- **As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Shanti should:**
 - (1) Express an **unmodified opinion** and
 - (2) Include in his audit report, a **separate section** under the heading **"Material Uncertainty Related to Going Concern"** to:
 - (i) **Draw attention to the note in the financial statements** that discloses the matters and
 - (ii) **State that these events or conditions** indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

(iii) Conclusion:- Thus, **CA Shanti should deal** with this matter in his **auditor's report in the above mentioned manner**.

63.

Reporting - Material uncertainty exist with respect to going concern

CA.K is appointed statutory auditor of SEEK INDIA LTD under Companies Act, 2013 for the first time. The company is preparing its accounts keeping in view applicable requirements of Division II of Schedule III of Companies Act, 2013. On scrutiny of financial statements of company put up for audit, it was noticed that notes to accounts show ageing of trade payables as per amended requirements of Schedule III of the Companies Act, 2013.

The ageing schedule forming part of notes is as under:-

Outstanding for following periods from due date of payment (₹ In crore)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	NIL	NIL	NIL	NIL	NIL
Others	2	4	3	1	10
Disputed dues-MSME	NIL	NIL	NIL	NIL	NIL
Disputed dues-others	NIL	NIL	NIL	NIL	NIL

Besides above, current ratio, debt-equity ratio, trade payables turnover ratio and net profit ratio disclosed in notes to accounts have slipped drastically as compared to last year and from standard norms. Most of the key financial ratios are in red.

There is no other relevant information concerning above in notes to accounts.

Further, on reviewing bank statement of cash credit limit (against hypothecation of paid stocks), it was noticed

that there is no debit transaction in the month of March, 2022. On inquiry, he came to know that stock audit of company was conducted in the month of January, 2022 and stock auditors have commented vide their report dated 25.2.2022 that company had negative drawing power due to high creditors. Accordingly, the bankers have refused further debits in cash credit account from start of March, 2022.

There is no information in this respect in financial statements and notes to accounts.

Discuss how CA K should deal with above for reporting in his audit report under the Companies Act, 2013.

(MTP-Nov-2022, RTP-May-2023, MTP-Sept-2025)

Ans.



- **It is clear from the ageing schedule** that company is **not able to pay its creditors** on time. Outstanding to creditors for a **period of 1 year or more** account for 80% creditors of the company.
- **Most of key financial ratios are adverse.**
- **Further, bankers have refused further debits** in cash credit account due to negative drawing power from March 2022. Cash credit loans are repayable on demand. **There is no other information available** how the company plans to run its business without bank finance.
- Also, Further, upon inquiry with the management, it was identified that management did not have any major future contracts to boost their revenue and financial position.
- **All the above factors are indicators** that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern.
- **There is no express disclosure** of this fact in financial statements.
- Therefore, it is a **situation where material uncertainty exists**, which has cast significant doubt on company's ability to **continue as going concern** in accordance with **SA 570, Going Concern.**
- **Considering above the fact that** although a material uncertainty exists casting significant doubt on the ability of the company to continue as going concern, adequate disclosure of material uncertainty is not made in financial statements. Thus, **CA K shall give qualified or adverse opinion** in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report.

64.

Reporting - Material uncertainty exist with respect to going concern

Mudit & Associates is appointed as Statutory Auditors of GRF Private Limited for the financial year 2023-24.

The company is into the business of Health Club, Fitness Centre and gym costumes. CA M is the Engagement Partner for the audit assignment. CA M observed the following points while auditing:

- (i) Customer's base is reducing continuously due to tough competition and discount war existing in the market.
- (ii) Payments of creditors are delayed and made with overdue interest.
- (iii) Company has not been able to pay the salaries of staff and trainers on time.
- (iv) Key financial ratios of the company, like current ratio, debt-service coverage ratio, are in the red and have deteriorated considerably as compared to last year.
- (v) The company has requested its bankers to provide it with additional working capital credit facilities of ` 1.5 Crores, but bankers are not considering the company's proposal favorably.

What audit procedures should be followed by CA M considering the above circumstances as per SA 570-"Going Concern"? How auditor should deal if the use of going concern basis of accounting is appropriate, but a material uncertainty exists, and adequate disclosure of material uncertainty is made in the financial statements?

(RTP-Nov-2024, SM)

Ans.



- (1) **As per SA 570, "Going Concern"** if events or conditions have been identified that may cast **significant doubt on the entity's ability to continue as a going concern**, the auditor shall **obtain sufficient appropriate audit evidence** to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern **through performing additional audit procedures**, including consideration of mitigating factors. These procedures shall **include**:
 - (a) **Where management has not yet performed an assessment** of the entity's ability to continue as a going concern, **requesting management to make its assessment.**

- (b) **Evaluating** management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (c) Where the entity has prepared a **cash flow forecast, and analysis of the forecast** is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
- Evaluating** the **reliability** of the **underlying data** generated to prepare the forecast; and
 - Determining** whether there is **adequate support for the assumptions** underlying the forecast.
- (d) Considering whether any additional facts or information have become **available** since the date on which management made its assessment.
- (e) Requesting **written representations** from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.
- (2) **In the given case**, CA M has observed such points that may cast **significant doubt on the entity's ability to continue as a going concern**. Therefore, CA M should **follow audit procedures such as**:
- Review of management's assessment** of the company's ability to continue as a going concern.
 - Examine and challenge** the **reasonableness** of the company's **cash flow forecasts and key assumptions**.
 - Review events after the reporting period** that might affect the going concern assumption, such as further financial deterioration or inability to secure financing.
 - Analysis** of the company's **key financial ratios and compliance with loan agreements** to assess liquidity and solvency.
 - Review** of the **company's challenges and efforts to secure additional financing** and the reasons for the bank's reluctance to provide further credit.
 - Assess the **impact of declining customer base, delayed payments, and other operational challenges** on the company's ability to continue as a going concern.

65.

Cash Flow Forecast

CA Kanishka is auditor of a company engaged in poultry farming and egg production. The company has performed very well since its incorporation in 2015. Its sales had also grown and the company had expanded its operations from its home state in North India to eastern regions of the country.

However, over the past two years, the company's financial performance has deteriorated significantly due to:

- The impact of the pandemic; and
- Three consecutive outbreaks of bird flu within a span of two years, resulting in substantial loss of livestock.

Consequently, the company's turnover declined sharply from ₹ 80 crores to ₹ 18 crores.

The management now wants to start with new batches of birds. The earlier working capital facilities of the company granted by bank have also been restructured to support the business. She was informed that the repayments of restructured working capital term loans are to begin from ensuing year. No fresh credit facilities have been granted by the bank. The company also plans longer credits from animal feed suppliers.

The company plans to take additional measures to prevent the safety of live stocks, including aggressive vaccination, preventive health check-ups, and more frequent visits of veterinary staff.

Further, the company is facing allegations from nearby villagers regarding environmental pollution.

The management has prepared a cash flow forecast for her examination. Discuss the approach to be adopted by her in examining the "going concern" assumption keeping in view above with specific reference to cash flow forecast.

(RTP-May-2026)

Ans.

In accordance with SA 570, "Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern by performing



additional audit procedures, including consideration of mitigating factors.

Where the entity has prepared a cash flow forecast, and analysis of forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions, it includes -

- (i) Evaluating the reliability of the underlying data generated to prepare the forecast and
- (ii) Determining whether there is adequate support for the assumptions underlying the forecast.

In the above situation, cash flow forecast has been prepared by management. Therefore, the auditor should carefully evaluate assumptions underlying forecast and also reliability of data to prepare the forecast. For example:

- She should verify assumption regarding new batch of livestock. The bankers have not provided fresh credit facilities. How funds from the same would be arranged? The reasonability of assumption in cash flow forecast needs to be looked into.
- She needs to check loan sanction letters/agreement to verify when repayments are beginning to see their accuracy in cash flow forecasts.
- The company plans to avail longer credits from animal feed suppliers. In the downturn situation of the company, how would suppliers extend longer credits? This is going to have effect on the cash flow forecast.
- Whether company has accounted for increased expenditure on preventive health check-up, vaccination and more frequent visits of veterinary staff in cash flow forecast.
- Since villagers have alleged the company of spreading air pollution, how does the company plan to deal with the same? Whether any proposed expenditure in this regard is accounted for in the cash flow statement. She may also consider other implications of this issue and possible effect on cash flows.

Further, **as per SA 570 if adequate disclosure** about the material uncertainty is **made** in the financial statements, the auditor shall **express** an **unmodified opinion** and the auditor's report shall **include** a **separate section** under the heading **"Material Uncertainty Related to Going Concern"** to:

- (a) **Draw attention** to the note in the financial statements that discloses the matters set out in paragraph 19; and
- (b) **State** that **these events or conditions** indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

SA-580

Written Representations

66.

Date of and Period covered by Written Representation

Mokshda & Co is the statutory auditor of Get My Trip Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2765 crore and profits are INR 285 crore. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580. (MTP-May-2021)

Ans.

(i) As per SA 580, "Written Representations – Date of WR

- As written representations are **necessary audit evidence**, the auditor's opinion **cannot be expressed**, and the auditor's report **cannot be dated**, before the **date of the written representations**.



- Furthermore, because the **auditor is concerned with events occurring up to the date of the auditor's report** that may require **adjustment to or disclosure** in the financial statements,
- The written representations are **dated as near as practicable to, but not after, the date of the auditor's report** on the financial statements.

(ii) WR for specific assertions

- In some circumstances it may be appropriate for the auditor to **obtain a WR about a specific assertion** in the financial statements during the course of the audit. Where this is the case, it may be **necessary to request an updated WR**.

(iii) Period covered in WR

- The written representations are for **all periods referred to in the auditor's report** because management **needs to reaffirm** that the written representations it previously made with respect to the **prior periods remain appropriate**.
- The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

(iv) Management's Responsibility:

- Situations may arise **where current management were not present during all periods referred to in the auditor's report**.
- Such persons **may assert that they are not in a position** to provide **some or all of the written representations** because they were not in place during the period.
- **This fact, however, does not diminish such persons' responsibilities** for the financial statements as a whole.

Accordingly, **the requirement for the auditor to request** from them written representations that cover the **whole of the relevant period(s) still applies**.

67.

Validity of Written Representation

The Auditor of PQR Pvt. Ltd. having turnover of ₹ 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the Management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach?

Ans.



(i) Responsibility of Management & Auditor

- The **physical verification of stock** is the **primary responsibility** of the management.
- The auditor, however, is required to **examine the verification programme adopted by the management**. He must satisfy himself about the **existence and valuation of stock**.

(ii) In the case of PQR Pvt. Ltd.:

- The auditor has not been able to **verify the existence and value of certain stock** despite the verification procedure followed in routine audit.
- **He accepted the certificate given** to him by the management without making any **further enquiry**.

(iii) As per SA 580 "Written Representations"

- When representation relate to **matters which are material** to the financial information, then the auditor should seek **corroborative audit evidence** for other sources inside or outside the entity.
- He should evaluate whether **such representations are reasonable** and **consistent** with other evidences and should consider whether **individuals making such representations** can be expected to be **well informed** on the matter.
- **"Written Representations" cannot be a substitute for other audit evidence** that the auditor could reasonably expect to be available.

(iv) Conclusion:

- **If the auditor is unable to obtain sufficient appropriate audit evidence** that he believes would

be available regarding a matter, which has or may have a material effect on the financial information, this will **constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter.**

Therefore, **the approach adopted by the auditor is not tenable.**

68.

WR for past years

CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e. 2023-24, 2022-23 and 2021-22 for onward submission to SEBI pursuant to their upcoming IPO (Initial Public Offer). CA N is planning to issue an Audit Report on 5th August, 2024 covering these restated financial statements. Before issuing the audit report, CA N requested Management Representation Letter from the management of the Company for this assignment. The Management of the Company provided Management Representation Letter dated " April, 2024 covering the period of financial year 2023-24 only as they were not in position to provide for the financial year 2022-23 and 2021-22 because they were not in place during that period.

How would CA N deal with the above situation as per relevant Standard on Auditing?

(May-2024, MTP-May-2025, SM, MTP-Sept-2025)

Ans.



In the given situation, CA N is carrying out an audit of restated financial statements of BQR Limited **for past 3 financial years i.e., 2023-24, 2022-23 and 2021-22** so he **requested Management Representation Letter** from the management of the Company for this assignment before issuance of the report. The **management** of the Company **provided the Management Representation Letter only for the financial year 2023-24** as they were not in place during that period.

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations.

As per SA 560, "Subsequent Events", the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The **written representations are for all periods** referred to in the auditor's report because **management needs to reaffirm** that the written **representations** it **previously made** with respect to the prior periods remain **appropriate**. The auditor and management may **agree to a form of written representation** that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where **current management** were **not present during all periods** referred to in the auditor's report. Such persons may **assert that they are not in a position to provide some or all the written representations** because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole.

Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. Therefore, as per the above requirement of SA 580 **CA. N should take written representation letter** from management of BQR Limited **for the financial year 2022-23 and 2021-22 also.**

In case the management of BQR Limited does **not provide** written representation as requested, the auditor shall discuss with the management, **re-evaluate** the integrity of management, and **take appropriate actions** including the impact on the audit report as per SA 705.

69.

WR on Management Responsibility

Udit & Co. is the statutory auditor of Fun Journey Ltd., a company engaged in the tours and travel business. The company has an annual turnover of ₹ 1,200 crores and profits of ₹ 150 crores. While planning, the auditors discussed the requirement for a written representation letter from management for confirming that:

- (i) The auditor is provided with all relevant information and access as agreed in the terms of the audit engagement; and
- (ii) All transactions have been recorded and are reflected in the financial statements

As the audit was near to completion, the auditor disagreed with the management on one of the matters including need of written representation contending that verbal confirmations given during the audit should be sufficient. Thus, separate written representation is not required. Udit & Co., however, explained that under SA 580 obtaining a formal written statement from management is mandatory. Fun Journey Ltd. refuses to provide a written representation letter, despite the auditor's several requests.

- (a) Whether the contention of auditor for seeking written representation letter is justified?
- (b) What should be the form of such written representation?
- (c) How should the auditor proceed if management refuses to provide the written representation?

(RTP-May-2025)**Ans.**

- (a)** As per SA 580, "Written Representations", the auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.

Further, the auditor shall request management to provide a written representation that:

- (i) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement
- (ii) All transactions have been recorded and are reflected in the financial statements.

In the given case, Fun Journey Ltd. refuses to provide a written representation letter, despite the auditor's several requests. Thus, in view of above the contention of auditor is correct.

- (b)** The written representations as per SA 580, shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required, the relevant matters covered by such statements need not be included in the representation letter.

- (c)** As per SA 580, if management does not provide one or more of the requested written representations, the auditor shall:

- (i) Discuss the matter with management;
- (ii) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (iii) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 (Revised).

Furthermore, the auditor shall disclaim an opinion on the financial statements in accordance with SA 705 (Revised) if the auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required are not reliable or management does not provide the written representations required.

Thus, refusal to provide a written representation could impact the auditor's ability to obtain sufficient appropriate audit evidence, potentially leading to a modified audit report.

70.

Cash Flow Forecast : Going Concern Assumption

CA. Somya is auditor of a company engaged in rearing of poultry birds and obtaining eggs therefrom. The company has performed very well since its incorporation in 2013. Its sales had also grown and the company had expanded its market from the native northern state of promoters to far-flung areas in eastern parts of country.

However, since last two years, company's fortunes have nosedived. First, due to the effects of the pandemic and then due to recurrent outbreaks of bird flu thrice in a span of two years. The company's sales have dipped from around ₹ 50 crores to ₹10 crores. Further, a major part of its livestock was also wiped off during bird flu. She is not optimistic about the going concern assumption followed by management.

The management now wants to start with new batches of birds. The earlier working capital facilities of the company granted by bank have also been restructured to support the business. She was informed that the repayments of restructured working capital term loans are to begin from ensuing year. No fresh credit facilities have been granted by the bank. The company also plans longer credits from animal feed suppliers.

The company plans to take additional measures to prevent the safety of live stocks, including aggressive vaccination, preventive health check-ups, and more frequent visits of veterinary staff.

The villagers in surrounding areas have accused the company of spreading air pollution.

The management has prepared a cash flow forecast for her examination. Discuss the approach to be adopted by her in examining the "going concern" assumption keeping in view above with specific reference to cash flow forecast.

Ans.



In accordance with SA 570, "Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors.

Where the entity has prepared a cash flow forecast, and analysis of forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions, it includes

- I. Evaluating the reliability of the underlying data generated to prepare the forecast and
- II. Determining whether there is adequate support for the assumptions underlying the forecast.

In the above situation, **cash flow forecast has been prepared by management**. Therefore, she should carefully **evaluate assumptions underlying forecast** and also reliability of data to prepare the forecast. For example:-

- She should verify **assumption regarding fresh batch of livestock**. The bankers have not provided fresh credit facilities. **How funds from the same would be arranged?** The reasonability of assumption in cash flow forecast needs to be looked into.
- She needs to check **loan sanction letters/agreement** to verify when repayments are beginning to see their accuracy in cash flow forecasts.
- The company plans to **avail longer credits from animal feed suppliers**. In the downturn situation of the company, how would suppliers extend longer credits? This is going to have effect on the cash flow forecast.
- **Whether company has accounted for increased expenditure** on preventive health check-up, vaccination and more frequent visits of veterinary staff in cash flow forecast.
- Since villagers have **accused the company of spreading air pollution**, how does the company plan to deal with the same? **Whether any proposed expenditure in this regard is accounted for in the cash flow statement**. She may also consider other implications of this issue and possible effect on cash flows.

Chapter 7

REPORTING

SA 700

Forming an Opinion and Reporting on Financial Statements

71.

Auditor's Report for Audits Conducted in accordance with Both SA's Issued by ICAI and ISA

KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2020 after doing all appointment formalities wherein auditors are required to ensure compliance with Standards on Auditing and Internal Standards on Auditing.

As an expert you are required to advise the auditor about the requirements regarding auditor's report for audits conducted in accordance with both Standards on Auditing issued by ICAI and International Standards on Auditing. **(SM)**

Ans.



Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing:

As per SA 700, "Forming an Opinion and Reporting on Financial Statements",

- An auditor may be required to **conduct an audit in accordance with the International Standards on Auditing**, in addition to the **Standards on Auditing** issued by ICAI.
 - **If this is the case**, the auditor's report **may refer to Standards on Auditing in addition to the International Standards on Auditing**, but the auditor shall do so **only if**:
 - (a) **There is no conflict between the requirements** in the International Auditing Standards and those in SAs that would lead the auditor:
 - to **form a different opinion**, or
 - **not to include an Emphasis of Matter paragraph or Other Matter paragraph** that, in the particular circumstances, is required by SAs; and
 - (b) **The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation** discussed above when the auditor uses the layout or wording specified by the **Standards on Auditing**.
- When the auditor's report refers to both the ISAs and the Standards on Auditing issued by ICAI**, the auditor's report shall clearly identify the same including **the jurisdiction of origin of the other auditing standards**.

72.

Supplementary Information Presented with the Financial Statements.

XYZ Limited involved in the hospitality business, appointed Charan & Karan Associates as their statutory auditor for FY 2022-23. Management of XYZ Limited, while drawing up the financial statement for the said period, decided to add the following statement after the Statement of Cash Flow as supplementary information to be presented with financial statements. No specific mentions or labels were added to this statement to present that this is supplementary information.

Statement of Average Revenue Per Booking (ARPB) and Comparative

(in ₹ or otherwise stated)

Total Bookings during FY	
- FY 2021-22	36500

- FY 2022-23	39000
Average Revenue per Booking	
- FY 2021-22 (Refer Note 28 Revenue from Operations)	3500
- FY 2022-23 (Refer Note 28 Revenue from Operations)	4200
Bookings Ratio (Organic source by Inorganic source)	
- FY 2021-22	1:2
- FY 2022-23	1:1.65

Kindly guide the audit team regarding the requirement of SA 700 with respect to the Supplementary Information Presented with the Financial Statements. **(RTP-Nov-2023)**

Ans.



Provision:

As per SA 700 "Forming an Opinion and Reporting on Financial Statements", if **supplementary information** that is **not required** by the **applicable financial reporting framework** is **presented with the audited financial statements**, the auditor shall **evaluate whether**, in the auditor's professional judgment, **supplementary information** is nevertheless an **integral part of the financial statements** due to its nature or how it is presented. **When it is an integral part** of the financial statements, the **supplementary information** shall be **covered by the auditor's opinion**.

If **supplementary information** that is **not required** by the **applicable financial reporting framework** is not **considered** an **integral part** of the audited financial statements, the auditor shall **evaluate whether** such **supplementary information** is **presented** in a way **that sufficiently and clearly differentiates it from the audited financial statements**. If **this is not the case**, then the auditor shall **ask management to change** how the unaudited supplementary information is presented. If **management refuses to do so**, the auditor shall **identify** the **unaudited supplementary information** and **explain** in the auditor's **report** that such supplementary information has not been audited.

The auditor's evaluation of whether **unaudited supplementary information** is presented in a manner that could be **construed** as being **covered by the auditor's opinion** includes, for example, **where** that **information is presented** in relation to the financial statements **and** any **audited supplementary information** and **whether it is clearly labelled as "unaudited."**

In the current case, the **Statement of Average Revenue Per Booking (ARPB) and Comparative** is **unaudited supplementary information** that could be **construed** as being **covered by the auditor's opinion**. Hence, the audit team should **evaluate whether such supplementary information** is presented in a way that sufficiently and **clearly differentiates it from the audited financial statements**. If not, then audit can **suggest management to change** the presentation of unaudited supplementary information **by:**

- **Removing** any **cross-references** from the financial statements to unaudited supplementary schedules or unaudited notes so that the demarcation between the audited and unaudited information is sufficiently clear.
- **Placing** the **unaudited supplementary information outside** of the **financial statements** or, if that is not possible in the circumstances, at a minimum placing the unaudited notes together at the end of the required notes to the financial statements and clearly labelling them as unaudited. Unaudited notes that are intermingled with audited notes can be misinterpreted as being audited.

Conclusion: If the **management** of XYZ Limited **refuses to do so**, the auditor shall **identify** the **unaudited supplementary information**, i.e., Statement of ARPB and Comparative **and explain** in the auditor's **report** that such supplementary information has not been audited.

SA 701

Communicating Key Audit Matters in the Independent Auditor's Report

73.

Determining Key Audit Matters

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for

F.Y. 2021-22, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit.

During F.Y. 2021-22, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him that such a matter may be a key audit matter to be reported in the audit report.

Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter. Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?
(RTP-Dec-2021, MTP-Nov-2024)

Ans.



(i) As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report'

The auditor shall determine, from the **matters communicated with those charged with governance**, those matters that required **significant auditor attention** in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) **Areas of higher assessed risk of material misstatement**, or **significant risks** identified in accordance with SA 315.
- (ii) **Significant auditor judgments** relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of **significant events or transactions** that occurred during the period.

(ii) Audit Procedure & Analysis

- a) The auditor shall determine which of the aforesaid matters **considered were of most significance** in the audit of the financial statements of the current period and **therefore are the key audit matters**.
- b) These aforesaid considerations **focus on the nature of matters communicated** with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.
- c) The fact that these considerations are **required is not intended to imply that matters related to them are always key audit matters**; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit
- d) **In addition to matters that relate to the specific required considerations**, there may be other matters communicated with **those charged with governance** that required significant auditor attention and that therefore may be determined to be **key audit matters**.
- e) **Such matters may include, for example:-** Matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements.

For example:- The implementation of a **new IT system** (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

- (iii) **In the given case:-** There was **implementation of ERP system** in the company due to which some of its **business processes got automated** and which had a **significant effect** on the auditor's overall audit strategy during the period. Accordingly, **such a matter can be considered as a key audit matter** if according to Mr. Hemant, such a matter required **significant attention** that had affected his **overall audit strategy**.

Conclusion:- Thus, the **contention of Mr. Vishay is not proper** as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant

attention of the auditor which had an impact on its audit.

74.

KAM vs Modification (SA 505 Reference)

While conducting audit of CGX Limited, a listed company, for year 2022-23, CA. Srishti notices that company has extinguished following material liabilities unilaterally without entering into settlement with creditors and reported these amounts as gains under "Other income". The details in this respect are as under: -

S. No.	Particulars	Amount involved
(i)	Liabilities for purchases of raw material were written back on account of poor quality of raw material and difference in rates	₹ 3.50 crores
(ii)	Liabilities for capital goods were written back on account of defects in machinery supplied by creditors	₹ 2.00 crores

The management is of the opinion that these dues are no longer payable. Therefore, retaining these liabilities on financial statements would lead to overstatement of liabilities. Extinguishment of liabilities was made by company in accordance with normal trade practices and outstandings were written back after stopping dealing with such creditors. She wanted to send external confirmation requests to such creditors. However, management informed her that sending such requests may be used by creditors as proof of existence of liability.

She is contemplating inclusion of above matters under "Key audit matters" in audit report. Analyse the situation threadbare.

(MTP-May-2024, SM)

Ans.



- (1) **A liability is a present obligation of the entity to transfer an economic resource as a result of past events. Instead** of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, **entities sometimes decide** to, for example: -
 - (a) **settle the obligation by negotiating** a release from the obligation;
 - (b) **transfer the obligation to a third party;** or
 - (c) **replace that obligation** to transfer an economic resource with another obligation by entering into a new transaction.
- (2) **In the above situations**, an entity has the **obligation** to transfer an economic resource **until** it has **settled, transferred or replaced that obligation**.
In the given situation,
 - The **company has written back liabilities** due to creditors **unilaterally**.
 - The company has **not settled the obligation by negotiating** a release from the obligation from respective creditors.
 - Such an accounting **treatment** by management **is questionable** and against the conceptual framework for financial reporting under Ind AS.
 - CA. Srishti wanted to send external confirmations in accordance with SA 505, "External Confirmations" but management informed her that sending such requests may be used by creditors as proof of existence of liability.

In fact, she should display professional skepticism and be alert to the possibility of misstatements in financial statements, if restrained by management from obtaining external confirmations.
- (3) The **reasons** advanced by management **do not appear to be valid and reasonable**.
In accordance with SA 505, she should **reassess risks and perform alternative audit procedures** to mitigate such risks.
 Besides, she should consider implications of same for her audit opinion.
- (4) **Further, SA 705, "Modifications to the Opinion in the Independent Auditor's Report"** requires that the auditor shall **modify the opinion** in the auditor's report **when**: -
 - (a) The auditor concludes that, based on the audit evidence obtained, the **financial statements as a whole** are **not free from material misstatement**; or
 - (b) The auditor is **unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement.
- (5) **SA 705 also states that**
 - **misstatements** in financial statements **arise when selected accounting policies** are **not in**

accordance with an applicable financial reporting framework.

- examples of an inability to obtain sufficient appropriate audit evidence arise from a **limitation on the scope of audit imposed by management** when management prevents the auditor from requesting external confirmation of specific account balances. Therefore, she needs to issue a modified opinion.

(6) **Keeping in view above,**

- her contemplation of **including above matters under “Key audit matters”** is **not proper** and is **not in accordance with SA 701,”** Communicating Key Audit Matters in the Independent Auditor’s Report”.
- It states that the auditor shall **not communicate a matter** in the **Key Audit Matters section** of the auditor’s report **when** the **auditor** would be **required to modify the opinion** in accordance with **SA 705** as a result of the matter.
- **Communicating key audit matters** in the auditor’s report is **not a substitute for** the auditor **expressing a modified opinion** when required by the circumstances of a specific audit engagement in accordance with SA 705.

SA-705

Modifications to the Opinion in the Independent Auditor’s Report

75.

Management Imposed Limitation

All in One Ltd., a large departmental store, appointed CA. Kabir as the statutory auditor. After accepting the engagement and performing the audit procedures, he noticed that the management has restricted his access to key inventory records and certain supplier confirmations. These limitations are likely to prevent from obtaining sufficient appropriate audit evidence relating to significant balances in the financial statements. When Kabir requested to remove the restrictions, the management refused, stating that the information is confidential and sensitive. You have communicated the issue to those charged with governance, but the restriction still remains. What are the consequences of this management-imposed limitation on audit opinion and what actions should Kabir take as an auditor in response to the limitation? **(MTP-Sept-2025)**

Ans.



Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement: As per SA 705, “Modification to the Opinion in the Independent Auditor’s Report”, if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the prescribed limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 1. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 2. If withdrawal from the audit before issuing the auditor’s report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

In the given case, management imposed limitation on audit opinion. Thus, CA. Kabir should take above mentioned actions in response to such limitations.

76.

Qualified Opinion

XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2021-22. The company has taken long term funding for fixed capital requirements and short-term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire and the company is unable to re- negotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the financial statements discuss the magnitude of financing arrangements, the expiration and the total financing arrangements; however, the financial statements do not include discussion on the impact or the availability of refinancing. Thus, the financial statements (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.? **(SM)**

Ans.



- (i) **In the present case:-** XYZ Ltd. is **unable to re- negotiate or obtain the replacement financing** for its long term and short-term funding requirements. This situation indicates the existence of a material uncertainty that may cast significant doubt on the **Company's ability to continue as a going concern** and therefore, XYZ Ltd. may be **unable to realize its assets** and **discharge its liabilities** in the normal course of business. Further, the financial statements of XYZ Ltd. **do not disclose this fact adequately**.
- (ii) **Conclusion:-** Thus, the financial statements of XYZ Ltd. are **materially misstated due to the inadequate disclosure** of the material uncertainty. CA Sudhir will express a **qualified opinion** as the effects on the financial statements of this inadequate disclosure are material but not pervasive to the financial statements.
- (iii) **Reporting -** The relevant extract of the **Qualified Opinion Paragraph** and **Basis for Qualified Opinion paragraph** is as under:
- **Qualified Opinion**
In our opinion and to the **best of our information and according to the explanations given** to us, except for the **incomplete disclosure** of the information referred to in the **Basis for Qualified Opinion** section of our report, the aforesaid **standalone financial statements** give the information required by the Act in the manner so required and give a **true and fair view** in conformity with the **accounting principles** generally accepted in India, of the state of affairs of XYZ Ltd. as at **March 31, 2022**, and profit/loss, for the year ended on that date.
 - **Basis for Qualified Opinion**
As discussed in Note 6, the Company's financing arrangements are about to expire and the Company has been unable to **conclude renegotiations** or **obtain replacement financing**. This situation indicates that a **material uncertainty exists** that may cast significant doubt on the Company's ability to **continue as a going concern**. The financial statements do not adequately disclose this matter.

77.

Adverse Opinion

ABC Ltd. is a company engaged in the manufacture of iron and steel bars. PP & Associates are the statutory auditors of ABC Ltd. for the FY 2023-24. During the course of audit, CA Prakash, the engagement partner, found that the Company's financing arrangements have expired and the amount outstanding was payable on March 31st, 2024. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Prakash express in case of ABC Ltd.?

(SM, MTP-Nov-2024, MTP-Jan-2026)

Ans.



- (i) **In the present case:-** Based on the audit evidence obtained, CA Prakash has concluded that a **material uncertainty exists** related to **events or conditions** that may cast significant doubt on the **entity's ability to continue as a going concern**, and the entity is considering bankruptcy. The financial statements of ABC Ltd. omit the required disclosures relating to the material uncertainty.
- (ii) **Conclusion:-** In such circumstances, CA Prakash **should express an adverse opinion** because the effects on the financial statements of such omission are **material and pervasive**.
- (iii) **Reporting:-** The relevant extract of the **Adverse Opinion Paragraph** and **Basis for Adverse Opinion**

paragraph is as under:

- **Adverse Opinion**

In our opinion, because of the **omission of the information** mentioned in the Basis for **Adverse Opinion** section of our report, the accompanying financial statements **do not present fairly**, the **financial position** of the entity as at March 31, 2024, and of its financial performance and **its cash flows** for the year then ended in accordance with the **Accounting Standards** issued by the Institute of Chartered Accountants of India.

- **Basis for Adverse Opinion**

The **financing arrangements of ABC Ltd.** has expired and the **amount outstanding was payable on March 31, 2024**. The entity has been unable to conclude **re-negotiations or obtain replacement financing** and is **considering filing for bankruptcy**. This situation indicates that a material uncertainty exists that **may cast significant doubt** on the Company's ability to continue as a going concern. The financial statements **do not adequately disclose this fact**.

78.

Disclaimer of Opinion

TEA Ltd., FMCG Company having its tea gardens in north eastern states of the country is exclusively dealing in blending, processing, packing and selling of various brands of Tea. During the year under audit, the company entered into joint venture for purchasing Tea Gardens in Sri Lanka and Kenya. M/s GN & Associates are the statutory auditors of the company for the financial year 2021-22. During the course of audit, the audit team was unable to obtain sufficient appropriate evidence about a single element of the consolidated financial statement being Joint venture investment in Kali Ltd. representing over 90% of the group's net assets having both material and pervasive possible effect to the consolidated financial statements. The group's investment in Kali Ltd. is carried at ₹ 100 crores in the group's consolidated balance sheet. Draft the opinion paragraph and basis of opinion paragraph to be included in the Independent Auditor's report. **(Dec-2021, MTP-Nov-2024)**

Ans.



(i) **In the present case:-** M/s GN & Associates are **unable to obtain sufficient appropriate audit evidence** about the financial information of a **joint venture investment** that **represents over 90% of the entity's net assets**.

(ii) **Conclusion:-** The possible effects of this **inability to obtain sufficient appropriate audit evidence** are **both material and pervasive** to the consolidated financial statements. Therefore, the statutory auditor should **issue a disclaimer of opinion**.

(iii) **Reporting:-** The relevant extract of the **Disclaimer of Opinion Paragraph** and **Basis for Disclaimer of Opinion** paragraph is as under:

- **Disclaimer of Opinion**

We were engaged to audit the **accompanying consolidated financial statements of Tea Ltd., FMCG Company** (hereinafter referred to as the "Holding Company") and **its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group")**, which comprise the consolidated balance sheet as at March 31, 20XX, the consolidated statement of Profit and Loss, (consolidated statement of changes in equity) and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the "Consolidated Financial Statements").

We do not express an opinion on the accompanying consolidated financial statements of the Group. Because of the **significance of the matter** described in the **Basis for Disclaimer of Opinion section of our report**, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

- **Basis for Disclaimer of Opinion**

The Group's investment in its joint venture Kali Ltd. Company is carried at **₹ 100 crores** on the Group's consolidated balance sheet, which represents **over 90% of the Group's net assets** as at March 31, 2021. **We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation.** As a result, we were unable to determine whether **any adjustments were necessary** in respect of the Group's proportional share of Kali Ltd.'s assets that **it controls jointly**, its proportional share of **Kali Ltd.'s liabilities for which it is jointly responsible**, its proportional share of **Kali Ltd.'s income and expenses** for the year, (and the elements making up the **consolidated statement of changes in equity**) and the **consolidated cash flow statement**.

79.

Extract & Basis of Disclaimer of Opinion Paragraph

The extract of the financial statements of Nex Limited for the financial year 2023-24 is as follows:

Particulars	Rupees (in Crores)
Trade Receivable - Unsecured considered Good	225.00
Provision for Bad and Doubtful Debts	50.00
Stock of Raw Materials	180.00
Stock of Finished Goods	250.00
Total of Assets	950.00

CA Yash is the statutory auditor of Nex Ltd. for the FY 2023-24. During the course of audit CA Yash noticed the following:

- With respect to the debtors amounting to ₹ 175 crore, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The company has created a provision for doubtful debts to the tune of ₹ 50 crore during the year under audit. The company has stated that the provision is based on receivables which are older than 36 months, which according to the audit team is inadequate and as such the audit team is unable to ascertain the carrying value of trade receivables.
- Further, in respect of inventories (which constitutes 45% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified.

What kind of opinion should be given by CA Yash in the given situation? Draft a suitable Opinion and Basis of Opinion paragraph. **(RTP-Nov-2024)**

Ans.



In the present case, CA Yash is unable to obtain sufficient and appropriate audit evidence with respect to the following:

- The **balance confirmation** with respect to debtors amounting to ₹ 175 crores are not available. Further there has been default in payment by the debtors and the provision so made is not adequate. The audit team is also unable to ascertain the carrying value of trade receivables.
- With respect to **45% of the company's inventory**, neither the physical verification has been done by the management nor adequate inventory records are maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, CA Yash should **give a Disclaimer of Opinion.**

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of Nex Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We are unable to obtain balance confirmation with respect to the debtors amounting to ₹ 175 crore. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The company has created a provision for doubtful debts of ₹ 50 crore during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained.

Further, in respect of inventories (which constitute 45% of the total assets of the company), during the

reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count and as such the value of inventory could not be verified.

7.4 - SA-706

Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

80.

Emphasis of Matter & Modification in the Opinion

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material. You are required to advise, whether AKB Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported?

(RTP-Nov-2020, MTP-May-2024, SM)

Ans.



Reporting of observations by the AKB Associates

(i) Observation-1

- **As per SA 706:- "Emphasis of Matter Paragraph & Other Matter Paragraph** in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to **matter appropriately disclosed** in the financials, that in the auditor's **judgement is of such importance** that it is **fundamental to users' understanding** of the financials.

In the given case:- The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material

- **Conclusion:-**Hence, in this case, the **auditor shall report** about the **consequences of the flood** which affected the Company's warehouse **under Emphasis of Matter Paragraph**.

(ii) Observation-2

- **As per SA 705:- "Modification to Opinion in the Independent Auditor's Report"**, where the auditor is **unable to obtain sufficient and appropriate** audit evidence and where such mater is **material but not pervasive**, the auditor shall issue a **qualified opinion**.
- **In the given case:-**Due to flood, few records maintained by the Company with respect to a particular transaction was **completely destroyed** and there was **no duplicate record** maintained by the Company. However, those details were **not pervasive, but material**
- **Conclusion:-**Thus, in the given situation, **on account of flood** few records pertaining to particular transactions was **completely destroyed** and in the **absence of duplicate records**, the auditor was unable to **obtain sufficient and appropriate audit evidence** and those details were **material but not pervasive**. Therefore, in accordance with **SA 705**, the auditor is required to issue **qualified opinion**.

81.

Unmodified Opinion with Going Concern Reporting

CA Sameer is the statutory auditor of Tram Fram Ltd. for the FY 2023-24. While concluding the audit CA Sameer decided to issue an unmodified opinion, though he also concluded that a material uncertainty exists with respect to the company's ability to continue as a going concern on account of a pending litigation related to labour laws. He is of the view that the company has made appropriate disclosures with respect to such pending litigation in the notes to accounts annexed to the financial statements of Tram Fram Ltd. for the FY 2023-24. Explain how CA Sameer will deal with the above situation in his auditor's report (draft the relevant

portion of the auditor's report.)

Ans.



Material Uncertainty Related to Going Concern

We draw attention to **Note 10 in the financial statements**, which indicates that the **outcome of a litigation** on account of **labour laws** is pending in case of the company during the **year 31 March, 2024**. As stated in Note 11, this event or condition, indicate that a **material uncertainty exists** that may cast significant doubt on the Company's ability to **continue as a going concern**. Our opinion is **not modified** in respect of this matter.

82.

EOM & OM Paragraph

In respect of the audit of BDS Ltd., the statutory auditor of the company noticed some matters. The statutory auditor wants to draw the user's attention towards such matters, though his opinion is not modified in respect of such matters. Draft the relevant paragraphs of the audit report for the following matters:

- i. The company has a plan to resume its construction activities with respect to one of its thermal power project, The activity of such power plant was suspended in the FY 2021-22. The thermal power project comprises of the plant and equipment amounting to ₹ 5.95 crore and capital work in progress of ₹ 147.50 crore.
- ii. The financial statements of 5 branches are included in the Standalone Financial Statements of BDS Ltd. whose financial statements reflect total assets of ₹90 crores as at 31.03.2022 and total revenue from operations of ₹40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors.

Ans.



Emphasis of Matter

We draw attention to the following note of the standalone financial statements:

Note 27 regarding the plans of the Company to **resume construction/developmental activities** of a thermal power project. The carrying amounts related to the project as at 31st March, 2022 comprise of plant and equipment of ₹ 5.95 crore and capital work in progress of ₹ 147.50 crore. Our opinion is not modified in respect of this matter.

Other Matter

We **did not audit the financial statements of 5 branches** included in the **Standalone Financial Statements** of the company whose financial statements reflect **total assets of ₹ 90 crores as at 31.03.2021** and **total revenue from operations of ₹ 40 crores** for the year ended on that date. The financial statements of these branches have been audited by the **branch auditors** whose reports have been furnished to us, and our opinion in so far as it relates to the **amounts and disclosures** included in respect of these branches, is based solely on the report of the branch auditors. Our opinion is **not modified in respect of this matter**.

83.

FS not prepared as GC

Fancy Limited is a foreign company providing software support services having its Branch Office at Delhi. During the year 2023-24, Fancy Limited incorporated a subsidiary Nancy Private Limited in Gurgaon. For furtherance of objectives, Fancy Limited entered into a Business Transfer Agreement dated 5th October 2023 with Nancy Private Limited for transfer of all assets and liabilities along with the business of Delhi Branch to Nancy Private Limited on a going concern basis effective from 01st April, 2023. Further necessary approval from regulatory authorities is also received on 20th December, 2023 for such transfer. Fancy Limited promised that it shall provide continuing financial and operational support to Delhi Branch and further confirmed that any losses incurred post the date of transfer shall be borne by Fancy Limited.

During the year 2023-24, Delhi Branch of Fancy Limited have prepared its financial statements on the basis that the Branch Office does not continue to be a going concern and all its assets are carried in the books of accounts at the values likely to be recovered at the time of closure of operations, to the extent ascertainable at the time of preparation of the financial statements. Delhi Branch has incorporated above matter in detailed form in Note XX to the financial statement.

You are the statutory auditor of Delhi Branch of Fancy Limited for the financial year 2023-24. According to you, Delhi Branch has correctly disclosed about the matter in Note XX to the Financial statement regarding management's intention to close the operations of the branch office. Further you have obtained sufficient appropriate audit evidence concerning audit and on the verge of finalization of audit report.

Draft a suitable opinion paragraph and basis thereof in the given case along with disclosure of Note XX with suitable place in audit report in terms of relevant auditing standard. (May-2024, SM)

Ans.



Drafting of Opinion Paragraph and basis thereof along with disclosure of Note XX:

INDEPENDENT AUDITOR'S REPORT

To the Members of Delhi Branch Office of Fancy Limited

Report on the Audit of the Standalone Financial Statements

Opinion

We have audited the standalone financial statements of Delhi Branch Office of Fancy Limited ("the Company"), which comprise the balance sheet as at March 31, 2024, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, give a true and fair view, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Delhi Branch Office of the Company as at March 31, 2024 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the ICAI's Code of Ethics and the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note XX regarding Delhi Branch Office management's intention to close the operations of the Branch Office subject to regulatory approvals. Accordingly, the financial statements have been prepared on the basis that the Delhi Branch Office does not continue to be a going concern and provisions have been made in the books of account for the losses arising or likely to arise on account of closure of operations including the losses on the realizability of current assets.

Our opinion is not modified in respect of this matter.

7.5 - SA 710

Comparative Information – Corresponding Figures and Comparative Financial Statements

84.

Impact of Modification in the Predecessor Auditor's Report

It was observed from the modified audit report of the financial statements of ULFA Ltd. for the year ended 31st March, 2021 that depreciation of ₹ 4.25 crore for the year 2020-2021 had been charged off to the Statement of Profit and Loss instead of including it in "carrying value of asset under construction". State in relation to the audit for the year ended 31st March 2022, whether such modification in the previous year's audit report would have any audit implication for the current year i.e. FY 2021-22 and if yes, how the auditor is required to deal with the same in his audit report for the current year? (MTP-Nov-2020, MTP-May-2023, Nov-2018)

Ans.



(i) Auditor's Responsibilities when modification resolved

- In cases where **audit report for an earlier year is qualified** is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements".
- **As per SA 710**, When the auditor's report on the **prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion** and the matter **which gave rise to the modified opinion** is resolved and **properly accounted for** or disclosed in the financial statements in accordance with the **applicable financial reporting framework**, the auditor's opinion on the current period **need not refer to the previous modification**.

(ii) When modification un-resolved

- SA 710 further states that if the auditor's report on the prior period, as **previously issued**, included a **qualified opinion** and the matter which gave rise to the **modification is unresolved**, the **auditor shall modify the auditor's opinion on the current period's financial statements**.
- (iii) In the **Basis for Modification paragraph** in the auditor's report, the auditor shall either:
- **Refer to both the current period's figures and the corresponding figures** in the description of the matter giving rise to the modification when the effects or possible **effects of the matter on the current period's figures are material**; or
 - **In other cases, explain that the audit opinion has been modified** because of the effects or possible effects of the **unresolved matter on the comparability** of the current period's figures and **the corresponding figures**.
- (iv) **Conclusion:**
- In the instant case, **if Ulfa Ltd. does not correct the treatment of depreciation** extent of rupees 4.25 crore for previous year, the **auditor will have to modify his report for both current and previous year's figures** as mentioned above.
 - If however, **the figures and provisions are corrected**, the auditor **need not refer to the earlier year's modification**.

85.

Provision for diminution in value of investments

Neptune Ltd. is a company that holds significant investments in a portfolio of equity securities. Due to a decline in market values, the company's investments have suffered a notable diminution in value. For the financial year ended 31st March 2023, the audit report of Neptune Ltd. included a qualification regarding the non-provision of ₹ 70 lakh for the diminution in the value of these investments. As the auditor for the financial year 2023-24, how would you report in the following situations:

- (i) If the company does not make a provision for the diminution in the value of investments in the year 2023-24?
- (ii) If the company makes an adequate provision for the diminution in the year 2023-24? **(MTP-Nov-2024, SM)**

Ans.


(1) As per SA 710, "Comparative Information –

Corresponding Figures and Comparative Financial Statements", when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

(2) SA 710 further states that

- if the **auditor's report on the prior period**, as previously issued, **included a qualified opinion and the matter** which gave rise to the modification **is unresolved**, the auditor shall **modify the auditor's opinion on the current period's financial statements**.
 - In the Basis for Modification paragraph in the auditor's report, the **auditor shall either:**
 - (i) **Refer to both the current period's figures and the corresponding figures** in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
 - (ii) In other cases, **explain that the audit opinion has been modified** because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
- In the instant case, if Neptune Ltd. does not make provision for diminution in the value of investment** to the extent of ₹ 70 lakh, the auditor will have to **modify his report for both the current and previous year's figures** as mentioned above. **If, however, the provision is made**, the auditor **need not refer to the earlier year's modification**.

86.

Reporting

Kuber Tech Solutions Ltd. is in the process of finalising its financial statements for the year ended 31st March 2025. The company is required to present comparative financial statements, including figures for the year ended 31st March 2024. Roshan & Co., Chartered Accountants, has been appointed as the statutory auditor for the current year.

During the audit, CA Roshan, the engagement partner, notes the following:

Particulars	FY 2023-24	FY 2024-25
Auditor	Gupta & Mehra LLP, Chartered Accountants	Roshan & Co., Chartered Accountants
Audit Opinion	Adverse	Audit in progress
Reason for Modified Opinion	Material misstatement in valuation and disclosure of trade receivables	Misstatement remains uncorrected
Presentation of Financial Statements	Figures presented as comparatives in FY 2024-25 audit	Comparative financial statements (current + previous year)

- (a) What are the duties of CA Roshan while reporting on the current year's financial statements, considering the prior year's adverse opinion?
- (b) What modifications or disclosures are required in the current year's audit report in accordance with the relevant Standards on Auditing? **(RTP-Sept-2025)**

Ans.



- (a) In the given case, CA Roshan noticed that the previous year's financial statements contained an adverse opinion for the financial statement whole due to a misstatement in the evaluation and disclosure of the trade receivables. As per SA 710, "Comparative Information-Corresponding Figures and Comparative Financial Statements", if the auditor's report on the prior period, as previously issued, included an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the present case, the matter leading to the prior year's adverse opinion i.e., material misstatement in trade receivables from the prior year remains uncorrected in the current year's financial statements, CA Roshan must modify the current year's audit opinion, in accordance with SA 710.

- (b) When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:
- That the financial statements of the prior period were audited by a predecessor auditor;
 - The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
 - The date of that report.

In the given case, the previous year's audit was conducted by Gupta & Mehra LLP, who issued an adverse opinion due to a misstatement in trade receivables. Accordingly, CA Roshan should include an Other Matter paragraph in the current year's auditor's report, disclosing that the prior year financials were audited by Gupta & Mehra LLP; an adverse opinion was expressed due to material misstatement in trade receivables; and the date of the prior auditor's report.

7.6 - SA 720

The Auditor's Responsibility in Relation to Other Information

87.

Responding when the Auditor concludes that a Material Misstatement of the Other Information exists

GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y 2021-22. The audit team has completed the audit and is in the process of preparing audit report Management of the company has also prepared draft annual report.

Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who

in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue. Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting. **(Nov-2020, MTP-Dec-2021, MTP-May-2024)**

Ans.



- (i) As per SA 720, "**The Auditor's Responsibility in Relation to Other Information**", Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information.
- The **auditor's discussion with management** about a **material inconsistency** (or other information that appears to be materially misstated) may include **requesting management to provide support** for the basis of management's statements in the other information.
 - **Based on management's further information or explanations**, the auditor may be **satisfied** that the other information is **not materially misstated**.
 - **For example, management explanations** may indicate **reasonable and sufficient** grounds for valid differences of judgment.
- (ii) **Auditor's duties with regard to reporting in the given case are given hereunder:**
 As per SA 720, "The Auditor's Responsibility in Relation to Other Information", if the auditor concludes that a **material misstatement of the other information exists**, the auditor shall request management to **correct the other information**. If management:
- Agrees to **make the correction**, the auditor shall **determine that the correction** has been made; or
 - **Refuses to make the correction**, the auditor shall **communicate the matter** with TCWG and request that the correction be made. Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

88.

Reporting of Supplementary Information in Audit Report

CA. S has been appointed as Statutory Auditor of SRT Ltd. for the financial year 2021-2022. The Company while preparing financial statements for the year under audit prepared one additional profit and loss account that disclosed specific items of expenditure and included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit and loss account is not covered under applicable financial reporting framework. Guide him as to how he should deal with his issue while reporting on the financial statement of SRT Ltd. **(MTP-Nov-2023, July-2021)**

Ans.



- ❖ If supplementary information that is **not required by the applicable financial reporting framework** is presented with the audited financial statements, the **auditor shall evaluate whether**, in the auditor's professional judgment, supplementary information is **nevertheless an integral part of the financial statements** due to its nature or how it is presented.
 - ❖ **When it is an integral part of the financial statements**, the supplementary information shall be covered by the auditor's opinion.
 - ❖ **If supplementary information that is not required by the applicable financial reporting framework** is not considered an integral part of the audited financial statements, the auditor shall evaluate **whether such supplementary information** is presented in a way that **sufficiently and clearly differentiates** it from the audited financial statements.
 - ❖ If this is not the case, then the **auditor shall ask management to change how the unaudited supplementary information is presented**.
 - ❖ **If management refuses to do so**, the auditor shall identify the **unaudited supplementary information** and **explain in the auditor's report** that such supplementary information **has not been audited**.
 - ❖ **When an additional profit and loss account that discloses specific items of expenditure** is disclosed as a separate schedule, included as an appendix to the financial statements, the **auditor may consider this to be supplementary information** that can be clearly **differentiated from the financial statements**.
- Conclusion:-** Thus, **additional profit and loss account is not considered an integral part of the audited financial statements** and the auditor shall evaluate that **supplementary information** is presented in a way that **sufficiently and clearly differentiates** it from the audited financial statements.

89.

Material Inconsistences

Sujit & Co., Chartered Accountants, have been appointed as Statutory Auditors of Anand Mills Ltd. for FY 2022-23. The audit team has completed the audit and is in the process of preparing the audit report. The

Management of the company has also prepared a draft annual report. While reviewing the company's draft annual report, the auditor observed a section that stated a decline in market prices for essential products compared to the previous year. Surprisingly, the financial statements indicated that the company's profit margin had actually increased. The audit Manager discussed this issue with the firm's partner, who replied that the auditors are not responsible for disclosures made by management in the annual report. Do you think that the partner is correct in his approach to this issue? Discuss with reference to the relevant Standards on Auditing the Auditor's duties with regard to reporting. **(MTP-Nov-2023, MTP-May-2025)**

Ans.



Auditor's responsibilities as to Other Information included in Annual Report :

SA 720, "The Auditor's Responsibilities Relating to Other Information", delineates the responsibilities of auditors in regard to other information, which can pertain to financial or non-financial matters and is encompassed within an organisation's annual report. This encompasses documentation of market trends pertaining to significant products and quantities or other items that may be included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting: If the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (i) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

In the given situation, Sujit & Co., Chartered Accountants, have been appointed as Statutory Auditors of Anand Mills Ltd. The auditor, while reviewing the company's draft annual report, has observed a section mentioning about a decline in market prices for essential products compared to previous year and financial statements indicated that company's profit margin has increased. Considering the requirements of SA 720 as stated above, it can be concluded that contention of firm's partner, that auditors are not responsible for disclosures made by management, is not correct. Accordingly, partner is not correct in his approach to this issue.

90.

Reporting

PQR Motors Ltd., a listed entity engaged in the manufacture, and sale of automobiles and related parts has prepared its annual financial statements for the financial year 2024-25. The company's management is also responsible for preparing other information, which includes:

- (1) **Annual Report:**
 - A Director's Report and Management Discussion & Analysis (MD&A) prepared by the management.
 - A Corporate Social Responsibility (CSR) report highlighting the company's initiatives and outcomes.
- (2) **Chairman's Message:**
 - A message from the chairman discussing the company's financial performance and strategic outlook.
- (3) **Future Projections:**
 - Forward-looking statements in the annual report about anticipated growth in revenue and expansion plans.

The Statutory auditors, M/s ST & Co., Chartered Accountants, have completed its audit of the financial statements and prepared the auditor's report. During the course of the audit, the following circumstances arise:

- The Director's Report and MD&A are finalized and provided to the auditor before the date of the auditor's report.
- The Chairman's Message and Future Projections are not finalized but are expected to be included in the annual report, which will be released after the auditor's report is issued.

Issues Identified:

- (1) In the MD&A, M/s ST & Co., noted a misstatement regarding the company's claim of achieving a 20% reduction in production costs. Audit evidence suggests the reduction was only 10%.
- (2) The Chairman's Message, which is yet to be reviewed, contains optimistic revenue projections that appear

inconsistent with the historical growth trend.

Answer the following with reference to the relevant Standard on Auditing:

- (i) What should M/s ST & Co., include in the "Other Information" section of the auditor's report for PQR Motors Ltd.?
- (ii) If management does not correct the identified misstatement in the MD&A, even after the same was brought to their attention, what should M/s ST & Co. report under the "Other Information" section?

(May-2025)

Ans.



- (i) As per SA 720 (Revised), "The Auditor's Responsibilities Relating to Other Information", the auditor is required to report on "Other Information" in the auditor's report for listed entities. "Other Information" refers to financial and non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

In the "Other Information" section of the auditor's report, the following should be included:

- A statement that management is responsible for the other information included in the annual report.
- Identification of other information obtained:
 - The Director's Report and MD&A have been obtained prior to the date of the auditor's report.
 - Mention of other information expected to be obtained later (e.g., Chairman's Message and Future Projections)
- A statement that the auditor's opinion does not cover the other information, and the auditor does not express any form of assurance conclusion on it.
- A description of the auditor's responsibilities relating to reading, considering, and reporting on the other information as per SA 720.
- A statement on the results of the auditor's review of the other information:
 - If no misstatement is identified, a statement to that effect.
 - If a material misstatement is identified, a description of the uncorrected misstatement (as applicable)

- (ii) As per SA 720 (Revised), if the auditor identifies a material misstatement in the other information and management refuses to correct it, M/s ST & Co. shall report the uncorrected misstatement in the "Other Information" section as:

- We have identified a material misstatement in the MD&A regarding the company's claim of a 20% reduction in production costs. However, based on our audit evidence, the reduction was only 10%.

7.8 - Section-143 Duties of Auditor: Reporting Responsibilities

91.



Enquiring into Propriety Matters of the Company as required by Section 143(1)

Mr. Raj, the engagement partner of R.O.K. & Co., in connection with statutory audit of Waria Ltd., had assigned the responsibility of enquiring into propriety matters of the Company as required by section 143(1) of the Companies Act, 2013, to Mr. Samay, an engagement team member. Mr. Samay while making such enquiries, was having following queries, as tabulated below, which he ought to get resolved from Mr. Raj, as follows:-

Sr. No.	Query of Mr. Samay
1	What documents to be seen in case of loan given by the company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?
2	What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?
3	Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of section 143(1) of the Companies Act, 2013?

Assuming that you are Mr. Raj the engagement partner, please provide answer to the queries of Mr. Samay?

(MTP-May-2021)

Ans.

As a engagement partner I will provide answer to queries as follows:

Sr. No.	Query of Mr. Samay	Response to Query
1	What documents to be seen in case of loan given by the	Mr. Samay should see deed of Hypothecation or other document creating the charge , together with a statement of

	company in lieu of hypothecation of goods from lender as a security for the purpose of reporting as per clause (a) of section 143(1) of the Companies Act, 2013?	stocks held at the balance sheet date in order.
2	What shall be the cost of Debentures and Bonus Shares sold by the company for which the cost is not ascertainable for the purpose of reporting as per clause (c) of section 143(1) of the Companies Act, 2013?	(i) For Debentures sold: Where the cost of debentures sold is not ascertainable, the book value thereof at the date of sale may be treated as the cost for the purposes of this clause. (ii) For Bonus Shares sold: When bonus shares are received, the number of shares in the portfolio would be increased by the bonus shares while the cost of the total portfolio would remain the same as before. The result would be that the average cost per unit of the total holding would come down proportionately. The usual accounting practice for apportioning the cost of a part of the total holding on the sale thereof is to take it at its average cost.
3	Whether the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash for the purpose of reporting as per clause (f) of section 143(1) of the Companies Act, 2013?	The law on the subject has hitherto been that, where the consideration for the issue of shares is an adjustment against a bona fide debt payable in money on demand by the company, the shares are deemed to have been subscribed in cash (vide the decision in Spargo's Case - 1873, 8, Ch. A. 407). According to the legal opinion obtained by the ICAI, the expression "shares allotted for cash" may also include shares allotted against a debt. Therefore, in cases which are covered by the decision in Spargo's case, no comment is required by the auditor, even though the company may have in the Return of Allotment under Section 75, shown such shares as allotted against adjustment of a debt. Thus, the shares allotted by Waria Ltd. against a loan taken by it from a NBFC can be considered to be allotted for cash.

92. Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Shrivastav & Company, a Chartered Accountant firm, signed the audit report of Om Ltd. on behalf of Shrivastav & Company. Comment.

Ans.



Signature on Audit Report:

(i) Provision:-

- **Section 145** of the Companies Act, 2013 requires that the **person appointed as an auditor** of the company **shall sign the auditor's report** or **sign** or **certify any other document** of the company
- In accordance with the provisions of **section 141(2)** i.e. where a **firm including a limited liability partnership** is appointed as an auditor of a company, **only the partners who are chartered accountants** shall be authorized to act and sign on behalf of the firm.

(ii) Conclusion:

- **Mr. Rajendra**, a fellow member of the Institute and a **manager of M/s Shrivastav & Co.**, Chartered Accountants, **cannot sign on behalf of the firm** in view of the specific requirements of the Companies Act, 2013.

(iii) In case of contravention:

If any **auditor's report** or **any document** of the company is **signed or authenticated** otherwise than in conformity with the requirements of **Section 145**, the **auditor concerned** and **the person**, if any, other than the auditor **who signs the report or signs or authenticates** the document shall, **if the default is willful, be punishable with a fine**.

Chapter 8

SPECIALISED AREAS

ICAI SM

- 93. Modified Opinion on complete set of FS & unmodified opinion on specific element**
CA P is auditor of a company responsible for auditing complete set of financial statements. He intends to express **adverse opinion on complete set of financial statements** considering conclusions drawn by him during course of audit. He is also auditing trade receivables of company for the same period in a separate engagement. Can he express **unmodified opinion in respect of trade receivables**? If so, discuss those circumstances.
- Ans.** Adverse opinion or disclaim an opinion on the entity's complete set of FS as a whole but, an unmodified opinion on that specific element that is included in those FS, the auditor shall only do so if (conditions):
- The auditor is **not prohibited by law or regulation** from doing so;
 - That opinion is expressed in an auditor's report that is **not published together** with the auditor's report containing the adverse opinion or disclaimer of opinion; and
 - The specific element **does not constitute a major portion** of the entity's complete set of FS (SA 805).
- 94. Adverse opinion on complete FS & unmodified opinion on separate engagement**
CA Rajni is appointed as the statutory auditor of STS Ltd. for the financial year 2023-24 for auditing complete set of financial statements. The company has also assigned the audit of Property, Plant and Equipment to CA Rajni as a separate engagement for the financial year 2023-24. While drafting the audit report of complete set of financial statements, CA Rajni decides to give an adverse opinion based on the audit observations noted during the course of audit. At the same time, she is also finalizing the audit report of the separate engagement where she wants to give an unmodified opinion.
Comment with reference to the relevant Standard of Auditing regarding the opinion to be given by CA Rajni in audit report of separate engagement of audit of Property, Plant and Equipment. **(Nov-2024)**
- Ans.** **Audit Report of Separate Engagement of Audit of PPE:** As per SA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement", if the auditor undertakes an engagement to report on a single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor shall express a separate opinion for each engagement. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole but, in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element, the auditor shall only do so if:
- The auditor is not prohibited by law or regulation from doing so;
 - That opinion is expressed in an auditor's report that is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion; and
 - The specific element does not constitute a major portion of the entity's complete set of financial statements.
- In the given situation, CA Rajni is statutory auditor of STS Ltd. for the financial year 2023-24 for the complete set of financial statements and has also assigned the audit of PPE as a separate engagement for the same financial year. Considering the same, it can be concluded that CA Rajni can give separate opinion on separate engagement i.e. adverse opinion for statutory audit and unmodified opinion for separate engagement provided the above conditions are satisfied.
- 95. Adverse opinion on audited FS**
CA Y is auditor of a company. He has expressed **adverse opinion on audited financial statements**. What additional points he has to keep in mind while expressing **opinion on summary financial statements** derived from such audited financial statements?

Ans.

**Adverse opinion**

- (a) State that auditor's report on audited FS contains adverse opinion or disclaimer of opinion;
 (b) Describe the basis for such opinion; and
 (c) State that, due to such opinion, it is inappropriate to express an opinion on summary FS.

96.

Opinion on Summary FS

When auditor's report on the audited financial statements contains a **qualified opinion**, but the auditor is satisfied that the **summary financial statements are a fair summary** of the audited financial statements, in accordance with the applied criteria, which other matters shall the auditor's report on the summary financial statements contain in addition to elements of auditor's report described in SA 810?

If **summary financial statements are not a fair summary** of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, what are implications for auditor's opinion on summary financial statements?
(MTP-May-2024, SM)

Ans.



When the **auditor's report** on the audited financial statements **contains a qualified opinion**, but the auditor is satisfied that the **summary financial statements are consistent**, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements of auditor's report on summary financial statements described in SA 810: -

- (a) **State that the auditor's report on the audited financial statements contains a qualified opinion** and
 (b) **Describe:**
 (i) The **basis** for the qualified opinion on the audited financial statements, and that qualified opinion; and
 (ii) The **effect thereof** on the summary financial statements, if any:

If the **summary financial statements are not consistent**, in all material respects, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, **and management does not agree to make the necessary changes**, the auditor shall **express an adverse opinion** on the summary financial statements.

Note

Chapter 9

AUDIT – RELATED SERVICES

97. Evaluating & Specific Element & Precautions Undertaken

Brown Enterprises Limited has huge funds locked up in its trade receivables standing at around ₹ 100 crores as on 31st December, 2023. The management of the company wants to **evaluate validity of the trade receivables** to ensure reliability of financial reporting at the year end. The accounts department has provided a list of trade receivables to the management containing about 1000 names, their balances and contact/communication details spread in different parts of the country. The company's management has requested CA. Karuna to take up this assignment and prepare a report for management in accordance with professional standards. Despite not being statutory auditor of the company, she decides to accept above engagement.

- By explaining nature of engagement described above, discuss whether it was proper for her to accept such engagement.
- While reporting, which precautions should be taken by her so that readers of the report do not misunderstand its scope? **(RTP-May-2024, SM)**

Ans.



- The **above situation involves** an engagement to **perform agreed-upon procedures**. In such an engagement, the **auditor** is engaged by the client to **issue a report of factual findings based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement**.

The management has requested CA. Karuna to take up the assignment and prepare report for management in accordance with professional standards. Such type of engagement and its reporting falls in purview of SRS 4400. The **reference to auditor in SRS 4400 does not imply** that a person performing related services need necessarily be the auditor of entity's financial statements. Hence, a **person performing related services need not necessarily be auditor of entity's financial statements. Therefore, it was proper for CA. Karuna to accept above engagement.**

- While reporting, she should take following **precautions** so that readers of report do not misunderstand its scope: -
 - A **statement** that the **procedures performed do not constitute** either an **audit or a review** and, as such, no assurance is expressed.
 - A **statement that**, had the **auditor performed additional procedures**, an audit or a review, other matters might have come to light that would have been reported.
 - A **statement that** the **report is restricted to those parties that have agreed to the procedures** to be performed.
 - A **statement** (when applicable) **that the report relates only to the elements, accounts, items or financial and non-financial information specified** and that it does not extend to the entity's financial statements taken as a whole.

98. SRS 4410 – Unable to complete engagement

You have been appointed to **compile the financial statements** of the Kings & Company (a partnership firm) for tax purposes. During the course of your work, you discover that the **inventory is grossly understated**, and the company has failed to apply applicable standards on accounting. On pointing out the same, the partners of the Kings & Co., inform you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment. **(MTP-May-2024, SM)**

Ans.



- As per SRS 4410, "Compilation Engagements", if the practitioner is unable to complete the engagement** because management has **failed to provide records, documents, explanations or other information**, including significant judgments, as requested, the practitioner shall **withdraw** from the engagement **and inform** management and those charged with governance of the reasons for withdrawing.

- (2) If the **practitioner becomes aware** during the course of the engagement that:
- The compiled financial information does **not adequately refer to or describe the applicable financial reporting framework**
 - Amendments** to the compiled financial information are required for the financial information not to be materially misstated; or
 - The compiled financial information is **otherwise misleading** the practitioner shall propose the appropriate amendments to management.
- (3) **If management declines, or does not permit** the practitioner to **make the proposed amendments** to the compiled financial information, the practitioner shall **withdraw** from the engagement **and inform** management and those charged with governance of the **reasons** for withdrawing.
- (4) **If withdrawal** from the engagement is **not possible**, the practitioner shall **determine the professional and legal responsibilities** applicable in the circumstances.
- The practitioner shall **obtain an acknowledgement** from management or those charged with governance, as appropriate, that they have taken **responsibility for the final version of the compiled financial information**.

99. Agreeing the terms of engagement with management

The practitioner shall not accept the compilation engagement unless the practitioner has agreed the terms of engagement with management, and the engaging party if different. In view of the above, mention the responsibilities of the management to be agreed on for the compilation engagement in accordance with SRS 4410. **(MTP-Nov-2024, SM)**

Ans.



The **practitioner shall not accept the compilation engagement unless the practitioner has agreed the terms of engagement** with management, and the engaging party if different. **In accordance with SRS 4410, "Compilation Engagement", the responsibilities of the management** to be agreed on for the compilation engagement **are that:**

- The **financial information, and for the preparation and presentation thereof**, in accordance with a financial reporting framework that is **acceptable** in view of the intended use of the financial information and the intended users
- Design, implementation and maintenance of such internal control as management determines is necessary** to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error
- The **accuracy and completeness of the records, documents, explanations and other information** provided by management for the compilation engagement and
- Judgments needed** in the preparation and presentation of the financial information, including those for which the practitioner may provide assistance in the course of the compilation engagement

100. Engagement Letter

ATP Limited, a large manufacturing company is planning to invest funds in RS Ltd. with a future vision of taking over the company at a later stage. On studying the financial statements of RS Ltd., the investing company wants to get detailed status regarding the Accounts receivable and Inventory appearing in the Balance Sheet. ATP Limited approached you to perform agreed upon procedures for the two elements of financial statement of RS Ltd. and submit a detailed report for the same. As the engagement partner, you are responsible for drafting the engagement letter. Enumerate the key matters that need to be agreed to form a clear understanding regarding agreed upon procedures and the conditions of the engagement. What matters will you include in the engagement letter addressed to the management of ATP Ltd.? **(Nov-2024)**

Ans.

As per SRS 4400 "Engagements to Perform Agreed-upon Procedures regarding Financial Information", matter to be agreed and would be included in the engagement letter are given as under:

A. Matters to be agreed include the following:

- Nature of the engagement including the fact that the procedures performed will not constitute an audit or a



review and that accordingly no assurance will be expressed.

- (b) Stated purpose for the engagement.
- (c) Identification of the financial information to which the agreed-upon procedures will be applied.
- (d) Nature, timing and extent of the specific procedures to be applied.
- (e) Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

B. Matters that would be included in the engagement letter include:

- A listing of the procedures to be performed as agreed upon between the parties.
- A statement that the distribution of the report of factual findings would be restricted to the specified parties who have agreed to the procedures to be performed.

101.

Purpose and Reporting: Compilation Engagement

Compilation engagement is an engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework and issues a report.

- (i) For what purposes may the financial information prepared under such an engagement be required?
- (ii) Briefly discuss the elements of Practitioner's report for such engagement. **(RTP-May-2025)**

Ans.



- (i) As **per SRS 4410, "Compilation Engagements"**, financial information that is the subject of a compilation engagement may be required for various purposes including:
 - To comply with mandatory periodic financial reporting requirements established in law or regulation, if any or
 - For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example:
 - For management or those charged with governance, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for **internal use**).
 - For periodic financial reporting undertaken for **external parties** under a **contract** or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).
 - For **transactional purposes**, for example, to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).
- (ii) The **practitioner's report** issued for the compilation engagement shall be in writing, and shall include the following elements: -
 - (a) The report title;
 - (b) The addressee(s), as required by the terms of the engagement;
 - (c) A statement that the practitioner has compiled the financial information based on information provided by management;
 - (d) A description of the responsibilities of management, or those charged with governance as appropriate, in relation to the compilation engagement, and in relation to the financial information;
 - (e) Identification of the applicable financial reporting framework and, if a special purpose financial reporting framework is used, a description or reference to the description of that special purpose financial reporting framework in the financial information;
 - (f) Identification of the financial information, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates;
 - (g) A description of the practitioner's responsibilities in compiling the financial information, including that the engagement was performed in accordance with this SRS, and that the practitioner has complied with relevant ethical requirements;
 - (h) A description of what a compilation engagement entails in accordance with this SRS;
 - (i) **Explanations that:** -

- (i) Since a compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation; and
- (ii) Accordingly, the practitioner does not express an audit opinion or a review conclusion on whether the financial information is prepared in accordance with the applicable financial reporting framework.
- (j) If the financial information is prepared using a special purpose financial reporting framework, an explanatory paragraph that:
 - (i) Describes the purpose for which the financial information is prepared and, if necessary, the intended users, or contains a reference to a note in the financial information that discloses this information; and
 - (ii) Draws the attention of readers of the report to the fact that the financial information is prepared in accordance with a special purpose framework and that, as a result, the information may not be suitable for other purposes;
- (k) The date of the practitioner's report;
- (l) The practitioner's signature; and
- (m) The place of signature.

Note:

Chapter 10

REVIEW OF FINANCIAL INFORMATION

ICAI SM - Direct Questions

- 102. Acceptance and Continuance of a Review Engagement**
 CA Amar has been approached by a company to undertake a review of its historical financial statements under SRE 2400. During preliminary discussions, the practitioner observes that:
- Certain key financial information may not be available.
 - Management has imposed restrictions on the scope of work.
 - There are concerns regarding management's integrity and compliance with ethical requirements, including independence.
- In the above circumstances, explain the factors affecting the acceptance and continuance of a review engagement. Also state the situations in which, unless required by law or regulation, the practitioner should not accept the review engagement. **(RTP-May-2026)**

Ans.



As per SRE 2400 "Engagements to Review Historical Financial Statements", the practitioner shall comply with relevant ethical requirements, including those pertaining to independence and the engagement partner is responsible for overall quality of each review engagement.

Factors affecting Acceptance and Continuance of Client Relationships and Review Engagements

Unless required by law or regulation, the practitioner shall not accept a review engagement if:

- The practitioner is not satisfied:
 - That there is a rational purpose for the engagement. Assurance engagements may only be accepted when the engagement exhibits certain characteristics that are conducive to achieving the practitioner's objectives specified for the engagement.
 It may be unlikely that there is a rational purpose for the engagement if, for example, there is a significant limitation on the scope of work or the practitioner suspects association of the practitioner's name with the financial statements in an inappropriate manner. Similarly, when the engagement is intended to meet compliance requirements of relevant law or regulation and such law or regulation requires the financial statements to be audited, there is no rational purpose for such a review engagement.
 - That a review engagement would be appropriate in the circumstances. When the practitioner's preliminary understanding of the engagement circumstances indicates that accepting a review engagement would not be appropriate, the practitioner may consider recommending that another type of engagement be undertaken. Depending on the circumstances, the practitioner may, for example, believe that performance of an audit engagement would be more appropriate than a review. In other cases, if the engagement circumstances preclude the performance of an assurance engagement, the practitioner may recommend a compilation engagement, or other accounting services engagement, as appropriate.
- The practitioner has reason to believe that relevant ethical requirements, including independence, will not be satisfied.
- The practitioner's preliminary understanding of the engagement circumstances indicates that information needed to perform the review engagement is likely to be unavailable or unreliable.
- The practitioner has cause to doubt management's integrity such that it is likely to affect proper performance of the review or
- Management or those charged with governance impose a limitation on the scope of the practitioner's work in the terms of a proposed review engagement such that the practitioner believes that the limitation will result in the practitioner disclaiming a conclusion on the financial statements.

- 103. Objective of Review**
 MK Limited, a company engaged in the manufacture of modular furniture, is headquartered at Mumbai. The company is recently listed at the recognized stock exchange in the month of July, 2024. CD & Co., chartered

accountants, are statutory auditors of the company for the F.Y. 2024-25. The company has approached statutory auditors for providing quarterly review report pursuant to requirement of SEBI to provide quarterly results of the company in accordance with SRE 2410. Elucidate the objective of the engagement assigned by the company to the statutory auditors. **(Sept-2025)**

Ans.



Objective of engagement to review interim financial information: As per SRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity", the objective of an engagement to review interim financial information is: -

1. To enable the auditor to express a conclusion whether, on the basis of the review, anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with an applicable financial reporting framework.
2. The auditor makes inquiries and performs analytical and other review procedures in order to reduce to a moderate level risk of expressing materially misstated.
3. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with Standards on Auditing (SAs). A review of interim financial information does not provide a basis for expressing an opinion on whether the financial information gives a true and fair view, or is presented fairly, in all material respects, in accordance with an applicable financial reporting framework.
4. A review, in contrast to an audit, is not designed to obtain reasonable assurance that the interim financial information is free from material misstatement. A review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.
5. A review may bring significant matters affecting the interim financial information to the auditor's attention, but it does not provide all of the evidence that would be required in an audit.

104.

Inquiry & Analytical Procedures to Obtain SAAE

In a review engagement performed under SRE 2400, practitioner relies mainly on certain procedures. Naming such procedures, discuss importance of these procedures in a review engagement.

Practitioner's report containing outcome of review engagement in form of "conclusion" also contains a description of a review of financial statements and its limitations. **Which statements in this respect are to be included in practitioner's report in accordance with SRE 2400?** **(MTP-May-2024, SM)**

Ans.



In a review engagement performed under **SRE 2400, the practitioner performs primarily inquiry and analytical procedures to obtain sufficient appropriate evidence** as the basis for a conclusion on the financial statements as a whole expressed in accordance with the requirements of SRE 2400.

In a review engagement, evidence obtained through **inquiry is often the principal source of evidence** about management intent. Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause the practitioner to believe that the financial statements may be materially misstated. Performing inquiry procedures **also assists the practitioner in obtaining or updating the practitioner's understanding of the entity and its environment**, to be able to identify areas where material misstatements are likely to arise in the financial statements.

In a review of financial statements, performing **analytical procedures assists the practitioner in:-**

- **Obtaining or updating the practitioner's understanding** of the entity and its environment, including to be able to identify areas where material misstatements are likely to arise in the financial statements.
- **Identifying inconsistencies or variances** from expected trends, values or norms in the financial statements such as the level of 13 congruence of the financial statements with key data, including key performance indicators.
- Providing **corroborative evidence** in relation to other inquiry or analytical procedures already performed.
- **Serving as additional procedures** when the practitioner becomes aware of matters that cause the practitioner to believe that the financial statements may be materially misstated. An example of such an additional procedure is a comparative analysis of monthly revenue and cost figures across profit centers, branches or other components of the entity, to provide evidence about financial information contained in line items or disclosures contained in the financial statements.

In a review engagement, practitioner's report contains a **description of a review of financial statements and its limitations**, and the following statements in this respect: -

- A review engagement under this SRE is a **limited assurance engagement**.
- The practitioner performs **procedures**, primarily consisting of making inquiries of management and others

- within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained and
- The **procedures performed in a review are substantially less** than those performed in an audit conducted in accordance with Standards on Auditing (SAs), and, accordingly, the practitioner does not express an audit opinion on the financial statements.

105. Steps in case of doubt over entity's ability to continue as GC

A review of financial statements includes consideration of the entity's ability to continue as a going concern. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern. Enumerate the steps to be taken by the practitioner for the same. **(MTP-Nov-2024, SM)**

Ans.


As per SRE 2400, "Engagements to Review Historical Financial Statements", a review of financial statements includes consideration of the entity's ability to continue as a going concern. **If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern, the practitioner shall:**

- Inquire** of management about **plans for future actions** affecting the entity's ability to continue as a going concern and about the **feasibility of those plans**, and also **whether** management believes that the **outcome of those plans** will **improve** the **situation** regarding the entity's ability to continue as a going concern.
- Evaluate** the **results of those inquiries**, to consider whether management's responses provide a sufficient basis to: -
 - Continue to present** the **financial statements on the going concern basis** if the applicable financial reporting framework includes the assumption of an entity's continuance as a going concern or
 - Conclude whether** the **financial statements are materially misstated** or are otherwise misleading regarding the entity's ability to continue as a going concern.
- Consider management's responses** in light of all relevant information of which the practitioner is aware as a result of the review.

106.
Reporting

Glow management Ltd., a workspace operator, seeks to secure funding from investors. The funds will be used for repayment of debt and cost of capital for strengthening its Balance sheet. To support this, the company has prepared its financial statements for the year ended March 31, 2025. The investors request a limited assurance review rather than a full audit, to ensure the reliability of the financial statements. The management of Glow management Ltd. engages an independent practitioner CA Kishore to perform a review engagement under SRE 2400. During the review, CA Kishore identifies that there was significant increase in deferred revenue. On inquiry, CA Kishore found management's explanation unreasonable that it is related to advances received for upcoming projects and was unable to corroborate this with contracts.

Based on the evidence gathered and procedures performed, CA Kishore determines, that the financial statements are materially misstated. He is bound to express a qualified conclusion, as the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements.

In the above context, you are required to help CA Kishore to:

- State the phrases to be used in conclusion paragraph as appropriate.
- State the matters to be included in the basis for conclusion paragraph. **(May-2025)**

Ans.


- As per SRE 2400, "Engagements to Review Historical Financial Statements", when the practitioner expresses a qualified conclusion on the financial statements because of a material misstatement, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate: -
 - "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects), in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework) or
 - "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial

(ii) In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the practitioner shall: -

- (a) Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures), unless impracticable, in which case the practitioner shall so state;

- (b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or

NOTES:

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Chapter 11

PROSPECTIVE FINANCIAL INFORMATION AND OTHER ASSURANCE SERVICES

ICAI SM

107.

Assurance Report over Controls of SC

Ayurda Ltd. is a fast-growing and award-winning SaaS software company which is headquartered in Mumbai. It also has offices in the UK and provides cloud-based professional services automation (PSA) software solutions to professional services organizations around the world. They want to engage you to provide an **assurance report** for one of its major clients over the **controls it operates as a service organisation**. Can you provide such an assurance report?

Ans.



- This SAE deals with **assurance engagements** undertaken by a professional accountant in public practice to provide a report for use by **user entities** and **their auditors**.
- It **complements SA 402**, in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.
- This SAE applies only when the **service organisation is responsible for**, or otherwise able to make an **assertion about, the suitable design of controls**.
- **Non-Applicability: It does not deal with assurance engagements:**
 - ✓ To **report only on whether controls at a service organisation operated as described**; or
 - ✓ To **report only on controls at a service organisation** other than those relevant to user entities' IC (for example, controls that affect user entities' production or quality control).

108.

Consideration for Exptence

Vishnu & Co. is in process to issue a prospectus containing projected financial statements to provide information about future expectations of the Company to potential investors. You are hired by Vishnu & Co. to examine the projected financial statements and give reports thereon. Briefly mention the factors you will consider before accepting the audit engagement. Also, under what circumstances the engagement should not be accepted or should be withdrawn?

(MTP-Sept-2025)

Ans.



Projected Financial Statements: 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:

- the intended use of the information;
- whether the information will be for general or limited distribution;
- the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- the elements to be included in the information; and
- 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. The auditor should consider the extent to which reliance on the entity's historical financial information is justified. Like in other engagements, it is necessary that terms of engagements should be agreed with client by sending an engagement letter.

109.

Objectives of auditor of user entity

STAR Limited has outsourced its payroll processing functions to a service organization - Little Solutions Private Limited. Little Solutions Private Limited is responsible for accurate preparation of payrolls and timely remittance of statutory dues to the government authorities on behalf of the company. Little Solution Private Limited's controls related to timely remittance of payroll deductions to government authorities are relevant to

the company as late remittances could result in interest and penalties resulting in liabilities for the company. The auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions throughout the year. In this regard, they require an **assurance report from auditors of Little Solutions Private Limited.**

- Why the auditors of STAR Limited require an assurance report from the auditors of Little Solutions Private Limited? Which engagement and quality control standard casts such kind of responsibility upon the auditor?
- Which type of report should be provided by the auditors of Little Solutions? Justify with reasons.
- State matters on which opinion is to be provided by the auditors of Little Solutions. **(RTP-May-2024, SM)**

Ans.



When the user entity uses the services of a service organisation, objectives of auditor of user entity are:

- To obtain an **understanding** of the **nature and significance** of the **services provided** by the **service organisation and their effect** on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and
 - To **design and perform audit procedures** responsive to those risks.
- Therefore, **it is in line with above requirements**, that auditors of STAR Limited require an assurance report from auditors of Little Solutions Private Limited. **SA 402 casts such responsibility on user auditors.**
- In accordance with requirements of SAE 3402, auditors** of Little Solutions Private Limited should **provide a type 2 report** to auditors of STAR Limited. As auditors of STAR Limited want to be sure about description, design and operating effectiveness of controls at Little Solutions Pvt. Ltd. throughout the year and type 2 report deals with such matters, type 2 report should be provided by the auditors of the Little Solutions Pvt. Ltd. Type 2 report is a report on the description, design and operating effectiveness of controls at a service organization whereas type 1 report is a report on the description and design of controls at a service organization.
- The **opinion** of auditors of Little Solutions Pvt. Ltd. **would state whether**, in all material respects, based on suitable criteria: -
 - The **description fairly presents** the **service organization's system** that had been designed and implemented throughout the specified period;
 - The **controls related to the control objectives** stated in the service organization's description of its system were suitably designed throughout the specified period and
 - The **controls tested**, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

110.



Planning and performing & pro forma adjustments

Smart Technology Ltd. plans to issue a prospectus to raise capital through a public offering. Smart Technology Ltd. acquired Cloud Computing Ltd., a leader in cloud advisory services, to strengthen its capabilities in providing cloud solutions and this acquisition aligned for a digital transformation strategy. The prospectus includes pro forma financial information to demonstrate the financial effects of a significant acquisition completed recently. As the engagement practitioner, you are entrusted with providing an assurance report on the compilation of this pro forma financial information in accordance with relevant Standard on Assurance Engagement.

Smart Technology Ltd.'s management has provided the following details:

- The source of the unadjusted financial information includes unaudited financial statements for a subsidiary acquired during the year.
- Pro forma adjustments which include Fair value adjustments for acquired assets and liabilities.
- The applicable financial reporting framework is IFRS, with modifications specific to the jurisdiction of operation.

In the above context, answer the following:

- (iv) State the aspects you will consider during planning and performing the Engagement while evaluating the source from which the unadjusted financial information has been extracted.
- (v) As a practitioner you need to obtain evidence about the appropriateness of the pro forma adjustments. Explain what it includes. (May-2025)

Ans.

- (i) **As per SAE 3420, as a practitioner, while planning and performing the engagement, the following aspects must be evaluated regarding the source of the unadjusted financial information:**
 - The practitioner shall obtain evidence about the appropriateness of the source from which the unadjusted financial information has been extracted.
 - If there is no audit or review report on the source from which the unadjusted financial information has been extracted, the practitioner shall perform procedures to be satisfied that the source is appropriate.
 - The practitioner shall determine whether the responsible party has appropriately extracted the unadjusted financial information from the source.
 - The practitioner shall obtain evidence about the appropriateness of the pro forma adjustments.
- (ii) **The practitioner shall obtain evidence about the appropriateness of the pro forma adjustments:** In relation to unadjusted financial information, Pro forma adjustments include:
 - (a) Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration, and
 - (b) Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity and its accounting policies under that framework.

111.

Factors to consider before accepting compilation engagement

The management of S Ltd. requests you to accept an engagement to report on the **compilation of pro forma financial information** to be included in a prospectus. In light of SAE 3420, what factors you will consider regarding the company acknowledging and understanding its responsibility in this matter before accepting engagement?

Ans.



The company's responsibility has to be acknowledged for the following matters:-

- (i) Adequately disclosing and describing the **applicable criteria** to the intended users if these are not publicly available
- (ii) Compiling the **pro forma financial information on the basis of the applicable criteria and**
- (iii) Providing the practitioner with:-
 - a. **Access to all information** (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria
 - b. **Additional information** that the practitioner may request from the responsible party for the purpose of the engagement
 - c. **Access to those within the entity** and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; and
 - d. When needed for purposes of the engagement, **access to appropriate individuals within the acquiree(s) in a business combination.**

Chapter 12

DIGITAL AUDITING AND ASSURANCE

112. Technology-driven changes on ICFR
 KLM Industries Ltd., a mid-sized company engaged in consumer electronics manufacturing, has recently undergone a major digital transformation by implementation of a fully automated production tracking system, cloud-based accounting software, and a blockchain-based vendor payment system. These changes were introduced during the financial year 2024-25. The management believes that these technologies will increase the efficiency and reduce the chances of errors, and hence, have revised the risk assessment accordingly. As an auditor, what steps should you take to evaluate the impact of such technology changes on the company's internal controls and financial reporting? **(MTP-Sept-2025)**

Ans.



Steps that the auditor should take to evaluate the impact of technology- driven changes on the company's internal controls and financial reporting include the following:

- Maintain sufficient professional skepticism when reviewing management's risk assessment for new systems.
- Understand the direct and indirect effects of new technology and determine how its use by the entity impacts the auditor's overall risk assessment.
- Understand how the technologies impact the flow of transactions, assess the completeness of the in-scope ICFR systems, and design a sufficient and appropriate audit response.
- Assess the appropriateness of management's processes to select, develop, operate, and maintain controls related to the organization's technology based on the extent the technology is used.

113. IT Dependencies
 While planning the audit of a company that heavily relies on automated processes, the auditor notices that several key financial reports used for decision-making are system-generated, and data is transferred across multiple IT applications through automated interfaces. Given this scenario, how do such IT dependencies arising from system-generated reports and interfaces develop within an entity's operations? Why is it important for the auditor to identify and understand these IT dependencies in order to design an effective and efficient audit approach? **(MTP-Sept-2025)**

Ans.



IT dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in the financial statements.

System generated reports are the information generated by the IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for the testing, performing substantive tests of details or performing a substantive analytical procedure. e.g. (Vendor master report, customer ageing report).

Interfaces are programmed logic that transfer the data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.

In this manner, IT dependencies arise due to "system generated reports" and "interfaces".

Identifying and documenting the entity's IT dependencies in a consistent, clear manner helps to identify the entity's reliance upon IT, understand how IT is integrated into the entity's business model, identify potential risks arising from the use of IT, identify related IT General Controls and enables us to develop an effective and efficient audit approach.

114. Phishing
 Yuvi, a finance manager at DCB Ltd., received a text message on his mobile phone claiming to be from his bank. The message states that:
 "Dear Customer, Your account has been temporarily suspended due to suspicious activity. To reactivate, please verify your details by clicking on the following link: [sendyourinfo-link.com]. Failure to do so within 24 hours will result in account deactivation. Thank you for banking with us".
 Yuvi is worried about his account security. Which type of phishing cyberattack Yuvi fell victim to? Also explain other types of such phishing attack. **(RTP-May-2025)**

Ans.



The type of phishing cyberattack Yuvi fell victim to is Smishing. It is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.

Other types of phishing cyberattacks are:

Spear Phishing: It is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.

Whaling: A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.

Vishing: Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

115.

Blockchain Technology

Certain studies have suggested that increase in cyber-attacks and rise in global payment processing cost have hit global banking and finance industries enormously. Therefore, such industries are going to place reliance on new technologies such as Blockchain. Blockchain is based on a decentralized and distributed ledger that is secured through encryption. Each transaction is validated by the blockchain participants, creating a block of information that is replicated and distributed to all participants. However, such technology comes with its weaknesses and associated risks.

What are common risks for Blockchain technology? Also discuss probable audit implications where such technology can be used. **(RTP-May-2024, SM)**

Ans.



- (1) The strengths of blockchain can also be its weaknesses. The **inability to reverse transactions and to access data without the required keys make the system secure but** also means that organisations need specific protocols and management processes to ensure that they are not locked out and have clear contingency plans.
- (2) Operating through network nodes could also **expose the organisation to cyber-attacks and data hacks**, so security issues are important.
- (3) Auditors should **consider the appropriate governance and security** around the transactions.
- (4) Although blockchain's core security premise rests on cryptography, there are risk factors associated with it. As blockchain interacts with legacy systems and business partners, concerns related to insecure application programming interfaces (APIs), data confidentiality and privacy cannot be ignored.
- (5) Weak blockchain application development protocols are something auditors cannot overlook. Similarly, **data privacy laws and regulations** may be an area of concern as data are communicated across geographic boundaries. Auditors must be able to determine whether the data put on blockchain will expose the enterprise for non-compliance with applicable laws and regulations.
- (6) Auditors should also **ensure that** the organisation has the **necessary data management processes** which complies with regulations. The regulatory landscape is still evolving for blockchain so audit teams should **check that compliance managers are following developments constantly and adapting processes accordingly.**

116.

IT dependencies

IT dependencies also arise due to "system generated reports" and "interfaces". How do such IT dependencies arise? Why it is important to identify IT dependencies to develop an effective and efficient audit approach?

(MTP-May-2024, SM)

Ans.



- (1) IT dependencies are **created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in the financial statements.**
- (7) **System generated reports** are the information generated by the IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of

entity information used by us when selecting items for the testing, performing substantive tests of details or performing a substantive analytical procedure. e.g. (Vendor master report, customer ageing report).

- (3) **Interfaces** are **programmed logic** that **transfer** the **data** from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.
- (4) In this manner, IT dependencies arise due to “system generated reports” and “interfaces”.
- (5) Identifying and documenting the entity’s IT dependencies in a consistent, clear manner **helps to identify the entity’s reliance upon IT**, understand **how** IT is **integrated into** the **entity’s business model**, **identify potential risks** arising from the use of IT, identify related **IT General Controls** and enables us to **develop** an effective and efficient **audit approach**.

117.

Examples of technology risks

Gravity Ltd. is a medium-sized manufacturing company that is planning to implement a new digital system to streamline its production processes and improve efficiency. The company appointed Mr. Ravi as IT manager. However, he is aware that emerging technologies can bring significant benefits but also pose various risks to the organization. In this context, he needs to identify examples of technological risks associated with the implementation of the new digital system and the control considerations necessary to mitigate these risks effectively.
(MTP-May-2024, MTP-May-2025, SM)

Ans.



Some examples of technology risks where Mr. Ravi should test the appropriate controls for relying on the digital systems

- Reliance on systems or programs that are **inaccurately processing data, processing inaccurate data**, or both
- **Unauthorized access to data** that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- The possibility of information technology personnel **gaining access privileges beyond those necessary** to perform their assigned duties, thereby leading to insufficient segregation of duties
- **Unauthorized or erroneous changes to data** in master files
- **Unauthorized changes to systems or programs**
- **Failure to make** necessary or appropriate **changes** to systems or programs
- **Inappropriate manual intervention**
- **Potential loss of data** or inability to access data as required
- **Risks introduced** when using third-party service providers
- **Cybersecurity risks**

Mr. Ravi should focus on the following control considerations to mitigate risks effectively:

1. Auditors should gain a holistic **understanding of changes in the industry and the information technology** environment to effectively evaluate management’s process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should **consider risks** resulting from the implementation of new technologies and **how those risks** may **differ** from those that arise from more traditional, legacy systems.
3. Auditors should **consider whether digital upskilling or specialists are necessary** to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

118.

IoT -Meaning, Key Components Example, Associated Risk & Audit Implications

Mr. Karan is a consultant tasked with helping a mid-sized manufacturing company modernize its operations by integrating Internet of Things (IoT) technology. The company wants to connect various devices such as

manufacturing equipment, smart home security systems for their facility, and inventory management systems. They aim to leverage IoT to improve operational efficiency, predict equipment maintenance needs, and enhance overall security. However, they are concerned about the potential risks and the impact on their audit processes. Describe the key components and benefits of IoT, the risks associated with IoT implementation, and the implications for the company's audit processes. How should the company address these concerns to ensure a smooth transition?

(RTP-Nov-2024, SM)

Ans.

Internet of Things: IoT is the concept of connecting any device (cell phones, coffee makers, washing machines, and so on) to the internet.

Key components of IoT are data collection, analytics, connectivity, and people and process. IoT not only changes the business model, but also affects the strategic objectives of the organisation. The risk profile of the entity changes with exposure to new laws and regulations.

Example

- (i) Connected Cars, connected manufacturing equipment's, smart home security, (The options for home security from doorbell cameras or outdoor cameras - users can view video feeds when they are away from home).
- (ii) Data from machines can be used to predict whether equipment will break down, giving manufacturers advance warning to prevent long stretches of downtime.
- (iii) Refrigerator placing an order with a grocery store whenever the supply of eggs falls below a certain number.
- (iv) Smart oven works by scanning QR or bar codes and connecting to Wi-Fi, which it then uses to determine the best temperature and time to cook the food to avoid undercooking or burning.
- (v) Researchers use IoT devices to gather data about customer preferences and behavior, though that can have serious implications for privacy and security.

Common risks of IoT:

The key risks associated with IoT including, device hijacking, data siphoning, denial of service attacks, data breaches and device theft.

Audit Implications

A shift to connected devices and systems may result in auditors not being able to rely only on manual controls. Instead, auditors may need to scope new systems into their audit. Audit firms may need to train and upskill auditors to evaluate the design and operating effectiveness of automated controls.

Consumer-facing tools that connect to business environments in new ways can impact the flow of transactions and introduce new risks for management and auditors to consider. Consider payment processing tools that allow users to pay via credit card at a retail location through a mobile device. This could create a new path for incoming payments that may rely, in part, on a new service provider supplying and routing information correctly. Auditors would need to consider the volume of those transactions, and the processes and controls related to it.

Notes



Chapter 13

GROUP AUDITS

119.

Consolidated Financial Statements : Applicability

R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its financial statements since the shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As the Statutory Auditor of R Ltd, how would you deal when the consolidated financial statements are to be drawn up in compliance with Ind AS? **(SM, RTP-May-2015, May-2015, May-2019)**

Ans.



- (i) **Provision:-** As per **Section 129(3)** of the Companies Act, 2013,
- Where a **company has one or more** subsidiaries, **including associate company and joint venture**,
 - It shall, in addition to its own financial statements **prepare a consolidated financial statement** of the **company** and of **all the subsidiaries** in the same form and manner as that of its own.
- (ii) **As per Companies (Accounts) Rules, 2014:**
- The **consolidation of financial statements** of the company shall be made in accordance with the **provisions of Schedule III** to the Act and the **applicable accounting standards**.
 - However, a **company which is not required to prepare** consolidated financial statements under the Accounting Standards, **it shall be sufficient if the company complies with provisions** on consolidated financial statements **provided in Schedule III** of the Act.
- (iii) **In case of Investment Company:-** An investment entity **need not present consolidated financial statements** if it is required, in accordance with **Ind AS 110 'Consolidated Financial Statements'**, to measure all of its subsidiaries **at fair value through profit or loss**. A parent shall determine whether it is an investment entity.
- An investment entity is an entity that:**
- obtains funds from one or more investors** for the purpose of providing those investor(s) with investment management services;
 - commits to its investor(s) that its **business purpose** is to invest funds solely **for returns** from **capital appreciation, investment income, or both**; and
 - measures and evaluates** the performance of **substantially all of its investments** on a **fair value basis**.
- (iv) **In the given case:-** R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its financial statements since the shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation.
- (v) **Conclusion:-** As per **Ind AS 110**, there is **no exemption for temporary control** where the shares are held as stock in trade, even though **there is an exemption under AS 21**. Hence **consolidation is mandatory for Ind AS compliant financial statement in this case**.

Therefore, **R Ltd. is required to prepare Consolidated Financial Statements** including S Ltd. as a subsidiary company in accordance with Ind AS 110. The auditor is required to ensure the compliance of the same. In case the management does not agreed for the same the auditor may modify the report accordingly.

120.

Consolidated Financial Statements: Applicability

H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.

(RTP-Nov-2023, RTP-Nov-2018, Nov-2018, SM)

Ans.



- (i) **Provision:-** As per **Section 129(3)** of the Companies Act, 2013,
- Where a **company has one or more subsidiaries, including associate company and joint venture**,
 - It shall, in addition to its own financial statements **prepare a consolidated financial statement** of the **company** and of **all the subsidiaries** in the same form and manner as that of its own.
- (ii) **As per Companies (Accounts) Rules, 2014:**
- The **consolidation of financial statements** of the company shall be made in accordance with the **provisions of Schedule III** to the Act and the **applicable accounting standards**.
 - However, a **company which is not required to prepare** consolidated financial statements under the Accounting Standards, **it shall be sufficient if the company complies with provisions** on consolidated financial statements **provided in Schedule III** of the Act.
- (iii) **In case of Investment Company:-** An investment entity **need not present consolidated financial statements** if it is required, in accordance with **Ind AS 110 'Consolidated Financial Statements'**, to measure all of its subsidiaries **at fair value through profit or loss**. A parent shall determine whether it is an investment entity.
- An investment entity is an entity that:**
- obtains funds from one or more investors** for the purpose of providing those investor(s) with investment management services;
 - commits to its investor(s) that its **business purpose** is to invest funds solely **for returns** from **capital appreciation, investment income, or both**; and
 - measures and evaluates** the performance of **substantially all of its investments** on a **fair value basis**.
- (iv) **In the given case:-** H Limited is an **investment company** preparing its financial statements in accordance with **Ind AS** and the company had invested **25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd.** of the respective share capitals of the investee companies. In view of provisions discussed in **Ind AS 110**, the Company is **not required to prepare consolidated financial statements** however, for the compliance of Companies (Accounts) Rules, 2014, **it shall be sufficient if the company complies with provisions** on consolidated financial statements **provided in Schedule III** of the Act.
- (v) **Conclusion:-** Thus, **it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law** and **if they give some exemption it should be followed**. If out of exemption some subsidiaries are not consolidated then list should be disclosed in notes to accounts with reason.

121.

Consolidated Financial Statements: Applicability

M & B Investments Ltd. is a company having paid up share capital of ₹ 1 Crore, It has a subsidiary, Investors Fund Management Ltd. Major business of M & B Investments Ltd. is to pool money from investors on a collective basis and invest this money in various funds. This company pooled ₹ 10 Crore from a number of clients, which represent the Company's shareholders.

While auditing books of accounts of M & B Investments Ltd. CA X observed that whole amount of ₹ 10 crore pooled has been invested in shares and debentures of various companies and profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company.

Now, CA X raised an issue while auditing financial statements of M & B Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013 ? Analyse the above issue and give your opinion.

(Dec-2021, RTP-May-2025, MTP-May-2025)

Ans.



- (i) **As per section 129(3) of the Companies Act, 2013:**
- Where a company has **one or more subsidiaries or associate companies**,
 - It shall, in addition to its own financial statements **prepare a consolidated financial statement** of the company and of **all the subsidiaries and associate companies**
 - In the **same form and manner** as that of its own and in accordance with the **applicable accounting standards**.
- (ii) **As per section 129(6) of the Companies Act, 2013:**

- The **Central Government** may, on **its own or on an application** by a class or classes of companies, by notification, **exempt any class or classes of companies** from complying with any of the requirements of section 129 or the rules made thereunder.
- **An investment entity is an entity that:**
 - (a) **obtains funds from one or more investors** for the purpose of providing those investor(s) with investment management services;
 - (b) commits to its investor(s) that **its business purpose is to invest funds** solely for returns from capital appreciation, investment income, or both; and
 - (c) **measures and evaluates** the performance of substantially all of its investments on a fair value basis.

(iii) As per Ind-AS 110:

- An investment entity need **not present consolidated financial statements** if it is required, in accordance with **paragraph 31 of Ind AS 110**, to measure all of its subsidiaries **at fair value through profit or loss**. A parent shall determine whether it is an investment entity.
- However, as per **paragraph 33 of Ind AS 110**, parent of an investment entity **shall consolidate all entities** that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

(iv) Conclusion:-Applying the above to the **given case of M&B Investment Ltd**, which fulfils all the conditions stated above, **it is an investment entity**. By applying **Para 31 and 33 of Ind AS 110**, it can be concluded that M&B Investment Ltd is **not required to consolidate as per Section 129 (3) of the Companies Act, 2013**.

122.

Consolidation of Financial Statement

Girdhar Ltd. owns 61% voting power in Meera Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. Girdhar Ltd. represents that while preparing Consolidated Financial Statements, Meera Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal? **(MTP-Nov-2024)**

Ans.



Provision:

- (1) **As per Ind AS 110**, there is no such **exemption for 'temporary control'**, or **"for operation under severe long-term funds transfer restrictions"** and **consolidation is mandatory for Ind AS compliant financial statement** in this case.
- (2) **Paragraph 20 of Ind AS 110 states that** "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".
- (3) However, **as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014**, where a company having subsidiary, which is **not required to prepare consolidated financial statements** under the Accounting Standards, it shall be **sufficient if the company complies with the provisions** on consolidated financial statements **provided in Schedule III** to the Act.
- (4) **In the given case, Girdhar Ltd.'s intention** is disposal of the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is **temporary**,

Conclusion:

Therefore, **Girdhar Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available in the same.**

123.

Reporting: Components Not Audited in case of CFS

RAO & Co., a Chartered Accountant Firm, is appointed as the principal auditor of a listed company, Triumph Ltd. Figures of income and net-worth of five out of seven components of Triumph Ltd., which are its unlisted subsidiaries, is tabulated below for the immediate preceding financial year along with the consolidated amount:-

(₹ in crores)

Particulars	Consolidated	Component 'A'	Component 'B'	Component 'C'	Component 'D'	Component 'E'
Income	300	35	10	70	65	20

Net Worth	800	40	20	140	180	50
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The remaining two components i.e., Component 'F' & Component 'G' of Triumph Ltd. were unaudited. According to Mr. RAO, the engagement partner, Component 'F' is material to the consolidated financial statements whereas Component 'G' is not material to consolidated financial statements and this fact has also been discussed in writing with those charged with governance of Triumph Ltd. and it will also form part of report as a 'Key audit matter' in accordance with SA 701.

What shall be the audit consideration in relation to reporting in case of unaudited components of Triumph Ltd. by RAO & Co. and how RAO & Co. as a principal auditor shall report in case of Component 'F' & Component 'G', respectively? (MTP-May-2021)

Ans.


(i) Provisions related to audit of CFS

- Generally, the **financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures** in the context of a multilocation group audit.
- Such audits and audit procedures **can be performed by the auditor reporting** on the consolidated financial statements or by the components' auditor.
- Where the financial statements of **one or more components continue to remain unaudited**, the auditor reporting on the consolidated financial statements **should consider unaudited components in evaluating a possible modification to his report** on the consolidated financial statements.
- The evaluation is necessary because the auditor (or other auditors, as the case may be) **has not been able to obtain sufficient appropriate audit evidence** in relation to such consolidated amounts/ balances.
- In such cases, the **auditor should evaluate both qualitative and quantitative factors** on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in **SA 705, "Modifications to the Opinion in the Independent Auditor's Report"**.

(ii) In the given situation:- Two out of seven components of Triumph Ltd. have **remained unaudited** where **Component 'F' is material and Component 'G' is not material** to the consolidated financial statements. Since Component 'F' is material, therefore, it may be assumed that **reporting of Key Audit Matter in accordance with SA 701 is being done** for Component 'F' and **not for Component 'G'**.

(iii) Reporting:

- **In case of Component 'F':-** The Principal Auditor needs to consider its impact on the **auditor's opinion** on the consolidated financial statements of the group, in terms of the principles laid down in **SA 705, Modifications to the Opinion in the Independent Auditor's Report**.
- **In case of Component 'G':-** The principal auditor **should make appropriate reporting** under the **"Other Matters"** paragraph, pursuant to **SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs, in the Independent Auditor's Report**.

124.

SA 600- Determination of materiality & observations made by component auditors

CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. and also 15 branches across India. *The Auditors are duly appointed for all the subsidiaries and branches. What should be the considerations of CA H regarding determination of materiality during the audit of consolidated financial statements? How he should deal in his report if there are observations (for instance modification and/or emphasis of matter paragraph in accordance with SA 705/706) made by component auditors?* (May-2022, MTP-Nov-2024, SM)

Ans.


CA. H should **consider the requirement of SA 600, "Using the Work of Another Auditor"**, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements **and he should comply with the requirements of SA 600**.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component **would be done component-wise on a standalone basis**.

However, with regard to **determination of materiality during the audit of consolidated financial**

statements (CFS), the auditor should **consider** the following:

- (i) The auditor is required to **compute the materiality for the group as a whole**. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
- (ii) The parent auditor can also use the materiality computed on the group level to **determine whether the component's financial statements are material to the group** to determine whether they should scope in additional components, and **consider using the work of other auditors** as applicable.
- (iii) The principal auditor also **computes materiality for each component and communicates to the component auditor**, if he believes is required for true and fair view on CFS.
- (iv) The principal auditor also **obtains certain confirmations from component auditors** like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, **while considering the observations** (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the **principles of SA 600 needs to be considered** i.e. **CA H (the parent auditor)** should comply with the requirements of SA 600, "Using the Work of Another Auditor".

125.

Opinion Paragraph of Audit Report

Fam Associates have been appointed auditors of Home Ltd. which acquired 55% shares in Sam Ltd. on 15th October, 2022. During the audit of Home Ltd., the auditors found that the **company has not prepared consolidated financial statements** because, on the date of acquisition, the fair value of certain assets & liabilities has not been ascertained, which is significant and are accounted for on estimated basis only.

Help Fam Associates in framing the opinion paragraph of the audit report.

(Nov-2023)

Ans.



Opinion Paragraph of Audit Report: In the instant case, Home Ltd. acquired 55% shares in Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not correct as the financial statements are materially misstated due to non- consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2023, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion is given below:

As explained in Note X, the Home Ltd. has not consolidated subsidiary Sam Ltd. that the Home Ltd acquired during 2022 because it has not yet been able to determine the fair values of certain material assets and liabilities of subsidiaries at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts.

Had Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

126.

Drafting of report

You are appointed as an auditor of Imperial Industries Limited, a listed company with a turnover of ₹ 3.5 billion, operating through 15 business units and nearly 200 branches across the country. Imperial Industries Limited is a key supplier to the American building and construction market. As an auditor, how will you draft the report in case:

- (a) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework

- Different than that of the Parent?
- (b) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?
- (c) Where the financial statements of one or more components are not audited? **(RTP-Nov-2024)**

Ans.



- (a) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent:** The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well-known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP.

When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies".

When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

- (b) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the**

Parent: Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS").

In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS.

- (c) Where the financial statements of one or more components are not audited:** The financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi-location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

127. Reporting

CA Rajul has been appointed as the statutory auditor of the consolidated financial statements of Nemi Limited for the financial year 2024-25. The consolidated financial statements include the financial statements and financial information of 9 subsidiaries, all of which have been audited by other auditors. The management of

Nemi Limited has provided CA Rajul with the audited financial statements, financial information, and audit reports of these subsidiaries. The following summary information pertains to these subsidiaries for the financial year 2024–25:

Particulars	Amount
Total Assets	₹ 2,200 crore
Total Revenue	₹ 1,400 crore
Net Cash Outflows	₹ 25 crore

Out of the 9 subsidiaries, three are located outside India. Their financial statements have been prepared in accordance with the generally accepted accounting principles (GAAP) of their respective countries and audited in accordance with the auditing standards applicable in those jurisdictions.

How should CA Rajul report this matter in the Independent Auditor's Report on the consolidated financial statements of NEMI Limited for the year 2024–25, in accordance with the applicable Standards on Auditing? Also, draft a suitable paragraph to be included in the auditor's report, making necessary assumptions.

(RTP-Sept-2025, MTP-May-2026)

Ans.



In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors. This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

In the given situation, CA Rajul, the statutory auditor of the consolidated financial statements, is not the auditor of all components included in the consolidation and intends to refer to the work of other auditors, such reference must be made through an Other Matter paragraph in the auditor's report. The draft "Other Matter Paragraph" is as under: -

Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of nine (9) subsidiaries, whose financial statements include total assets of ₹ 2,200 crores as at March 31, 2025, and total revenues of ₹ 1,400 crores and net cash outflow of ₹ 25 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

Three of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

128.


Group Audit - Reporting – Foreign Subsidiary, Different GAAPs

M/s CES & Associates, Chartered Accountants are appointed as auditors for consolidated financial statements of King Ltd. for financial year 2024-25. Pawn Ltd., Rook Ltd., Bishop Ltd. and Queen Ltd. are the subsidiaries of King Ltd. The consolidated financial statements consist of financial statements and financial information of these subsidiaries audited by other auditors. Such financial statements, financial information and auditor's reports of subsidiaries have been furnished by management of King Ltd. to them. Following further information is also available in respect of these subsidiaries for the financial year 2024-25:-

	Total assets ₹ in crore	Total Revenues in crore	Net cash outflows Total assets
Pawn Ltd.	300	440	15
Rook Ltd.	200	330	8
Bishop Ltd.	150	220	12
Queen Ltd.	250	300	10

One Subsidiary company, Queen Ltd. is located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in the respective country and which has been audited by auditors in the respective country under generally accepted auditing standards applicable.

You are required to draft a suitable paragraph based on the above information to be included in the independent auditor's report on consolidated financial statements by making necessary assumptions. **(Sept-2025)**

Ans.
Information to be included in the independent auditor's report on consolidated financial statement where financial statements of subsidiaries are audited by other auditors.

In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors. This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under: -

Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of four (4) subsidiaries, whose financial statements include total assets of ₹ 900 crores as at March 31, 2025, and total revenues of ₹ 1,290 crores and net cash outflow of ₹ 45 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors, and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

One subsidiary company, Queen Ltd., is located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in the respective country and which has been audited by other auditors under generally accepted auditing standards applicable in the respective country. The Holding Company's management has converted the financial statements of Queen Ltd. from accounting principles generally accepted in the respective country to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiary is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us.

Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

129.

Written Representations

TRP Ltd. is a holding company with three subsidiaries namely T Manufacturing Pvt. Ltd., R Traders Ltd. and P Services Pvt. Ltd. While auditing the consolidated financial statements of TRP Ltd., the auditor observed that although management of all the subsidiaries have provided written representations, no formal written representation has been provided by the management of parent company TRP Ltd. acknowledging its responsibility for the true and fair presentation of the consolidated financial statements. Furthermore, the auditor could not find any evidence that the management of the parent company has approved the consolidated financial statements. How should the auditor of the parent company deal with this situation?

(RTP-Jan-2026)

Ans.



SA 580, "Written Representations", requires the auditor to obtain written representations from management and, where appropriate, those charged with governance. The auditor of the consolidated financial statements should obtain evidence that the management of the parent acknowledges its responsibility for a true and fair presentation of the consolidated financial statements in accordance with the financial reporting framework applicable to the parent and that parent management has approved the consolidated financial statements. In addition, the auditor of the consolidated financial statements obtains written representations from parent management on matters material to the consolidated financial statements.

Examples of such representations include:

- (i) Completeness of components included in the CFS;
- (ii) Identification of reportable segments for segmental reporting;
- (iii) Identification of related parties and related party transactions for reporting;
- (iv) Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

In the given situation, the auditor should request written representations from the management of TRP Ltd., specifically acknowledging its responsibility for and approval of the consolidated financial statements. If such written representations are not provided, the auditor should express the opinion accordingly.

130.

Generally accepted auditing standards applicable in their respective countries

CA.MV Chitale is auditor of consolidated financial statements of "D and D Limited" for year 2022-23. The consolidated financial statements consist of financial statements and financial information of 8 subsidiaries audited by other auditors. Such financial statements, financial information and auditor's reports of subsidiaries have been furnished by management of the "D and D Limited" to him. Following further information is also available in respect of these 8 subsidiaries for year 2022 -23:-

Total assets	₹ 1500 crore
Total revenues	₹ 1000 crore
Net cash outflows	₹ 10 crore

Two of these subsidiaries are located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries.

Where and how such information should be included in **the** independent auditor's report on consolidated financial statements of company? Also **draft a suitable para** by making necessary assumptions. **(SA 706 related)**

Ans.



In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, **if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors.** This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under:-

Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of eight (8) subsidiaries, whose financial statements include total assets of ₹ 1500 crores as at March 31, 2023, and total revenues of ₹ 1,000 crores and net cash outflow of ₹ 10 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

Two of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

NOTES:

This image shows a blank sheet of white paper with horizontal blue or grey ruling lines, typical of notebook paper. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

**Chapter
14A**
SPECIAL FEATURE OF AUDIT OF BANK

131.

System of Internal Controls in Banks

You are auditing a small bank branch with staff strength of the manager, cashier and three other staff S1, S2 and S3. Among allocation of work for other areas, S1 who is a peon also opens all the mail and forwards it to the concerned person. He does not have a signature book so as to check the signatures on important communications. S2 has possession of all bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a record meticulously which you have test checked also. However, no one among staff regularly checks that. You are informed that being a small branch with shortage of manpower, it is not possible to always check the work and records. Give your comments.

(MTP-Dec-2021, RTP-May-2021, MTP-May-2023)

Ans.



- (i) Banks are required to **implement and maintain a system of internal controls** for mitigating risks, **maintain good governance** and to meet the regulatory requirements.
- (ii) **Given below are examples of internal controls that are violated in the given situation:**
- **Staff-S1:-** Who is a peon opens all the mail and forwards it to the concerned person. Further, **he does not have a signature book** so as to check the signatures on **important communications** is not in accordance with implementation and maintenance of general internal control.
Comment:- The mail should be **opened by a responsible officer**. Signatures on all the letters and advices received from other branches of the bank or its correspondence **should be checked by an officer with the signature book**.
 - **Staff-S2:-** Has possession of **all bank forms** (e.g. cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.). He maintains a **record meticulously** which were also verified on **test check basis**.
Comment:- All bank forms (e.g. Cheque books, demand draft/pay order books, travelers' cheques, foreign currency cards etc.) should be **kept in the possession of an officer**, and another **responsible officer** should **verify the issuance** and stock of such stationery.
- (iii) **Conclusion:-**Contention of bank that being a small branch with shortage of manpower **they are not able to check the work and records on regular basis, is not tenable** as such lapses in internal control pose risk of fraud. **The auditor should report the same in his report accordingly**

132.

Internal Control on Loans and Advances

You are auditing the branch operations of XS Bank, a scheduled commercial bank, for the year ending 31st March 2025. During the audit of the loans and advances portfolio, you observed the following:

- Advances were sanctioned without proper credit appraisal in some cases.
- Certain loans were sanctioned without adequate documentation like demand promissory notes and hypothecation letters and others where post-disbursement monitoring was weak.
- In several branches, securities were being held by a single officer instead of under joint custody.
- A few loan accounts had exceeded the sanctioned limit and drawing power, but no intimation was given to the Head Office.

On pointing out the above, branch manager replied that they rely on their internal control framework to mitigate such risks. Based on the above situation, explain the internal controls that bank is expected to implement in the area of loans and advances.

(RTP-Sept-2025)

Ans.

Banks are expected to implement the following internal controls in loans and advances are:

- The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank.
- All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.



- Sufficient margin should be kept against securities taken to cover any decline in the value thereof and to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or after detailed scrutiny for specific accounts.
- All the securities should be received and returned by responsible officer. They should be kept in the joint custody of two such officers.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give the title of the bank.
- All accounts should be kept within both the drawing power and the sanctioned limit as per prescribed norms. Additional temporary limit may be sanctioned, for a maximum of 20% of existing limit and 90 days maximum tenure.
- All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
- The operation (in each advance account) should be reviewed at least once every year).

In the given case, the observations made during the audit indicate serious lapses in adherence to internal control procedures relating to credit appraisal, documentation, custody of securities, and monitoring of advance accounts. The branch's reliance on the internal control framework is not substantiated by its execution in practice. The bank must ensure strict compliance with its internal controls and regulatory guidelines to mitigate credit risk and safeguard its interest.

133.
Audit of Banks & Insurance Companies

CA. Sundaram is an engagement partner conducting a statutory audit of a nationalised bank. The bank operates on the CBS platform, and the identification of NPAs is system based in accordance with RBI guidelines on asset classification. He wants to be assured of satisfactory operation of internal control in this respect. He wants to be sure that there exists an internal control system in the bank which not only prevents and reduces the risk of loan assets becoming non-performing at the initial stages but also sends out timely signals to the bank subsequently. He is putting considerable importance on effective credit appraisals due to their role in preventing NPA slippages.

While carrying out a walk-through of internal control over advances of banks especially in areas of "credit appraisals" and "credit monitoring", identify any four specific controls which you may be looking for. **(RTP-Nov-2022)**

Ans.


The **following controls may be considered by auditor in areas of credit appraisals and credit monitoring** for ensuring that internal control over advances is effective and the system is capable of not only preventing and reducing the risk of NPAs at the sanction stage itself but also sending out timely signals to the bank subsequently.

- Use of third-party data sources** in the bank **for comprehensive due diligence** at the sanction stage itself to mitigate risk on account of misrepresentation and fraud.
- Classification of accounts as special mentioned accounts (SMA)** for early recognition of signs of incipient stress resulting in default in timely servicing of debt obligations. It can enable banks to initiate timely remedial actions to prevent potential slippages into NPAs.
- Institution of comprehensive, automated Early Warning Systems (EWS)** in banks with EWS triggers to detect stress and reduce slippage into NPAs
- Reporting of repayment behaviour of borrowers** in their loan accounts to credit information companies and inclusion of this information in the credit appraisal and decision-making process for further sanctioning of loans to borrowers.

134.
Sale of NPAs:

NRF Bank Ltd. is suffering from huge number of NPAs. During the month of April 2023, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (₹ In Lakh)
Fin Pvt. Ltd.	2019-20	36.55

Dairy Works	2021-22	55.24
Book Store	2018-19	29.85
Fancy Corp.	2017-18	61.42
RSM and Associates	2020-21	19.25

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered. **(MTP-May-2024, SM)**

Ans.



Provision: In case of Sale of NPA by Bank, the auditor should examine that:

- The **policy laid down by the Board of Directors in this regard** relating to procedures, valuation and delegation of powers including non- performing financial assets that may be sold, norms or such sale, valuation procedure and accounting policy.
- **Only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.**
- The **assets** have been **sold "without recourse" only** i.e., the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank.
- Subsequent to the sale of the NPA, the bank does **not assume** any **legal, operational or any other** type of **risk** relating to the sold NPAs.
- The NPA has been **sold at cash basis only**. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis.
- The bank has **not purchased an NPA** which it had **originally sold**.
- On the sale of the NPA, the **same has been removed from the books** of the account of selling bank on transfer;
- **If the sale is at a price below the net book value (NBV)** (i.e., book value less provisions held), the **shortfall** should be **debited to the profit and loss account** of that year.
- **If the sale is for a value higher than the NBV**, the **excess provision** shall **not be reversed but** will be **utilised** to meet the shortfall/ loss on account of sale of other non-performing financial assets.

In the given situation, management of NRF Bank Ltd. is considering to sell following NPAs, during the month of April, 2023:

Name	NPA since F.Y.	Amount (₹ in lakh)
Fin Pvt. Ltd.	2019-20	36.55
Dairy Works	2021-22	55.24
Book Store	2018-19	29.85
Fancy Corp.	2017-18	61.42
RSM and Associates	2020-21	19.25

In view of above-mentioned conditions, the auditor is required to **ensure that only such NPA has been sold which has remained NPA** in the books of the bank for at least 2 years.

Considering the facts given in the question **all the NPAs, except for Dairy Works, are prior to April 2021 i.e., 2 years prior to April 2023.**

Conclusion: In view of the above provisions, management of NRF Bank Ltd. **can sell all the NPAs except for NPA of 55.24 lakh rupees of Dairy Works** as it has remained NPA in the books of the banks less than 2-year duration.

135.

NPA Classification

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

Sr. No.	Queries
1	One of the NPAs' was sold for a value higher than the net book value. Profit was not recognized

	but the excess provision in respect of the same has been reversed.
2	Interest in a State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.
3	There is an account for which the ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction and such account has been treated as a performing asset in the books.
4	On verification of outstanding forward exchange contracts, the 'net position' in respect of one of the foreign currencies was not squared and was uncovered by a substantial amount.
5	In the case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit and for 120 days tenure.

Please provide the reasons due to which such queries would have been raised by Mr. Chahal and describe the actions that may be taken by the person responsible on behalf of JOE Bank Ltd. for solving such queries.

(RTP-May-2025)

Ans.



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

136.

NPA

BOT Limited is enjoying cash credit facility sanctioned from Nariman Point, Mumbai branch of KNB Bank for ₹ 250 crore. However, for practical considerations, various sub-limits have been fixed for the borrower company for operation at Solapur, Pune and Nashik branches of the same bank.

The manager of the Solapur branch notices that there are no credit transactions in sub-limit account being operated at the Solapur branch for more than 90 days as on 31st March, 2022.

Discuss the approach of CA. Muni, statutory branch auditor of Nariman Point branch, Mumbai of KNB Bank, in the matter of asset classification of the above borrower account. Also discuss considerations for classifying said account at the Solapur branch.

(RTP-MAY-2023, MTP-Sept-2025)

Ans.

(1) Sometimes, a customer is **sanctioned a cash credit limit at one branch but is authorised to utilise such overall limit at several other branches also, for each of which a sub-limit is fixed.**

(2) **In such a case, the determination of status of the account as NPA or otherwise should be determined at**



the **limit-sanctioning branch with reference to the overall sanctioned limit/drawing power and not by each of the other branches** where a sub-limit has been fixed.

- (3) The **auditor** of the limit-sanctioning branch should **examine whether it receives particulars of all transactions** in the account at sub-limit branches **and whether status of the account** has been determined considering the total position of operation of the account at all concerned branches.
- (4) The standalone matter of no credit transactions for more than 90 days as on 31st March, 2022 at Solapur branch is irrelevant.
- (5) Hence, **keeping in view above**, CA. Muni should **consider asset classification considering the total position of operation of the account at all concerned branches. Regarding sub-limit at branches, the classification adopted** by the limit-sanctioning branch should be followed.
- (6) Hence, the **Solapur branch has to follow asset classification made by the limit-sanctioning branch.**

137.

Cross NPAs & Net NPAs

PQS & Associates are one of the joint auditors of KNO Bank for the year 2022 -23. While auditing KNO Bank, they are analysing industry data relating to NPAs in select public sector banks as part of risk assessment procedures:-

Name of Bank	Gross NPAs (in ₹ crore)	Net NPAs (in ₹ crore)	Ratio of Net NPAs to Net advances
BBi Bank	55,000	13,000	1.72%
DAB Bank	45,000	10,000	2.34%
CNI Bank	55,000	18,000	2.65%
KNO Bank	28,000	6,500	3.97%
BRB Bank	35,000	8,800	2.27%

In the above context, what do you understand by "Gross NPAs" and "Net NPAs" as on reporting date in the context of financial statements of a Bank? As an auditor of KNO Bank, what inference would you draw by comparing the "**Ratio of net NPAs to net advances**" with other public sector banks?

(RTP-Nov-2023, MTP-May-2024, SM)

Ans.



- (1) **Gross NPAs represent opening balances of NPAs as increased by fresh NPAs during the year and reduced by upgradations, recoveries and write-offs during the year.**
- (2) **Net NPAs are arrived at after deducting amounts on account of the total provision held against NPAs/ balance in the interest suspense account to park accrued interest on NPAs and certain other adjustments.**
- (3) The **Net NPAs to Net advances ratio is higher in the case of KNO Bank** as compared to other public sector banks. It **shows** that there is a **risk** that the **bank could not have made the required provisions in accordance with RBI guidelines**. A higher net NPAs to Net advances ratio **indicates the probability and risk of under-provisioning**.
- (4) Keeping in view the above, **audit procedures have to be tailored towards the examination and verification of this crucial area.**

138.



NPA - Substandard asset - Provisioning Rates and Classification

M/s TZ and Associates are appointed as a statutory branch auditors of the Delhi Branch of ABC Bank Limited for the F.Y. 2024-25. CAT is the engagement partner for this assignment. He is verifying the advances and has obtained the list of advances outstanding as on 31 March, 2025. On sampling basis, he selected one account of Mr. X who has borrowed 1.00 crore in the form of housing loan in the year 2021-22. The account was operating positively till 2023-24. Since April 2024, the account was often remaining overdue. On 01.10.2024, Mr. X approached the Branch and requested to increase the repayment period and to reduce the rate of interest as he was facing some financial crunch due to sudden medical emergency in the family. On 01.11.2024, the Branch accepted the proposal of Mr. X and increased the repayment period and reduced the rate of interest. The Branch classified the account of Mr. X as a Standard Asset as on 31.03.2025. CAT insisted the Branch Manager to classify

the account as Sub-standard Asset as on 31.03.2025 as there is a change in the terms of payment. CA T started to draft Memorandum of Changes (MOC) for account of Mr. X to be submitted to the Branch. The rate of provision for secured portion of Sub-standard Assets as prescribed by the Board of ABC Bank Limited is 20% whereas the requirement as per IRAC norms is 15% for secured portion. In this context:

- (i) Justify the classification insisted by CA T regarding the account of Mr. X as on 31.03.2025.
- (ii) Guide CAT in deciding the rate to be applied for secured portion of Sub-standard Asset while finalizing the Memorandum of Changes (MOC).

(Sept-2025)

Ans.

Restructuring of Advances:

- (i) Restructuring is an act in which a lender, for economic or legal reasons relating to borrower's financial difficulty, grants concessions to the borrower. It may involve modification of terms of advances including alteration of amount of instalments/alteration of repayment period/ rate of interest/sanction of additional credit facilities etc. to help in curing default.

Under RBI prudential norms, banks may restructure the accounts classified under standard, substandard or doubtful categories. On restructuring, the account will be downgraded from Standard to Sub-standard whereas NPAs will remain in the same category.

In the given situation CA T selected account of Mr. X whose account was often overdue since April, 2024 but did not become NPA. On 01.11.2024, Bank accepted Mr. X's request to increase the repayment period and reduced rate of interest. Branch classified the account as Standard Asset as on 31.3.2025. However, CA T is of the view that the account should be classified as sub-standard asset as there is change in terms of payment.

Thus, classification insisted by CA T regarding the account of Mr. X as on 31.03.2025 as sub-standard is correct.

- (ii) The Reserve Bank has prescribed objective norms for determining the quantum of provisions required in respect of advances. However, these norms should be construed as laying down the minimum provisioning requirements and wherever a higher provision is warranted in the context of the threats to recovery, such higher provision should be made.

In the given situation, CA T drafted Memorandum of changes for account of Mr. X to be submitted to the branch. Rate of provision for secured portion of sub-standard assets prescribed by Board of ABC Bank Ltd. is 20%, whereas requirement as per IRAC norms is 15%.

Since 15% provisioning prescribed by IRAC norms is minimum requirement, therefore, rate of provision prescribed by ABC Bank Ltd. for secured portion of Sub-standard Asset as 20% as higher provision is in order.

139.

IC on Advances

PDSJ & Associates are Statutory Auditors of a scheduled Commercial Bank for the year 2023-24. While evaluating internal control over advances, it came to their notice that classification of term loan borrower accounts into SMA as well as NPA is done in the system on the following lines:

- In case full dues are not received on a particular due date, a borrower account is immediately considered as overdue on the very next day. For example, if due date of loan account is 31st March, 2023 and dues are not received on 31st March, 2023, it shall be considered as overdue on 1st April, 2023.
- If it continues to remain overdue, then account is tagged as SMA-1 on 1st May, 2023.
- If it continues to remain overdue further, then account is tagged as SMA-2 on 31st May, 2023.

If it continues to remain overdue even after being tagged as SMA-2, it is classified as NPA on 30th June, 2023. Evaluate above control designed by bank in the system for the purpose of exercising control over such advances in compliance to regulatory guidelines.

(RTP-May-2024, SM)

Ans.



- (1) The **design of above control** instituted by bank in its system is **not in accordance with the regulatory guidelines**.
- (2) Any **amount due to the bank under any credit facility is 'overdue'** if it is **not paid on the due date** which is fixed by the bank, the borrower accounts are flagged as overdue by the banks as part of their day-end processes for the due date.

- (3) **Classification** of borrower accounts as **SMA as well as NPA** is done as part of day-end process for the relevant date.
- (4) SMA or NPA classification date is the **calendar date** for which the day end process is run. In other words, the date of SMA/NPA reflects the asset classification status of an account at the day-end of that calendar date.
- (5) **In the given situation, due date** of a loan account is **March 31, 2023**, and **full dues** are **not received** by the bank **before it runs** the **day-end process for this date**, the **date of overdue shall be March 31, 2023** and not 1st April, 2023.
- (6) **If it continues to remain overdue**, then this **account** shall get **tagged as SMA-1** upon running day-end process on **April 30, 2023** [i.e. upon completion of 30 days of being continuously overdue]. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2023.
- (7) Similarly, **if the account continues to remain overdue**, it shall get **tagged as SMA-2** upon running day-end process on **May 30, 2023** and **if continues to remain overdue further**, it shall get **classified as NPA** upon running day-end process on **June 29, 2023**.

140.

Government Guaranteed Advances

In course of audit of Good Samaritan Bank as at 31st March 2022 you observed the following: in a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government? (SM, MTP-May-2021, RTP-May-2020, RTP-Nov-2019, MTP-May-2018, MTP-May-2023)

Ans.

**(i) Classification of Government Guaranteed advances:**

- **The credit facilities backed by Central Government guarantee:-**

Though overdue will be classified as NPA only when the govt. repudiates its guarantee when invoked.

- **Credit facilities backed by State Government guarantee:-** Should be classified as NPA in normal way.

- **This exemption in case of Central Government:-**

Is only for the purpose of asset classification and provisioning and not for the purpose of recognition of income

- **Interest on government guaranteed advances :-**

Should not be taken to Income Account unless it has been realized.

- (ii) In the present case:** Bank has **not revoked the guarantee**, the question of **repudiation does not arise**. Therefore, advance need not be classified as NPA in case of Central Government Guarantee. However, as this exemption is not available in respect of income recognition norms, the income to the extent not recovered should be reversed.

(iii) Conclusion:

- **Bank is correct** to the extent of **not applying the NPA norms** for provisioning purpose. But this **exemption is not available** in respect of **income recognition norms**.
- **The situation would be different** if the advance is guaranteed by **State Government** because this **exception is not applicable** for State Government Guaranteed advances.

141.

Consortium Advance

Your firm ABC Associates is appointed as Central Statutory Auditors of a Nationalised Bank for the year 2023-24. The Bank follows the financial year as accounting year. During the audit, CA Aadi, the Audit Manager has noticed following issues and placed the same before the team.

Particulars

Consortium Cash Credit Facilities to Prime Ltd.	₹ 75 crores
Bank's own Share in Cash Credit Facilities	₹ 15 crores
Debits towards Interest in the Last Two Quarters	₹ 2.25 crores
Credits in Prime Ltd.'s Account in the Last Two Quarters	₹ 1.75 crores
Classification of Prime Ltd.'s Account (Based on Lead Bank's Certificate)	Performing Account

As an auditor, how will you deal with the above mentioned matter?

(RTP-Nov-2024)

Ans.



The bank is a consortium member of cash credit facilities of ₹ 75 crores to Prime Ltd. Bank's own share is ₹ 15 crores only. During the last two quarters against a debit of ₹ 2.75 crores towards interest, the credits in X Ltd.'s account are to the tune of ₹ 1.75 crores only. Sometimes, **several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed.** This is despite the certificate of lead bank to classify that the account as performing. **Accordingly, the amount should be shown as non-performing asset (NPA).**

142.

NPA Classification

During the statutory audit of Fair Bank, you are examining the Cash Credit account of M/s Bright Traders as at 31st March, 2025.

The following facts are observed:

- Sanctioned Limit: ₹ 4 crore
- Outstanding as on 31st March, 2025: ₹ 4.10 crore
- Excess over limit: ₹ 10 lakh for 15 days
- Latest stock statement available: dated 31st January 2025
- Renewal of limit was due on 28th February 2025 and is under process
- Interest is regularly serviced and no amount is overdue beyond 90 days
- Drawing Power is properly calculated based on the stock statement less than 3 months old

The Branch Manager has treated the account as Standard Asset. Examine whether the account requires classification as NPA.

(RTP-May-2026)

Ans.



In the given case, the borrower is enjoying a cash credit facility of ₹ 4 crore and the outstanding balance as on 31st March 2025 is ₹ 4.10 crore. The excess over limit has continued only for 15 days. The latest stock statement available with the bank is dated 31st January 2025, which is within three months from the balance sheet date. The renewal of the limit, though due, is under process. Interest is being serviced regularly and no amount is overdue beyond 90 days.

Banks should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of drawing power based on latest available stock statement, balance outstanding exceeding the limit temporarily and non-renewal of limits on the due date. However, stock statements relied upon by the banks for determining drawing power should not be older than 3 months. The outstanding in the account based on drawing power calculated from stock statements older than 3 months are considered as irregular.

Since the deficiencies in the account are purely temporary in nature, drawing power is based on stock statement not older than three months, and the account has not remained out of order for more than 90 days, the account should not be classified as NPA. Accordingly, the treatment of the account as a Standard Asset by the branch is in accordance with RBI IRAC norms.

143.

M/s LMN & Co., Chartered Accountants, has been appointed as the statutory auditors of Integrity Bank Ltd. for the financial year 2024–25. While reviewing the loans and advances portfolio of one of the major branches of the bank, the audit team examined certain credit files and operational records.

During the course of audit, the following observations were made:

- A cash credit facility of ₹ 12 crore was granted to Bright Metals Pvt. Ltd. mainly on the recommendation

of the branch credit officer. The credit file did not contain adequate evidence regarding appraisal of the borrower's creditworthiness or approval of the competent sanctioning authority.

- (ii) In another borrower account of Rajul Enterprises, the loan amount was disbursed before execution of certain loan documents such as the demand promissory note and letter of hypothecation.
- (iii) Certain pledged securities requiring registration were not registered in the name of the bank and the documents supporting the bank's title were also not found on record.
- (iv) In addition to the pledged securities mentioned in (iii), certain other pledged securities were found to be kept in the custody of a single officer instead of being maintained under joint custody of two responsible officers.
- (v) In certain cash credit accounts secured by inventory, the branch had not maintained the prescribed margin against securities as per the credit policy aligned with the directives of Reserve Bank of India.

Identify the audit lapses evident from the above case in respect of loans and advances of the bank.

(MTP-May-2026)

Ans.



- (i) **Loan granted without proper appraisal and sanction:** In the given case, the cash credit facility granted to Bright Metals Pvt. Ltd. was based mainly on the recommendation of the branch credit officer and the credit file did not contain adequate evidence regarding appraisal of the borrower's creditworthiness or approval by the competent sanctioning authority. As per the control requirements relating to loans and advances in banks, advances should be granted only after the bank satisfies itself regarding the creditworthiness of the borrower and after obtaining sanction from the proper authorities. Hence, granting the advance without proper appraisal and sanction constitutes a lapse.
- (ii) **Disbursement of loan before execution of necessary documents:** The auditor observed that in borrower account of Rajul Enterprises the loan amount was disbursed before execution of loan documents such as the demand promissory note and letter of hypothecation. However, all necessary documents such as agreements, demand promissory notes and letters of hypothecation should be executed before advances are made. Therefore, disbursement of funds before execution of documents represents a procedural lapse.
- (iii) **Securities not registered in the name of the bank:** It was observed that certain pledged securities requiring registration were not registered in the name of the bank and supporting title documents were not available. As per prescribed procedures, all securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to establish the bank's title. Hence, failure to ensure proper registration of securities constitutes a lapse.
- (iv) **Improper custody of securities:** The auditor noticed that certain pledged securities were kept in the custody of a single officer instead of being maintained under joint custody. As per control requirements, all securities should be received and returned by responsible officers and kept in the joint custody of two such officers. Therefore, keeping securities under the custody of a single officer indicates weakness in internal control over safeguarding of securities.
- (v) **Failure to maintain prescribed margin against securities:** In certain cash credit accounts secured by inventory, the branch had not maintained the prescribed margin against securities in accordance with the directives of the Reserve Bank of India. Banks are required to keep sufficient margin against securities to cover any decline in their value and to comply with RBI directives. Hence, failure to maintain the required margin indicates non-compliance with lending norms.

Notes



Chapter 14B

SPECIAL FEATURES OF NON-BANKING FINANCIAL COMPANIES (NBFCs)

144.

NBFC – Deemed NBFC & Registration

ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements:

- (i) Paid-up share capital ₹ 40.53 Cr.
- (ii) Non-Current Assets - Loans & Advances ₹ 55.90 Cr.
- (iii) Current Assets - Loans and advances ₹ 344.47 Cr.
- (iv) Total assets of the company ₹ 530 Cr.
- (v) Intangible assets ₹ 3 Cr.
- (vi) Profit for the Year ₹ 7.25 Cr.
- (vii) Income from interest and dividends ₹ 52 Cr.
- (viii) Gross income ₹ 102.57 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise **(Dec-2021, MTP-Nov-2024, SM)**

Ans.



(I) Provision:- In order to identify a particular company as **Non-Banking Financial Company (NBFC)**, it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. **The company will be treated as NBFC when a company's**

- (i) **Financial assets** constitute more than 50 per cent of the total assets (netted off by intangible assets) and
- (ii) **Income from financial assets** constitute more than 50 per cent of the gross income.

A company which fulfils **both these criteria** shall qualify as an NBFC and would require to be registered as NBFC by RBI.

(II) In the given case of ABC Ltd Its -

Financial Assets are = ₹ 55.90 + ₹ 344.47 = ₹ 400.37 Cr

Total Assets (netted off by intangible assets) = ₹ 527 Cr

Income from financial assets = ₹ 52 Cr

Gross Income = ₹ 102.57 Cr

(III) Conclusion:- From the above, it is clear that ABC Ltd.'s **financial assets** constitute more than 50 per cent of the total assets (netted off by intangible assets) and **income from financial assets** constitutes more than 50 per cent of the gross income. Hence, **ABC Ltd. fulfills both these criteria to qualify as an NBFC**. Thus ABC Ltd. **can apply for registration** under Section 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

145.

Mobilization of Public Deposits (Downgrading of credit facilities)

CA Nadar is conducting the statutory audit of RHL Ltd., a non-banking financial company. It has branches in various parts of India. The company with a focus on housing finance, has outstanding non-convertible debentures worth ₹ 150 Crores. The company reportedly missed interest payments of INR 15 Crores on its debts because of inadequate liquidity. As a result, RHL Ltd. faced a series of downgrades by rating agencies on its debts over the past two months. Rating was cut to D from A4 implying that the company was in default or expected to be in default soon. What aspects CA Nadar should look into in relation to the activity of mobilization of public deposits (particularly in relation to downgrading of credit facilities) by RHL Ltd?

(MTP-May-2023, MTP-May-2022, Nov-2020)

Ans.

CA Nadar has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-

- (i) The **ceiling on quantum of public deposits** has been **linked to its credit rating** as given by an approved **credit rating agency**. In the event of a **upgrading/downgrading** of credit rating, the



auditor should bear in mind that the NBFC will have to **increase/reduce its public deposits** in accordance with the **revised credit rating assigned** to it within a specified time frame and should ensure that the NBF Chas informed about the same to the RBI in writing.

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

146.

Capital adequacy

Instant Finance Ltd. is a Non-Banking Financial Company (NBFC-BL) primarily engaged in providing loans to small businesses and individuals. As per its audited financials for the year ending March 31, 2025, the following information was observed:

- (1) Instant Finance Ltd. has an aggregate risk-weighted asset base of ₹ 1,000 crore.
- (2) The company has reported Tier 1 capital of ₹ 130 crore, which includes ₹ 15 crore raised through perpetual debt instruments.
- (3) Instant Finance Ltd. has investments in shares and bonds of other NBFCs totalling ₹ 10 crore, which amounts to 12% of its owned fund.
- (4) The company's primary business involves lending against gold jewellery, with such loans comprising 60% of its financial assets.

As a statutory auditor, you are entrusted with assessing compliance with the prudential norms prescribed under the Master Direction – Reserve Bank of India (Non-Banking Financial Company Scale Based Regulation) Directions, 2023, regarding capital adequacy.

You are required to:

- (i) Evaluate whether Instant Finance Ltd. complies with the minimum Tier 1 capital requirements as per the RBI prudential norms.
- (ii) Discuss the treatment and impact of perpetual debt instruments in the calculation of Tier 1 capital for NBFCs primarily engaged in lending against gold jewellery.
- (iii) Analyse the adjustment required in Tier 1 capital for Instant Finance Ltd. due to its investments in other NBFCs.

(May-2025)

Ans.



Compliance with Minimum Tier 1 Capital Requirements: As per RBI norms, Instant Finance Ltd. must maintain a minimum capital adequacy ratio of 15 % of aggregate risk-weighted assets. Since 60 % of its financial assets are loans against gold, it must maintain a Tier 1 Capital of at least 12% (₹ 120 Crore) of its risk-weighted assets.

- (i) In the given situation, Instant Finance Ltd. has reported Tier 1 Capital of ₹ 130 crore. However, NBFC-BL are not eligible to include perpetual debt instruments in their Tier 1 capital. Thus, the amount of Tier 1 Capital will be 115 crores (₹ 130-₹ 15 = ₹ 115 crores).

Since, Instant Finance Ltd.'s primary business involves lending against gold jewellery, with such loan comprising of 60% of its financial assets which is exceeding the criteria of 50% or more, thus, Instant Finance Ltd. is required to maintain a minimum Tier 1 capital of 12 percent of aggregate risk weighted assets of on-balance sheet and of risk adjusted value of off-balance sheet items.

Considering the ₹ 120 crore (Aggregate Risk Weighted assets $1000 \times 12\% = 120$ crore) as Tier 1 Capital, it can be concluded that Instant Finance Ltd. has not complied with the minimum Tier 1 Capital requirements as per the RBI Prudential Norms.

Alternative Answer:

- (i) As per the facts, Instant Finance Ltd. has investment in shares and bonds of other NBFCs totalling of ₹

10 crore, which amount to 12% of its owned fund.

“Tier 1 capital” for NBFCs (except NBFCs-BL) is the sum of (i) Owned fund as reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund; and (ii) Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to the extent it does not exceed 15 percent of the aggregate Tier 1 capital of such company as on March 31 of the previous accounting year. However, NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.

Since Owned Fund = 83.33 crore [i.e., = 10 crore /12%] – 1.667 [in excess of 10% of owned fund] = 81.667 crore

In the given situation, Instant Finance Ltd. has reported Tier 1 Capital of ₹ 130 crore. However, NBFC BL are not eligible to include perpetual debt instruments in their Tier 1 capital. Thus, amount of Tier 1 Capital will be ₹ 113.333 crore = 130 crore – 15 crore – 1.667 (i.e., Tier 1 Capital -Perpetual Debt Instrument - excess of 10% of owned fund)

Considering the ₹ 120 crore = (Aggregate Risk Weighted assets 1000*12%) as Tier 1 Capital, it can be concluded that Instant Finance Ltd. has not complied with the minimum Tier 1 Capital requirements as per the RBI Prudential Norms.

- (ii) Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to the extent it does not exceed 15 percent of the aggregate Tier 1 capital of such company as on March 31 of the previous accounting year are included while calculating Tier 1 capital. However, NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.

In the instant case, Instant Finance Ltd. falls under the category of NBFC-BL, hence, perpetual debt instruments will not be included in Tier I Capital.

(iii) While computing Tier I capital, Owned fund shall be reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund.

In the given case, Tier I capital of Instant Finance Ltd should be reduced by investment in shares of other NBFCs, exceeding in aggregate ten percent of the owned fund. In the current scenario, the investment in shares and bonds of other NBFCs totaling to ₹ 10 Crore is 12% of owned funds, hence, the excess of 2% of owned funds should be adjusted to arrive at Tier I Capital.

Alternative Answer:

- (iii) While computing Tier I capital, Owned fund shall be reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund.

In the given case, Tier I capital of Instant Finance Ltd should be reduced by investment in shares of other NBFCs, exceeding in aggregate ten percent of the owned fund. In the current scenario, the investment in shares and bonds of other NBFCs totaling to ₹ 10 Crore is 11.33% of owned funds, hence, the excess of 1.33% of owned funds should be adjusted to arrive at Tier I Capital.

147.

Net Owned Funds

Super Non-Bank Limited, a “Systemically Important Non-Deposit Taking Non-Banking Financial Company”, was operating appropriately till the start of COVID-19 Pandemic. Due to unforeseen conditions during the Pandemic and after that, the operating revenue of the NBFC started decreasing. Following were the position of Net Owned Funds of the company during the last 4 financial years:

Financial Year	Net Owned Funds
FY19-20	₹ 15 Crore
FY20-21	₹ 6 Crore

FY21-22	₹ 4 Crore
FY22-23	₹ 1.5 Crore

Super Non-Bank Limited appointed Mr. Shyam as their statutory auditor for the FY 22-23. Mr. Shyam identified that the Net Owned Funds of the company have been less than ₹ 2 Crore since June 2022. Kindly guide Mr. Shyam with respect to his reporting requirements as per relevant NBFC provisions. **(MTP-Nov-2023)**

Ans.


- (1) **In exercise of the powers conferred under clause (b) of sub-section (1) of section 45-IA of the RBI Act and all the powers enabling it in that behalf**, the Bank hereby **specifies two hundred lakh rupees as the Net Owned Fund (NOF)** required for a non-banking financial company to commence or carry on the business of non-banking financial institution, except wherever otherwise a specific requirement as to NOF is prescribed by the Bank.
- (2) It will be incumbent upon such NBFCs, the **NOF** of which currently **falls below ₹200 lakh, or as prescribed to category to NBFC to submit a statutory auditor's certificate certifying compliance with the prescribed levels** by the end of the period as given above.
- (3) NBFCs **failing to achieve the prescribed level** within the stipulated period shall **not be eligible to hold the CoR** as NBFCs.
- (4) Every non-banking financial company shall **submit a certificate from its Statutory Auditor that it is engaged** in the **business** of a **non-banking financial institution** requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it.
- (5) A **certificate from the Statutory Auditor** in this regard with reference to the position of the company as at end of the financial year ended March 31 may be **submitted** to the **Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, within 5 days from the date any case not later than December 31st of that year under Section 134.**
- (6) The **format** of the Statutory Auditor's Certificate (SAC) to be **submitted by NBFCs** has been **issued vide Directions, 2024.**
- (7) Hence, **in the current case, it is the responsibility of the Statutory Auditor, i.e., Mr. Shyam, to report where NOF has fallen below ₹ 200 Lakhs.**

Note:


Chapter 15

AUDIT OF PUBLIC SECTOR UNDERTAKINGS

148.

Compliance Audit

During the course of an audit of a state government department, the Office of the Comptroller & Auditor General of India (CAG) observed that the prescribed law in the state defined a "flat" based on the following two criteria in a premises:

- Dwelling units exceeding a threshold limit
- Buildings with a total area surpassing a threshold limit

However, it was noted during the audit that the relevant database did not include a column for entering the area of the building. Consequently, a certain number of buildings were identified as flats even though they had fewer dwelling units than the threshold limit. In the absence of data regarding the area, the audit team directed physical verification of these flats. The physical verification confirmed that these buildings were incorrectly classified as flats, resulting in the department under collecting water charges.

Identify type and nature of audit being performed by Office of Comptroller & Auditor General of India. To whom report of such audit was likely to have been submitted.

(MTP-May-2024, SM)

Ans.



- (1) **In the given case**, it is a "Compliance Audit" performed by Office of Comptroller & Auditor General of India.
- (2) **Compliance audit** is the **independent assessment of whether a given subject matter is in compliance with** the applicable criteria.
- (3) This audit is carried out by **assessing whether activities, financial transactions and information comply** in all material respects **with the regulatory and other rules** which govern the audited entity.
- (4) Compliance auditing is **concerned with**:-
 - (a) **Regularity**- adherence of the subject matter to the formal criteria emanating from relevant laws, regulations, and agreements applicable to the entity.
 - (b) **Propriety**- observance of the general principles governing sound financial management and the ethical conduct of public officials.
- (5) While **regularity is emphasized in compliance auditing, propriety** is equally pertinent in the public sector context, in which there are certain expectations concerning financial management and the conduct of officials.
- (6) **Under Article 151, audit reports of the C&AG** relating to the accounts of the Central/ State Government should be **submitted to the President/Governor of the State** who shall cause them **to be laid before Parliament/State Legislative Assemblies**.
- (7) **In the given situation**, the **report relates to the State Department. Therefore**, report was **likely to have been submitted to Governor of state to be laid before State legislative assembly**.

149.

Govt. co-meaning & audit applicability

Abhinandan Ltd., a company wholly owned by Delhi government was disinvested during the previous year, resulting in 38% of the shares being held by public. The shares were also listed on the NSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the NSE etc.

Paras, the Finance Manager of the company is of the opinion that now the company is subject to stringent control by NSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act, 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

(MTP-Nov-2024)

Ans.



- (1) **Section 2(45) of the Companies Act, 2013, defines a “Government Company” as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.**
- (2) **The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.**
- (3) **In the given situation, Abhinandan Ltd. is a company wholly owned by Delhi Government was disinvested during the previous year, resulting in 38% of the shares being held by public. The shares were also listed on the NSE. The listing of company’s shares on a stock exchange is irrelevant for this purpose and hence, opinion of finance manager Paras is not correct.**

150.

Audit Identification & Steps for Planning such Audit

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

- (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
- (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
- (iii) metering, billing and collection was managed efficiently and effectively;
- (iv) monitoring and internal controls were efficient.

What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

(SM, RTP-May-2022)

Ans.



In the given scenario, in view of the objectives discussed, **performance audit** is being referred. The following steps are suggested to the auditors for planning while conducting the performance audit:

- (i) **Understanding the entity /programme:** Auditors should **obtain an understanding of the programme** to be audited to help assess, among other matters, the **significance of possible audit objectives** and the feasibility of achieving them.
- (ii) **Defining audit objective:** These are the **basic audit questions** that performance auditors seek answers to. These are usually expressed in terms of questions about performance i.e., **achievement of economy, efficiency and effectiveness** of an entity, programme or activity under audit.
- (iii) **Scope of audit:** Defining scope focuses the **extent, timing and nature** of the audit. Answers to the following four questions help in defining the audit scope: **WHAT, WHO, WHERE, WHICH PERIOD.**
- (iv) **Determining the audit Criteria:** Criteria are the **standards used to determine whether a program meets or exceeds expectations.** In selecting criteria, auditors have a responsibility to use criteria that are reasonable, attainable, and relevant to the matters being audited.
- (v) **Deciding audit approach:** Performance auditing **generally follows one of three approaches** in examining the performance of the audited entity (ies).
- (vi) **Developing audit Questions:** Audit team should **prepare a list of questions** to which they would seek answers. There could be many ways to **develop and frame audit questions.** The performance auditors should frame a **comprehensive and detailed list of questions.**
- (vii) **Assess audit team skills and requirement of outside expertise:** The performance auditor **must possess the range of skills and experience** necessary for effective discharge of audit mandate. The Audit team needs to decide at the planning stage on which aspect expertise is required.
- (viii) **Audit design matrix:** Audit Design matrix is a **rigorous, structured and highly focused approach** to designing a performance audit study, based around the audit objectives, associated sub-objectives and lower level detailed questions.
- (ix) **Establish the timetable and resources:** It is important to determine the timetable and the resources needed. **Selection of appropriate audit team** is the most important component in planning an audit. Considerations for selection of a particular team **should be recorded in the**

planning documents along with the proposed timelines for various activities to be undertaken as part of the audit process.

Intimation of audit: Audited entities **must be informed about intention of taking up planned performance audit** with **scope and extent of audit** well before commencement of Audit.

151.

Audit Criteria

Direct Benefit Transfer (DBT) is a major reform initiative of the Government of India to ensure better and timely delivery of benefits from Government to people. It marks a paradigm shift in the process of 15 delivering benefits like wage payments, fuel subsidies, food grain subsidies, etc. directly into the bank accounts of the beneficiaries removing leakages and enhancing financial inclusion.

The office of C & AG of India is likely to undertake a performance audit for a block of years in a state of some selected social security pension schemes and scholarship schemes under DBT. What are likely to be objectives of such performance audit? Explaining meaning of “audit criteria”, discuss how these can be determined in above case. (MTP-May-2024, SM)

Ans.



The likely **objectives of performance audit** to be **conducted by** office of **C&AG** of India of some selected **social security pension schemes and scholarship schemes in a state** could be:-

- **Whether proper planning and process** were **in place to capture data of beneficiaries** under above schemes
- **Whether necessary steps** were **taken for implementation of DBT** like preventing delay in payments to the intended beneficiaries and pilferage and duplication
- **Whether the infrastructure, organization and management of DBT** were **adequate and effective**.
- **“Audit criteria”** are **standards used to determine whether a programme meets or exceeds expectations**. It **provides a context for understanding the results of the audit**. Audit criteria are **reasonable and attainable** standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.
- **In the above situation**, various **documents issued by Government of India and state government** like circulars, instructions, Standard operating procedure manuals, guidelines of schemes on identification and authentication of beneficiaries etc, general management and subject matter literature **can be used to determine “audit criteria”**.

152.

Audit Identification & Sample Observations

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

- (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
- (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;
- (iii) metering, billing and collection was managed efficiently and effectively;
- (iv) monitoring and internal controls were efficient.

What kind of audit is this?

Prepare two sample observations which could be part of the audit report.

(SM)

Ans.



This is a performance audit. Sample observations could be:

- (i) **Non replacement of defective/ burnt meters:** Large number of meters, much in excess of the **permitted limit of 1%** of the total meters were **defective and their replacement was not completed** within the **stipulated time of 1 month**. This resulted in billing on average basis for a continuous period of several months. This could result in **losses as well as administrative hassles and disputes with consumers**.
- (ii) **Under charging of meter rent:** As per Schedule of Charges, the Company is required to **charge meter rent of ₹30 per month** for a single phase meter and **₹ 40 per month for three phase meter**. It was observed that the **Company had short charged meter rent of ₹ 60 lakh from 3 lakh consumers in 5 lakh bills during the period**.

153.

Performance Audit & Audit Report

Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit (only) with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG. (SM, Dec-2021, MTP-May-2023, RTP-May-2024, MTP-Sept-2025, RTP-Jan-2026)

Ans.



In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the **objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability** by assisting those charged with governance and oversight responsibilities to improve performance; **and transparency** by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing **focuses on areas in which it can add value** which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is **not performance audit in all aspects.**

154.

Comprehensive Audit - Matters to be taken by the CA firm

RST Ltd., a public sector company engaged in power generation, has recently completed five years of operations. The Board of Directors has requested an audit to evaluate not only the accuracy of its financial statements but also the efficiency of operations, adequacy of internal controls, and overall performance of the company. Preliminary review shows:

- Several projects experienced cost overruns compared to approved budgets.
- Some plants are operating below installed capacity.
- Raw material and fuel consumption exceed standard norms, and inventory management appears weak.

Identify the type of audit suitable in this scenario and suggest the key issues that the auditors should examine during such type of audit, considering the company's operational and financial activities. (RTP-May-2026)

Ans.



(i) A CA Firm has been appointed to conduct **comprehensive audit of Metro Company Limited**, which is a **listed Govt. Company** handling the Metro project. CA firm has **observed the shortcomings** as stated in **internal audit report** regarding understatement of **Current liabilities** and **CWIP by ₹ 84.68 crore.**

(ii) **The matters to be undertaken by the CA firm while conducting the comprehensive audit of Metro Company Limited: Some of the broad areas are listed below:**

- a) How does the **overall capital cost of the project compare** with the approved planned costs? Were there any **substantial increases** and, if so, what are these and whether there is **evidence of extravagance** or **unnecessary expenditure**?
- b) Have the **accepted production or operational outputs** been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?
- c) Has the **planned rate of return been achieved**?
- d) Are the **systems of project formulation and execution sound**? Are there inadequacies? What has been the effect on the **gestation period** and **capital cost**?
- e) Are **cost control measures** adequate and are there **inefficiencies, wastages in raw materials** consumption, etc.?
- f) Are the **purchase policies adequate**? Or have they led to **piling up of inventory** resulting in redundancy in stores and spares?
- g) Does the enterprise have **research and development programmes**? What has been the performance in **adopting new processes, technologies, improving profits** and in reducing costs through technological progress?
- h) If the enterprise has an **adequate system of repairs and maintenance**?
- i) Are procedures **effective and economical**?
- j) Is there any **poor or insufficient** or inefficient **project planning**?

SJ's Comment:-

*Though question is specific to **solar power manufacturer**, the suggested answer is **generic in nature**.*

155.

Audit Report of C&AG

The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG. **(SM, Dec-2021-New, May-2019-Old)**

Ans.



For facility of consideration, the **reports of the Comptroller and Auditor General** on the public sector undertakings of the **Central Government** are presented to the Parliament in **several parts** consisting of the following:

- (a) **Introduction** containing a general review of the **working results** of Government companies, Deemed Government companies and Corporations.
- (b) **Results of comprehensive appraisals** of selected undertakings conducted by the Audit Board.
- (c) **Resume of the company auditor's reports** submitted by them under the **directions issued** by the C&AG and that of **comments on the accounts** of the Government companies.
- (d) **Significant results** of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the **Comptroller and Auditor General submit a separate audit report (commercial) to the legislature**, while for **other States/Union Territories** with legislature, there is a commercial chapter in the **main audit report**. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, comments noticed in Government audit in the audit functions of certification of accounts and a general review of the working results of Government companies and corporations.

Chapter 16

INTERNAL AUDIT

156.

Appointment of internal Auditors for the Group Companies

One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below:

Figures are in ₹ crore and correspond to the previous year

Name	Nature	Equity Share Capital	Turnover	Loan from Bank and PFI	Public Deposits
AADI Ltd.	Listed	100	190	50	24
AJIT Ltd.	Unlisted Public	60	190	50	24
NEMI Ltd.	Unlisted Private	60	190	50	-

You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss.

(MTP-Nov-2023, RTP-May-2022, MTP-Nov-2024, SM, MTP-Jan-2026)

Ans.



Applicability of Provisions of Internal Audit:

(i) **Provision:-** 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.

(ii) **Analysis of the cases:**

- **AADI Ltd. is a listed company.** As per section 138 of the Companies Act, 2013, **every listed company is required to appoint an internal auditor** or a firm of internal auditors. Thus, **in view of the above, AADI Ltd. is required to appoint an internal auditor.**
- **AJIT Ltd. is unlisted public company.** The company is having ₹ 60 crore as equity share capital which is exceeding the prescribed limit of rupees fifty crore as per section 138. **Thus, AJIT Ltd. is required to appoint an internal auditor** as per section 138 of the Companies Act, 2013.
- **NEMI Ltd. is unlisted private company** and having ₹ 60 crore as equity share capital, ₹ 190 crore as turnover and ₹ 50 crore loan from Bank and PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. **Therefore, NEMI Ltd. is not required to appoint an internal auditor.**

(iii) **Conclusion:-** It can be concluded that **AADI Ltd. and AJIT Ltd. is required to appoint the internal auditor** as per the provisions of the Companies Act, 2013 **whereas NEMI Ltd. is not required** to do the same.

157. Internal Audit Applicability on Companies

Jeneva Technologies Pvt. Ltd., a private limited company engaged in the manufacturing of automation equipment, having turnover of ₹ 210 crores during the financial year 2023-24. Additionally, the company had taken a loan of ₹ 95 crores from a consortium of banks during the same year, which remained outstanding as of the balance sheet date.

Meanwhile, Cross Buildcon Ltd., an unlisted public company involved in real estate development, had the following financial details for the year 2023-24:

Particulars	Amount
Paid-up share capital	₹ 48 crores
Turnover	₹ 198 crores
Outstanding borrowings from a bank	₹ 110 crores
Outstanding deposits	₹ 30 crores

The management of both companies has approached their respective consultants seeking clarity on whether they are required to appoint an internal auditor under the Companies Act, 2013.

As a professional consultant, you are required to advise:

- Whether Jeneva Technologies Pvt. Ltd. is required to appoint an internal auditor for the financial year 2024-25.
- Whether Cross Buildcon Ltd. is required to appoint an internal auditor for the financial year 2024-25.
- State who can be appointed as internal auditors under the Companies Act, 2013. **(RTP-Sept-2025)**

Ans.


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 which may be either an individual or a partnership firm or a body corporate, namely-

- every listed company;
- every unlisted public company having-
 - paid up share capital of fifty crore rupees or more during the preceding financial year; or
 - turnover of two hundred crore rupees or more during the preceding financial year; or
 - 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
 - outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year; and
- every private company having-
 - turnover of two hundred crore rupees or more during the preceding financial year; or
 - 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 case of Jeneva Technologies Pvt. Ltd., the company recorded a turnover of ₹ 210 crores during the financial year 2023-24 and had obtained a loan of ₹ 95 crores from a consortium of banks during the same period. As the turnover exceeds the prescribed threshold of ₹ 200 crores, the company falls within the criteria specified under Rule 13 of the Companies (Accounts) Rules, 2014. Hence, it is mandatorily required to appoint an internal auditor for the financial year 2024-25.
 - In the case of Cross Buildcon Ltd., the company has a paid-up share capital of ₹ 48 crores, a turnover of ₹ 198 crores, outstanding borrowings from a bank amounting to ₹ 110 crores, and outstanding deposits of ₹ 30 crores as per the financial year 2023-24. Although the paid-up capital and turnover are below the prescribed thresholds, the outstanding borrowings and deposits exceed the specified limits under Rule 13 of the Companies (Accounts) Rules, 2014. Therefore, Cross Buildcon Ltd. is mandatorily required to appoint an internal auditor for the financial year 2024-25.

- (c) As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

- The internal auditor may or may not be an employee of the company.
- To be effective, the internal auditor must be regarded as a part of the management and not merely as an assistant thereto.

158.

High Employee Attrition Rate

The Managing Director of X Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyse the cause for the same. What factors would you consider in such analysis? **(SM)**

Ans.



The factors responsible for high employee attrition rate are as under:

- Job Stress & work life imbalance**
- Wrong policies** of the Management
- Unbearable behaviour** of Senior Staff
- Safety factors**
- Limited opportunities** for promotion
- Low monetary benefits**
- Lack of **labour welfare** schemes
- Whether the organization has properly **qualified and experienced personnel** for the various levels of works?
- Is the number of people employed at various work centres **excessive or inadequate**?
- Does the organization provide **facilities for staff training** so that employees and workers keep themselves abreast of current techniques and practices?

159.

Critical Activities in Internal Audit Function

CA. Jayesh has recently been appointed Chief Internal auditor of a listed company. The internal audit charter inter alia includes long term view of internal audit function, purpose and objectives of internal audit, reporting structure, scope & approach, accountability for certain deliverables like reducing risk ratings, improving control environment etc. & authority attached. Given his sharp insight, he realizes that a proper plan needs to be put in place for reviewing performance/ training of professional staff constituting in-house teams and acquisition of fresh professional talent. Does the above fall within purview of critical activities to be performed by Chief Internal Auditor to achieve objectives of Internal audit function? Comment on the above with regards to critical activities intended to achieve objectives of internal audit function outlined in internal audit charter.

(MTP-Sept-2025)

Ans.



As per Standard on Internal Audit (SIA) 210, "Managing the Internal Audit Function", the Internal Audit Function performs a number of activities to achieve its objectives as outlined in its Charter (or Terms of Engagement). A few of the critical activities are as follows:

- Define the overall plan, scope and methodology of the Internal Audit Function on a periodic basis.
- Oversee and monitor various audit assignments, their proper planning, execution, reporting of findings and subsequent closure of reported observations.
- Plan, acquire, engage and review the performance, training and development of professional staff, talent and other resources to achieve its objectives.
- Identify, source, engage and manage external experts and technical solutions, if required.
- Communicate and engage with all key stakeholders regarding progress and achievement of objectives.
- Develop and maintain a quality evaluation and improvement program.

Therefore, planning, acquiring and review of performance, training and development of professional staff is one of the critical activities for achievement of internal audit objectives. Without performance of this critical activity, it would be difficult to achieve objectives of internal audit function as outlined in internal audit charter. Hence, it falls within purview of critical activities to be performed by Chief Internal auditor to achieve objectives as outlined in internal audit charter.

160.

Review of Utilization of Resources

Dreams Pvt. Ltd. is a travel management company which provides its customers with customized packages of domestic and international tours. During the period of COVID-19 and a year after that, company suffered losses due to which it went under cost cutting regime. As a part of the process, the company has adopted various courses of actions one of which is appointment of internal auditor. The internal auditor observed that the company has given a huge hall for providing a gym facility to its employees. The internal auditor observed that the gym is being used only 1-2 days week on an average basis by the employees. There is a huge balance lying in the company's bank account, but the management could not take a decision regarding investing the same, due to fluctuating market situations. The company has taken a hall on rent for the purpose of sitting cum waiting lounge for its customer. Besides, everyday there is downtime of one hour during the working hours for computers and other machines. The internal auditor of the company wants to cover these matters and report them, but Mr. X the manager of the company, is of the opinion that these matters are not related to internal audit and therefore, should not be commented upon. Express your opinion in this regard and suggest appropriate course of action. **(Nov-2023)**

Ans.



The scope of the internal auditor's work should include a review of the Utilization of Resources.

Review of Utilization of Resources –

- The internal auditor should **check** whether **proper operating standards and norms** have been **established** for measuring the economical and efficient use of resources.
- They should be **detailed enough to be identifiable with specific operating responsibilities** and should be capable of being used by operating personnel for monitoring and evaluating their performance.
- The internal auditor should **review** the **methods of establishing operating standards and norms**. He should carefully **examine** the **assumptions made** while setting the standards to ensure that they are appropriate and necessary.
- Where there is a wide divergence between actual performance and the corresponding standards, reasons may be considered. As a part of evaluating resources utilisation, **identifying the facilities which are under-utilized** is an important function of the internal auditor.

In the given situation, the **following observations have been noted by the Internal Audit Team that:**

- The company has provided a huge hall as a gym facility to employees, which is operating only 1-2 days a week. The rest of the days, it remains unutilized. Moreover, the company has taken a sitting cum waiting lounge for the customers.
- There is a huge amount lying in bank accounts on which the management is not able to make decisions regarding investing. This results in a loss of interest.
- There is a downtime of one hour for resources and computers in the company.

Moreover, Mr. X, the Manager of the company, has denied the internal auditors from reporting the said observations.

All the above-mentioned issues fall under the purview of the Internal Audit function, i.e., Review of Utilization of Resources. The auditor must highlight the weaknesses observed and give suggestions for improvement of the same. Accordingly, opinion of Mr. X, the manager of the company Dreams Pvt. Ltd. that above matters are not related to internal audit and therefore, should not be commented upon, is not tenable.

161.

Direct Assistance from IA & External Confirmation Procedure

Mr. A is appointed as a statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

- (a) Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
- (b) Will your answer be different if Mr. A asks direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

(SM, MTP-Sept-2025)

Ans.

(a) Direct Assistance from Internal Auditor


As per SA 610 “Using the Work of Internal Auditor:-

- The external auditor shall not use internal auditors **to provide direct assistance to perform procedures that involve making significant judgments** in the audit.
- Since the external auditor has **sole responsibility for the audit opinion** expressed, the external auditor needs to **make the significant judgments** in the audit engagement.
- **Significant judgments include the following:**
 - Assessing the **risks of material misstatement**;
 - Evaluating the **sufficiency of tests performed**;
 - Evaluating the appropriateness of management’s use of the **going concern assumption**;
 - Evaluating significant **accounting estimates**; and
 - Evaluating the **adequacy of disclosures in the financial statements**, and other matters affecting the auditor’s report. In view of above, Mr. A cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(b) Direct Assistance from Internal Auditor in case of External Confirmation Procedures:

- **SA 610 “Using the Work of Internal Auditor:**
 - Provide relevant guidance in determining the **nature and extent of work that may be assigned to internal auditors**.
 - **In determining the nature of work** that may be assigned to internal auditors, the external auditor is **careful to limit such work** to those areas that would be appropriate to be assigned.
- Further as per **SA 505, “External Confirmation:**
 - The external auditor is **required to maintain control over external confirmation requests** and
 - Evaluate the **results of external confirmation procedures**, it would not be appropriate to assign these responsibilities to internal auditors.
 - However, **internal auditors may assist in assembling information** necessary for the external auditor to resolve exceptions in confirmation responses.

162.

Reporting Structure for Internal Audit

The XYZ Ltd has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the Company. The Managing Director of the Company has asked the HR head to define the reporting structure of the Chief Internal Auditor, so that he can discharge his duties objectively? Suggest the ideal reporting structure of the Chief Internal Auditor that HR head may propose to the Managing Director? **(SM)**

Ans.



HR Head need to evaluate multiple options and identify most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also need to evaluate different option for his administrative reporting and various options for functional reporting of Chief Internal Auditor. **The possible options to be considered and evaluated include Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.**

As per **section 138** of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.

As per the revised definition of the term ‘Internal Audit’ as per para 3 of the ICAI’s Framework Governing Internal Audits, **“Internal audit provides independent assurance** on the effectiveness of internal controls and risk management processes to **enhance governance and achieve organisational objectives”**.

Further, Internal Auditor shall be **free from any undue influences** which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

As per the requirement of the above stated provision, **Chief Internal Auditor need to be independent of the**

operational activities and report of Audit Committee / Board of Directors to enjoy his true status of independent auditor. He may **administratively report to CEO or Managing Director** for his administrative reporting purpose or any other similar authority till the time it is approved by Board of Directors and it does not impact his independence to be able to perform his duties and report to audit committee / Board of Director independently.

163.

Internal Audit Plan

Daksh Ltd. has appointed **Mr. Gopal** to conduct their internal audit for **the** new financial year. The Audit committee requested **Mr. Gopal** to present their Internal Audit plan for next financial year? What approach would **Mr. Gopal** follow to prepare the internal audit plan for next year? **(SM)**

Ans.



The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

Internal audit plan should be developed in such a manner that **all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle.** Also, ensuring that appropriate consideration is made and adequate **balance is ensured to the following:**

- **Risk underlying** the business process
- **Value** that the internal audit can provide to the organization
- **Effort involved** in conducting the internal audit for a particular business process
- **Risk Appetite** of the organization
- **Coverage** of all auditable areas within the defined time range

164.

Internal Audit Report

The XYZ Ltd is has appointed Mr. A to conduct their internal audit for **the** new financial year. The Audit committee requested Mr. A to present detailed report on their finding and areas where immediate action is needed to mitigate critical risks? What should be the content of internal audit report to address this requirement of the Audit Committee? **(SM)**

Ans.



As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

- At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.
- On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

Accordingly, a typical **internal audit report** should **include** the **following:**

- Audit **Scope** performed;
- Audit **period** Covered;
- **Executive Summary;**
- **Summary of the critical findings;**
- **Detailed audit findings** with elaboration on business impact and root cause of such issues;
- **Rating of the highlighted issues** (E.g. High / Medium / Low) in accordance to the rating criteria approved by Audit Committee;
- **Audit recommendation** to improve control environment and address the highlighted finding;
- **Response received** from the responsible functional authority containing action plan and target timelines for action.

165.

Action Taken Report (ATR)

CA. Sanjana has recently joined as Chief Internal Auditor of Up Scale Limited, a listed company. Her subordinate staff in internal audit department brings to her knowledge many prior audit issues highlighted in the previous internal audit reports which are still open. Does she have any responsibilities in this regard? How should she proceed in this situation? **(RTP-May-2024, SM)**

Ans.



(1) In the given situation,

- (a) CA. Sanjana has recently joined as Chief Internal Auditor in Up Scale Limited, a listed company.
- (b) As a Chief Internal Auditor, CA. Sanjana is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance.

The responsibility to implement the action plans remains with the management.

- (c) In monitoring and reporting of prior audit issues, the **responsibility of the CA. Sanjana** as internal auditor **is usually in the form of an "Action Taken Report (ATR) of previous audits"**.
- (d) The term **"Monitoring and Reporting"** refers to the **periodic tracking of issues raised** during prior audits **and evaluation of the corrective actions undertaken** by the auditee to resolve them **and to report any open and pending matters to the management and those charged with governance**.
- (2) CA. Sanjana should **review whether follow-up action is taken** by the management on the basis of his report. **If no action is taken** within a reasonable time, she should **draw the management's attention** to it. **Where the management has not acted upon the suggestions or not implemented the prescribed recommendations**, she should **ascertain the reasons thereof**.
- (3) **Where the management has accepted recommendations** of the CA. Sanjana **and initiated the necessary action**, she should **periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly**.

166.



Audit Trail

The management of High Limited is concerned with the reporting requirement cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 for the financial year 2023-24 with regard to the Audit Trail (edit log). Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software. Consequently, the management of the company approached CA J and asked him to suggest them list of internal controls which may be required to be implemented and operated to demonstrate that the Audit trail (or Edit Log) feature was functional, operated and was not disabled. Help CA J. **(May-2024, SM)**

Ans.

In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate.

An illustrative list of internal controls which may be required to be implemented and operated are given below:

- Controls to ensure that the **audit trail feature** has **not been disabled or deactivated**.
- Controls to ensure that **User IDs** are **assigned to each individual** and that User IDs are **not shared**.
- Controls to ensure that **changes to the configurations of the audit trail** are **authorized and logs** of such changes are maintained.
- Controls to ensure that **access to the audit trail (and backups)** is **disabled or restricted and access logs**, whenever the audit trails have been accessed, are **maintained**.
- Controls to ensure that **periodic backups** of the **audit trails** are **taken and archived** as per the statutory period specified under the provisions of the Act.

Chapter 17

DUE DILIGENCE, INVESTIGATION & FORENSIC ACCOUNTING

- 167. Classification and Scope**
- CA Purva is working as Credit manager in branch of ADC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth ₹12 crore for meeting usual business requirements. As part of the appraisal process, CA Purva undertakes a comprehensive review which includes:
- Examining the past history of the company and background check of its promoters and directors.
 - Review of the shareholding structure and understanding the nature of company's business.
 - Analysis of the company's past financial statements along with its future financial projections.
 - SWOT analysis to evaluate the company's internal and external position.
 - Assessing the net worth of the directors, reviewing their CIBIL scores, and verifying if their names appear in the RBI's defaulter list.
 - Discreet inquiries from existing clients of the branch engaged in a similar line of business to assess the creditworthiness of the company its promoters and directors.
- (i) What is the nature of the activity being performed by CA Purva? Discuss its nature.
- (ii) Would your answer be different if the same activity was performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.
- (iii) Name any three other areas where identified activity can be undertaken. **(MTP-Sept-2025)**

Ans.



- (i) The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.
- Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.
- Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.
- (ii) There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.
- (iii) The areas where due diligence may be undertaken are: -
- Corporate restructuring
 - Venture capital financing
 - Public offerings

- 168. DD : Scope**
- CA. Sanjana is acting as Credit manager in branch of DFC Bank Limited. A company has approached the branch for a request to sanction credit facilities worth ₹10 crore for meeting usual business requirements. It is a

prospective new client. She checks past history of the company, back ground of promoters & directors, shareholding pattern and nature of business. Assessment of financial results of past years and future projections is also undertaken. She also carries out SWOT analysis of the company.

Besides, assessment of net worth of directors is also undertaken. Status of CIBIL score and position of name of promoters/directors in RBI defaulter list is also verified.

She also makes discreet inquiries from few clients of the branch engaged in similar line of activity regarding credit worthiness of company, its promoters and directors.

Based on above-

- Identify activity being performed by CA Sanjana and discuss its nature.
- Would your answer be different if this activity was to be performed by a person not qualified as a Chartered Accountant? Can a non-CA perform such activity? State reason.
- Name any three other areas where identified activity can be undertaken. (SM)

Ans.



- The activity described in the situation is **Due diligence**. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

- There would be **no difference in answer** if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.
- The areas where **due diligence may be undertaken are:-**
 - Corporate restructuring**
 - Venture capital financing**
 - Public offerings**

169.

Inventory Frauds & Verification Procedures

MF Ltd., a manufacturing company specialising in industrial and consumer products, has been experiencing significant inventory shortages despite maintaining detailed procurement and production records. The management suspects fraudulent activity, as discrepancies have been noticed in stock reconciliation, production wastage reports, and inventory adjustments.

Some of the reason for suspicion include:

- Manual adjustments in stock records on frequent basis.
- Higher than usual production wastage, inconsistent with historical data.
- Raw materials recorded as issued for production but missing from factory floors.
- Finished goods dispatched but not recorded in sales accounts.
- Unexplained inventory shrinkage over consecutive months.

Considering the above, you are appointed by MF Ltd. to evaluate the options for verifying the process to reveal fraud and the corrective action to be taken. As an investigating accountant what will be your areas of verification and the procedure to be followed for verification of defalcation of inventory? (RTP-May-2025)

Ans.



Inventory Frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.
- (iv) Inflating the quantities issued for production is another way of defalcating raw materials and store items.
- (v) Stocks actually dispatched but not entered in sales/ debtor's account.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book. Investigating accountant should ascertain the exact duties of persons handling the stocks received in and issued from store for production/ sale or any other purpose. Identify the excessive control in the hands of a single person, without any supervision as it will widen the scope of investigation.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for the shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past.

Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

170.

Difference in forensic accounting and audit

ABC Ltd. is a listed company having turnover of ₹ 50 crores & plans expansion by installation of new machines at new building having total additional project cost of ₹ 20 crore.

Rupees (In crore)	Purpose
10.0	for Building
8.5	for Machinery
1.5	for Working Capital
20 Crore	Total

Project gets implemented in 2022-23 and one of the accountants report to the Managing Director that some

suspicious transactions are noticed in the purchase of building material. But the Management is confused as to whether they should get an audit or Forensic Accounting done for the same. Advise Management about the difference in forensic accounting and audit. (SM)

Ans.

**Forensic Accounting**

- In response to an event
- Financial investigation
- Finding used as evidence in court or to resolve disputes

Audit

- Mandatory
- Measures compliance with reporting standards
- Obtain reasonable assurance that financial statements are free of material misstatement

A **Forensic Professional** will often **look for indications of fraud** that are **not subject to the scope of a financial statement audit**. Forensic Accounting has **Investigative mentality** however auditing is done with "professional scepticism". A Forensic Professional will often require **more extensive corroboration**. A Forensic Professional may **focus more on** seemingly **immaterial transactions**.

171.

Forensic Accounting: Working Papers

CA. Puranjay is performing a forensic accounting engagement involving gathering of evidence in relation to suspected fraud of substantial amount in a company. He has been appointed under terms of a contractual agreement with the company.

The company operates in an electronic environment. While performing engagement, his team has gathered evidence from electronic records in Enterprise Resource Planning system (ERP), messages in company's e-mail system and also from system logs and audit trails generated by company's computer systems. However, while doing so, team has failed to take care of aspects such as keeping record of each person in team gathering relevant evidence, date and time of collection and storage of such evidence. What implications it may have on forensic accounting engagement as such? (MTP-May-2024)

Ans.



In a forensic accounting engagement, professional **undertakes a scrutiny and detailed examination of all transactions and balances** relevant to the mandate so that evidence gathered is suitable in a Court of Law i.e. in compliance with legal requirements where it can be challenged through cross-examination by the defending party. It is important that team is skilled in collecting evidence that can be used in a court case keeping a clear chain of custody till evidence is presented in court. If there are gaps in chain of custody, then the evidence may be challenged in court or even become inadmissible.

In the given case, team has **failed to keep record of matters** such as persons gathering relevant evidence, date and time of collection and storage of evidence. **Therefore**, team has **failed to maintain the chain of custody**. It can, therefore, **defeat the objective of forensic accounting engagement** as evidence may be challenged in Court of law by defending parties and may become inadmissible.

17.6 - Financial Due Diligence

172.

Hidden Liabilities

Vicky is a financial analyst working for a large corporation that is considering the acquisition of a mid-sized manufacturing company. The initial financial statements provided by the target company appear to be in order, showing profits and a solid asset base. However, his team is concerned about potential risks that may not be immediately visible in the financial documents provided.

Guide Vicky on what specific aspects should be focused during due diligence to ensure that there are no hidden liabilities in this deal? (MTP-Nov-2024)

Ans.



The **objective** of the Due Diligence exercise will be to **look specifically for any hidden liabilities or over-valued assets**.

Example of Hidden Liabilities:

- The company may not **show any show cause notices which have not matured into demands**, as contingent liabilities. These may be material and important.
- The company may have given **"Letters of Comfort"** to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- The Company may have **sold some subsidiaries/businesses** and may have **agreed to take over and indemnify all liabilities and contingent liabilities** of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- **Product and other liability claims; warranty liabilities; product returns/discounts; liquidated**

damages for late deliveries etc. and all litigation.

- **Tax liabilities** under direct and indirect taxes.
- Long **pending sales tax assessments**.
- **Pending final assessments of customs duty** where provisional assessment only has been completed.
- Agreement to **buy back shares sold at a stated price**.
- **Future lease liabilities**.
- **Environmental problems/claims/third party claims**.
- **Unfunded gratuity/superannuation/leave salary liabilities**; incorrect gratuity valuations.
- **Huge labour claims** under negotiation when the labour wage agreement has already expired.
- Unresolved labour litigations.

173.

**Investigation of Fraud - Inflated commission**

BIL Limited is a company manufacturing premium shampoos since last decade. The company functions through various salesmen appointed across the country. The management of company came across the news that the salesmen in the central and western regions have exaggerated their sales through fictitious billings to achieve higher commission and to accommodate the sales volume achieved by one employee with other employees, who falls short of their target. The management of the company appointed you to investigate and unearth such type of fraud, if it is prevailing in their company. What procedures will be followed by you to investigate such type fraud?

(Sept-2025)**Ans.****Procedure to be followed to Investigate Commission Schemes Fraud:**

- (1) Before proceeding to investigate frauds of the type aforementioned, 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.
- (2) 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.
- (3) At times, an accountant is called upon to investigate a suspected fraud, the details or the nature whereof is not known. In such a case, for localising the source of the fraud, the investigating accountant will have to study the financial and accounting structure of the organisation.
- (4) As a first step, he should examine the line of responsibility between the various members of the staff. 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.
- (5) 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 person/employee, without any supervision by any other person/employee or, any other inherent weakness that may be in existence in the system.

NOTES:

Chapter 18

SUSTAINABLE DEVELOPMENT GOALS (SDG) & ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) ASSURANCE

174.



ESG Pillars

KLM Chemicals and Paints Ltd., a manufacturing company listed on the stock exchange, has committed to enhancing its Environmental, Social and Governance (ESG) transparency. Sustainability Reporting plays a crucial role in enhancing transparency and accountability regarding an entity's Environmental, Social and Governance (ESG) performance. The company wants to apply Sustainable development in its corporate policy. During the review of its sustainability practices, the management is keen to assess the safety of the products, its quality and labour relations.

What should be addressed in the pillar envisaged above? Highlight the various key elements included in this pillar. (Sept-2025)

Ans.

Social Pillar: The ESG pillar highlighted here is the “Social” pillar which addresses the relationships the entity has and the reputation it fosters with people and institutions in the communities where you do business, and the value chain involved. It further includes labour relations, diversity, and inclusions.

The Social pillar includes the following elements as under:

- **Human Capital:**
 - ◆ Labour Management
 - ◆ Health & Safety
 - ◆ Human Capital Development
 - ◆ Supply Chain Labour Standards
- **Product Liability:**
 - ◆ Product Safety & Quality
 - ◆ Chemical Safety
 - ◆ Financial Product Safety
 - ◆ Privacy and Data Security
 - ◆ Responsible Investment
- **Stakeholders Opposition:**
 - ◆ Controversial Sourcing
- **Social Opportunity:**
 - ◆ Access to Communication
 - ◆ Access to Finance
 - ◆ Access to Health Care
 - ◆ Opportunities in Nutrition & Health

175.

Principle-wise performance disclosures

CTO Limited is engaged in the fintech business. It is a member of few prominent industry chambers and trade associations and has come under mandatory purview of Business Responsibility and Sustainability Reporting (BRSR) for year 2022-23.

The company had submitted inputs on draft Digital personal data protection bill to concerned Ministry during year 2022-23. It had also submitted to one of the industry chambers during the same year certain key inputs on leveraging India's digital public infrastructure for creating solutions by banks and fintechs together as its taskforce member on the subject. Considering the above, discuss how above information would likely be disclosed by company in “Principle-wise performance disclosures” as part of BRSR for year 2022-23?

Whether information discussed above would require to be **disclosed mandatorily?** (MTP-May-2024)

Ans.



- The given case highlights that CTO Limited, engaged in Fintech business, **is a member of Chamber of Commerce/associations.**
- Such information **needs to be disclosed under Principle 7** of Principle-wise Performance Disclosures.
- **Principle 7 recognizes that** businesses, when engaging in influencing public and regulatory policy, operate within the framework of statutory and legislative policies of the governing authority. Collective associations such as trade groups and industry chambers have to be utilized when moving ahead with policy advocacy and formulation.
- The information under each principle is to be **disclosed under Essential indicators** (mandatory disclosures) **and Leadership indicators** (optional disclosures).
- **Information relating to membership of Chamber/associations** is in the **nature of Essential Indicators and requires mandatory disclosures.**
- Information relating to **inputs provided** by company to the **Ministry on a legislative bill** and inputs provided **to one of the prominent chambers** on leveraging India's digital public infrastructure for creating solutions by banks and Fintechs together as a taskforce member on the subject **are in nature of leadership positions** taken by the company. **These are in the nature of Leadership Indicators and are optional disclosures.**

176..

Business Responsibility and Sustainability Report: Core Principle

SU Limited is amongst the top 1000 listed entities. With the introduction of new reporting requirements by SEBI on ESG parameters called the Business Responsibility and Sustainability Report (BRSR), it requires SU Limited to make disclosures on their performance against the various principles of the "National Guidelines on Responsible Business Conduct". One of the principles emphasizes that the business decisions in an organization should be open to disclosure and accessible to the relevant interested parties. Elucidate the essence of core elements associated with the aforesaid principle. **(May-2024, MTP-Sept-2025)**

Ans.



Principle 1 – Ethics, Transparency and Accountability: The first principle **emphasizes that the business decisions** in an organisation should be **open to disclosure and accessible to the relevant interested parties.** **The essence of the core elements associated with the first principle are:**

- The entities' governing structure should **develop policies, procedures, and practices** for their offices, factories, and work areas, ensuring that ethics is not compromised.
- The **information** relating to the policies, procedures, and practices along with the performance **should be made available to the stakeholders.**
- In case of adverse effects, more care has to be taken for **transparent disclosures.**
- The entities in the value chain should be **encouraged to adopt these principles by the governance structure.**
- The entities should **proactively respond to the outside entities that violate the nine principles of the BRSRs.** This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

177.

Identification of Principle & Core Elements

Sukaran Ltd., a leading textile manufacturing company, has been facing criticism from its employees regarding various workplace concerns. Some employees have raised issues about delayed salary payments, while others have reported excessive working hours that affect their work-life balance. Additionally, a few workers have complained about inadequate safety measures in the factory, leading to frequent minor accidents. Which principle of BRSR deals with this? Mention the core elements of this principle. **(RTP-May-2025)**

Ans.



Principle 3 – Promote Well-Being of All Employees Including those in the Value Chain: The third principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

- The entity should ensure compliance with all regulatory requirements as far as employees are concerned.
- The entities are to respect the dignity of employee as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.

- (c) The entities should prevent all kinds of child labour, bonded labour, and any other forms of involuntary labour.
 - (d) The entities should have a system in which the work-life balance of the employees is not compromised.
 - (e) The businesses have to ensure timely payment of the worker's wages and compensation.
 - (f) The payment of the wages has to be as per the living wages, that can take care of the basic needs and provide economic security to the employees.
 - (g) The entities are responsible to create a workplace and work environment that is safe, hygienic, and comfortable for people to work for long durations.
 - (h) The skill development, career development and training of the workforce is another responsibility of the entities employing them.
 - (i) The creation of a workplace which is free of harassment and violence is also a responsibility of the entity.
- In the given case, employees have raised issues about delayed salary payments, excessive working hours that affect their work-life balance and complained about inadequate safety measures in the factory.
- In view of the above, Sukaran Ltd. must take corrective actions to align with this principle.

178.

Core Principle

Pink Ltd., a leading manufacturing company, is expanding its operations globally. However, the company has received multiple complaints from stakeholders regarding misleading advertisements and a lack of transparent grievance redressal mechanisms.

As part of its Business Responsibility and Sustainability Reporting (BRSR) compliance, which principle is the company required to adhere to? This principle emphasizes engaging with and providing value to consumers responsibly and transparently.

What are the key consumer protection aspects that Pink Ltd. should focus on under this principle of BRSR?

(MTP-May-2025)

Ans.



Pink Ltd. shall adhere to Principle 9 of BRSR which focuses on Providing Value to the Consumers in a Responsible Manner.

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

- i) Entities should put in their efforts to reduce the negative impacts of their products and services on consumers, natural environment, and society at large.
- ii) When conceptualizing, designing, and marketing their products, the organisation should not in any manner prevent the freedom of choice and fair competition.
- iii) The entities should transparently and accurately disclose all kinds of adverse impacts to the user, planet, society, on the biodiversity from their products.
- iv) When handling customer data, the right to privacy of the customer needs to be maintained.
- v) Entities should inform the customers on the safe and responsible ways of usage, reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.
- vi) When advertising about their products, the organisations should ensure that misleading and confusing information is not exposed to the customers about their products or its usage.
- vii) Business enterprises should make available transparent and accessible grievance redressal and feedback management system for their customers to raise their voices or to seek clarifications.
- viii) Entities, when in the business of providing essential goods and services (e.g., Utilities), should enable universal access, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

179.

Core Principle

The nine principles in BRSR are categorized into the ESG components of Environment, Social and Governance with two of the nine in Environment, three in social and four in Governance. One of the principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health,

well-being. Elucidate the essence of core elements associated with the aforesaid principle. **(Model Test Paper)**

Ans.



Principle 3 – Promote well-being of all employees including those in the value chain:

The third principle relates to all the initiatives an entity has to take for the benefit of its employees from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

- a) The entity should ensure compliance with all regulatory requirements as far as employees are concerned.
- b) The entities are to respect the dignity of employee as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.
- c) The entities should prevent all kinds of child labour, bonded labour, and any other forms of involuntary labour.
- d) The entities should have a system in which the work-life balance of the employees is not compromised.
- e) The businesses have to ensure timely payment of the worker's wages and compensation.
- f) The payment of the wages has to be as per the living wages, that can take care of the basic needs and provide economic security to the employees.
- g) The entities are responsible to create a workplace and work environment that is safe, hygienic, and comfortable for people to work for long durations.
- h) The skill development, career development and training of the workforce is another responsibility of the entities employing them.
- i) The creation of a workplace which is free of harassment and violence is also a responsibility of the entity.

180.



Core principles

GAS limited, is in the business of renewable energy, including fuel cell, electrolyzer, battery energy storage system wishes to contribute to clean energy ecosystem and National Green Hydrogen mission. GAS limited is among top 1000 listed entities and have to mandatorily provide BRSR reporting (Business Responsibility and Sustainability Reporting) on ESG parameters in accordance with the principles of "National Guidelines on Responsible Business Conduct" as mandated by SEBI. One of the principles states that "This can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalized communities." Elucidate the essence of core elements associated with the aforesaid principle. **(May-2025)**

Ans.

Principle 8 – Promote Inclusive Growth and Equitable Development can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalized communities.

The core elements of the eighth principle are:

- (i) The entities should have systems in place to identify and address the impacts of their activities on the social, cultural, and economic aspects of the people. This includes business-created issues like land acquisition and use, and construction activities for new facilities.
- (ii) The entities should review, measure, and track the adverse impacts of their activities on society and the environment and make action plans to mitigate them adequately.
- (iii) The entities should make efforts to bring up creative products, technologies, and business concerns that help the marginalized communities to have well-being and a better quality of life.
- (iv) Entities, when designing their CSR activities, should review the local and regional development priorities to help the marginalized groups and communities.
- (v) The entities should take care to ensure that business-induced displacement or relocation of communities does not happen, and in unavoidable cases, should make sure to have mutually agreed, participative, and informed negotiations to provide fair compensation to the affected people.
- (vi) All forms of intellectual property and traditional knowledge should get the deserved respect from the

organisation, and efforts should be made to ensure that benefits derived from their knowledge are shared equitably.

181.

Core Principle

SkinGlow Ltd., an e-commerce company dealing in skincare products, promotes its newly launched cream on its official website as “100% natural and chemical-free.” However, a review of the product label reveals the presence of artificial fragrance and preservatives. A customer who noticed the same tried to complain, but there was no proper complaint form or helpline available on the website. Additionally, the company's website states that its primary business objective is to offer useful products and services to customers in exchange of reasonable profits. With reference to the principles of the Business Responsibility and Sustainability Reporting (BRSR) framework, identify which principle is being referred to in this case. Also, state the core elements of this principle.

(RTP-Sept-2025)**Ans.**

In the case of SkinGlow Ltd., the misrepresentation of product contents and lack of a proper grievance mechanism are in direct conflict with Principle 9 of the BRSR framework. The company should take corrective measures to ensure alignment of its operations with responsible consumer practices as outlined in the BRSR principles 9 given below.

Principle 9 – Provide Value to the Consumers in a Responsible Manner:

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

- (a) Entities should put in their efforts to reduce the negative impacts of their products and services on consumers, natural environment, and society at large.
- (b) When conceptualizing, designing, and marketing their products, the organisation should not in any manner prevent the freedom of choice and fair competition.
- (c) The entities should transparently and accurately disclose all kinds of adverse impacts to the user, planet, society, on the biodiversity from their products.
- (d) When handling customer data, the right to privacy of the customer needs to be maintained.
- (e) Entities should inform the customers on the safe and responsible ways of usage, reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.
- (f) When advertising about their products, the organisations should ensure that misleading and confusing information is not exposed to the customers about their products or its usage.
- (g) Business enterprises should make available transparent and accessible grievance redressal and feedback management system for their customers to raise their voices or to seek clarifications.
- (h) Entities, when in the business of providing essential goods and services (e.g., Utilities), should enable universal access, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

Note:

**Chapter
19****Professional Ethics & Liabilities of Auditors**

182.

NOCLAR

Shri Limited, a listed Company, having its registered office at Mumbai is engaged in manufacturing of various types of yarns to be supplied to the textile mills. The Company has installed pollution control equipment for processing the pollutants so that before discharge of effluents outside the factory, the level of pollution is kept at a level below the prescribed standard. The company managed to get the pollution clearance certificate by unfair means, while still there continues to be breach of pollution control laws in matters of discharge of polluting effluents. The amount of ₹ 18.75 Lacs had been incurred for arranging clearance certificate and the amount incurred unlawfully had been booked as pollution recycling expenditure. The matter had not reached those in governance, and the Director-Finance, who is a Chartered Accountant, came to know of these matters on review of major expenditure incurred during the period. Comment the action/responses expected of Director - Finance (CA Gopal) referring to any applicable requirements of Responses for NOCLAR under Code of Ethics. **(MTP-Nov-2024, SM)**

Ans.**(i) In the given situation:**

- Shri Limited, a listed company, has installed pollution control equipment for processing the pollutants to keep the level of pollution below the prescribed standard.
- The company managed to get pollution certificate by unfair means whereas breach of pollution control laws still continues.
- For arranging clearance certificate amount of ₹ 18.75 lacs had been incurred unlawfully.
- CA Gopal, Director Finance, came to know about these matters on review of the same during the period.

(ii) Provision:

- NOCLAR, under Code of Ethics, is **applicable on professional accountants in service, and in practice.**
- Among those in practice, it **applies to Auditors, as well as professional services other than Audit.**
- It is **applicable to Senior Professional Accountants in service**, being employees of listed entities. Senior professional accountants in service ("senior professional accountants") includes directors.
- NOCLAR **takes into account non-compliance that causes substantial harm** resulting in serious consequences in financial or non-financial terms.
- As per NOCLAR, **in exceptional circumstances**, the **professional accountant** might **become aware of an imminent breach of a law or regulation** that would **cause substantial harm** to investors, creditors, employees or the general public.
- Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall **exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority** in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.

(iii) Conclusion:

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

- Obtaining an understanding of the Matter.
- Addressing the matter.
- Seeking advice.

- Determining whether further action is needed.
- Determining whether to disclose the matter to an Appropriate Authority.
- Imminent breach.
- Documentation.

183. Representative for taxation matters

CA Ram, a practicing chartered accountant, is well known for his expertise in handling Goods and Services Tax (GST) cases at the GST Tribunal and he does not provide any assurance services. Given his long-standing reputation in the field, CA Ram is approached by DEF Limited to file an appeal in the Tribunal against a GST demand of ₹ 6 crore, which was imposed by the Commissioner (Appeals), and to represent DEF Limited in the matter. CA Ram offers to accept a fee of ₹ 3,50,000 for filing the appeal and pleading at the GST Tribunal.

Comment on the act of CA Ram in terms of the Chartered Accountant Act, 1949 and Schedules thereon.

(MTP-Nov-2024)

Ans.


(i) Provision:
(a) Under Section 2(2)(iv) of the Chartered Accountants Act, 1949,

- a member of the Institute shall be deemed "to be in practice"
- when individually or in partnership
- with Chartered Accountants in practice,
- he, in consideration of remuneration received or to be received
- renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

(b) Pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949, read with Regulation 191 of Chartered Accountants Regulations, 1988

- a member shall be deemed to be in practice
- if he, in his professional capacity and neither in his personal capacity nor in his capacity as an employee,
- acts as representative for taxation matters.

(ii) **In the given situation:** CA Ram, a practicing Chartered Accountant, provides non-assurance services. He is approached by DEF Limited, a non-audit client, to file an appeal in GST Tribunal against GST Demand of ₹ 6 crore, which was imposed by the Commissioner (Appeals) and to plead on behalf of DEF Limited in the matter. CA Ram offers to accept the case and agrees to charge fees of ₹ 3,50,000

(iii) **Conclusion:** Therefore, CA Ram is not guilty of professional misconduct.

184. Maintenance of Separate Office

M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city, had great difficulty in regularly attending to the consultancy needs of his clients who are mostly located in an industrial cluster in a nearby outskirt which is situated at a distance of 26 kms from the office of the firm. To mitigate the difficulty and to have ease of business, a facilitation centre was opened in the industrial cluster. The proprietor managed, both the office and the facilitation centre, by himself. No intimation was made to the Institute of Chartered Accountants of India. Examine whether there, is any professional misconduct in this respect.

(May-2018, MTP-May-2025)

Ans.



(i) **Provision:- As per section 27 of the Chartered Accountants Act, 1949,** if a chartered accountant in practice has **more than one office in India**; each one of these offices should be in the **separate charge of a member** of the Institute.

(ii) **2nd office Exemption:-** There is however an exemption for the above

- **If the second office is located in the same premises,** in which the **first office** is located; or
- The **second office** is located **in the same city,** in which the first office is located; or
- The **second office** is located within a **distance of 50 kms** from the **municipal limits of a city,** in which the first office is located.
- Further a member having two offices of the type referred to above shall have to **declare which**

of the two offices is his main office, which would constitute his professional address.

(iii) **Regulation 189 of CA Regulations, 1988 requires that -**

A CA in practice or a firm of such CAs **shall inform the Council within one month of the opening or closing of a branch office.**

(iv) **In the given case:-** A CA in practice has opened a new office with 26 Kms from the existing office and managing both offices by himself. However, no intimation was made to the ICAI.

(v) **Conclusion:-** Though there is **no problem in managing both the offices**, but **misconduct arises due to non-intimation** to Council of ICAI.

185.

Maintenance of Branch Office

Mr. Z, a newly qualified chartered accountant started his practice in February 2018 by setting up an office in the hill station Kodaikanal. Initially, since he was getting very less assignments, he decided to set up a temporary office in the nearby city Marudai, situated at about 100 kms from the main office. As planned, he took an office space on rent for the months of April, May & June. During these months, his regular office was not closed and Mr. Z was in-charge for both the offices. Mrs. A, another newly qualified chartered accountant who is also in practice in Marudai came to know about the new office of Mr. Z. Thinking that he could be a potential competitor, she informed the institute stating that Mr. Z had violated the provisions of the Chartered Accountant Act. As a member of the Board of Discipline of ICAI, you are requested to analyse this complaint. **(MTP-May-2021)**

Ans.



(i) **Provision: -As per section 27 of the Chartered Accountants Act, 1949**, if a chartered accountant in practice **has more than one office in India**; each one of these offices should be in the **separate charge of a member** of the Institute.

(ii) **2nd office Exemption:-** There is however an exemption for the above

- If the second office is **located in the same premises**, in which the first office is located; or
- The second office is **located in the same city**, in which the first office is located; or
- The second office is **located within a distance of 50 kms** from the municipal limits of a city, in which the first office is located.

(iii) **Hill area Exemption: - Members in practicing in hill areas subject to certain conditions such as:**

- Such member/ firm be **allowed to open temporary offices** in a city in the plains for a limited period **not exceeding 3 months in a year**.
- The regular office **need not be closed during this period** and all correspondence can continue to be made **at the regular office**.
- The **name board** of the firm in temporary office **should not be displayed** at times other than the period such office is permitted to function.
- The temporary office **should not be mentioned in letter head, visiting card**, any other documents as a place of business of the member/ firm.
- Before commencement of every winter, it shall be obligatory on the **member/firm to inform the Institute** that he/it is **opening the temporary office** from a particular date and after the office is closed at the **expiry of the period** of permission, an intimation to that effect should also be sent to the office of the Institute **by registered post**.

(iv) **In the given case:-** Mr. Z has set up his **regular office in the hill area** of Kodaikanal, he decided to set up a **temporary office in the nearby city Marudai**, situated at about **100 kms from the main office**. As planned, he took an office space on rent for the months of **April, May & June**. During these months, his regular office **was not closed**. Further he was in-charge for **both the offices**.

(v) **Conclusion: -**In view of abovementioned criteria's, **he is eligible to avail the benefits of the above exemptions**. Also, it is given that the **temporary office was open in Madurai for only 3 months** and not beyond that. The fact that Mr. Z is **in-charge for both the offices**, the temporary office being set-up in the plains **which is 100 kms away** and the regular office kept open during the **3 months does not constitute any violation** of the provisions of the Chartered Accountant Act. **Assuming Mr. Z has informed the Institute** regarding such temporary office in the prescribed manner. Therefore, in the

given case, **no penal action needs to be taken on the basis of complaint registered** by Mrs. A, as Mr. Z is **not guilty of professional misconduct**.

186. Sale of Goodwill to Another Member

CA Ravi, a practising Chartered Accountant, was proprietor of M/s. Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for 25 Lacs along with right to use the firm name i.e., M/s. Ravi & Associates and requested the Institute to consider the effect of such sale. Give your comments on the following issues with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (i) Whether Roohi can sell the practice to CA Balwan?
- (ii) Can CA Balwan continue to practice as proprietor in name of M/s. Ravi & Associates ? **(May-2022)**

Ans.



(1) Provision

- (a) With reference to **Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949**, the Council of the Institute of Chartered Accountants of India considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.
- (b) It is being resolved that the **legal heir** of the deceased member **has to obtain the permission of the Council within a year of the death of the proprietor** concerned.
- (c) It further lays down that the sale is permitted subject to certain conditions like such a sale is completed/ effected in all respects and the Institute's **permission to practice in deceased's proprietary firm name is sought within a year of the death** of such proprietor concerned.
- (d) In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

(2) In the given case: Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ₹ 25 lakhs. This sale is in effect the sale of goodwill.

(3) Conclusion: From the discussion given above it can be concluded that:

- (i) Mrs. Roohi **cannot sell the practice to CA. Balwan** with right to use the firm name.
- (ii) **CA Balwan cannot continue to practice in the name of the firm M/s. Ravi & Associates** as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

187.



Sharing of fees

CA A, the proprietor of A & Colleagues, Chartered Accountants, is developing his practice and recently secured a major audit assignment for B state Cooperative Society. The engagement fee for this audit is ₹ 1 Cr.

In view of his vision of growth to expand the development of his business, CA A has entered into an agreement with an unregistered financial consultant, Mr. X, who is an MBA from a local university. Mr. X introduced CA A to his business clients and in return, CA A agrees to pay him a 2.5% commission (₹ 2.5 lakhs) on the audit fee as a referral bonus.

Additionally, as per the State Cooperative Registrar's Circular, 5% of the audit fee (₹ 5,00,000) has to be deposited into the State Treasury to cover administrative expenses. CA A complies with this requirement.

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. **(May-2025)**

Ans.

As per Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

The exception to this rule is specified in regulation 53A (3). The Regulation specifies that a Master in Business Administration from Universities established by law or technical institutions recognized by the All India Council for Technical Education. In the given situation, Mr. X is an MBA from a local university and CA. A agrees to pay commission on the audit fee as a referral bonus to Mr. X for introducing him to his business clients. Hence, CA A is guilty of misconduct.

Additionally, as per the State Cooperative Registrar's Circular, 5% of the audit fee (₹ 5 Lakh) must be deposited into the State Treasury to cover administrative expenses. Council decided that as such, there is no bar in the Code of Ethics to accept such an assignment wherein a percentage of the professional fee is deducted by the Government to meet the administrative and other expenditure. Hence, no violation is there.

188.

Acceptance of Original Professional Work - Client Introduced to Him by Another Member

During the opening ceremony of a new branch office of CA. Young, his friend CA. Old introduced to CA. Young, his friend and client Mr. Rich, the owner of an Export House whose accounts had been audited by CA. Old for more than 15 Years. After few days, Mr. Rich approached CA. Young and offered a certification work which earlier to have been done by CA. Old. CA. Young undertook the work for a fee which was not less than fee charged by CA. Old in earlier period. Comment whether CA. Young had done any professional misconduct. (Nov-2018)

Ans.



(i) **As per Clause:- (6) of Part I of First Schedule** to the Chartered Accountants Act, 1949

A Chartered Accountant in practice is deemed to be guilty of professional misconduct **if he solicits clients or professional work:**

- either **directly or indirectly** by circular, advertisement, personal communication or
- **interview or by any other means**

(ii) **As per Council Guidelines:-**

- The Council **has prohibited include that a member should not accept the original professional work** emanating from a **client introduced to him by another member.**
- If any professional work of such client comes to him directly, **it should be his duty** to ask the client that he **should come through the other member** dealing generally with his original work.

(iii) **In the given case:-** CA Old introduced his friend CA. Young to his friend and client Mr. Rich, the owner of an Export House **whose accounts has been audited by CA. Old** for more than 15 years. After a few days **Mr. Rich approached CA. Young** and offered a certification work which hitherto had been done by CA. Old. Fees charged by CA. Young is also not less than fee charged by CA. Old.

(iv) **Conclusion:-** In view of above decision **CA Young should ask the client to come through CA Old.** However, CA Young **undertook the work without informing** CA. Old. Thus, **CA. Young is held guilty under Clause (6) of Part I of the First Schedule** to the Chartered Accountants Act, 1949.

189.

Appointment of CAiP as Independent Director

A company has appointed a practicing Chartered Accountant as an independent director on its board. The said company publishes description about the Chartered Accountant's expertise, specialization and knowledge in any particular field or add appellations or adjectives to his name in the prospectus or public announcements issued by this company. Whether the said publication will be covered under Code of Ethics? What should be the role of the Chartered Accountant in this regard? (July-2021)

Ans.



(i) **Guidelines with respect to Appointment of CAiP as a Independent Director**

- The Council of the ICAI has in a communication to members stated that **if the prospectus or public announcements** issued by these Companies often publish descriptions about the **Chartered Accountant's expertise, specialisation and knowledge** in any particular field or add appellations or adjectives to their names. it shall constitute a **misconduct under Clause (6) and (7) of Part I of the First Schedule** to the Chartered Accountants Act.
- **The Council has further stated that** in such cases the member concerned has to **take necessary steps** to ensure that such prospectus or public announcements or public communications **do not**

advertise his professional attainments and also that such prospectus or public announcements or public communications **do not directly or indirectly amount to solicitation of clients** for professional work by the members.

- **It is advisable for a member that** as soon as he is appointed as a **director on the Board of a Company**, he should specifically invite the attention of the **management of the Company** to the aforesaid provisions and should request that before **any such prospectus or public announcements or public communication** mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be **got approved by him**.
- (ii) **In the given situation:** - A company has appointed a practicing chartered accountant as independent director on its board. The said **company published description about the Chartered Accountant's expertise, specialisation and knowledge** in any particular field or add appellations or adjectives to his names in the prospectus or public announcements issued by this Company.
- (iii) **Conclusion:** - Thus in the instant case, **Chartered Accountant would be held to be guilty of professional misconduct** under Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949 and liable for disciplinary action.

190.



Conditional Acceptance of Appointment

- (a) PN and Associates are appointed as the Statutory Auditors of The Iron Company Ltd. The Central Government holds 65% of the paid-up share capital in this company. The appointment letter of the company gave a very limited time to PN and Associates for accepting the audit. CA N, the engagement partner communicated with the previous auditor but due to lack of time he had to give acceptance for the audit assignment before receiving reply from the previous auditor, Hence CA N gave a conditional acceptance of the appointment and commenced the audit. Discuss with reference to the Chartered Accountants Act, 1949 and the schedules thereunder, whether CA N has complied with the same.
- (Nov-2024, RTP-May-2025, MTP-Jan-2026)**
- (b) If CA Yash is guilty of misconduct in the above situation given in part (a), then before which authority, the matters of CA Yash would have been placed and what punishment could have been imposed on him by the said authority in accordance with the Chartered Accountants Act, 1949? **(RTP-May-2025)**

Ans.

- (a) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

In the given case, PN and Associates are appointed as the Statutory Auditors of The Iron Company Ltd. which is a government company as Central Government holds 65% of the paid-up share capital of the company and CA N has given a conditional acceptance of the appointment and commenced the audit. In view of above, it can be concluded that CA N has complied with the provisions of the Chartered Accountants Act, 1949 and the Schedules thereunder.

- (b) **If CA Yash would have been found guilty of professional misconduct under Clause 8 of Part I of the First Schedule of the Chartered Accountants Act, 1949:** The matter would have been placed

before the Board of Discipline. The punishment that the Board of Discipline could have imposed would be:

- (i) Reprimand the member.
- (ii) Remove the name of the member upto a period of 3 months.
- (iii) Impose fine upto rupees ₹ 1,00,000/-

191.

Appointment in Case of Resignation

Mr. Sunil was appointed statutory Auditor of M. Autotech Limited after Mr. Ram resigned from the position of auditor on 31-07-2022 for the financial year 22-23. Mr. Sunil received the appointment letter duly signed by the Board of Directors and a resolution of the Audit Committee recommending the name of Mr. Sunil to the Board. Mr. Sunil received the letter of appointment on 31 -07-2022, which he accepted on 01-08-2022. On 15- 08-2022, Mr. Sunil fixed a meeting with Mr. Ram to understand the reasons for his resignation and any concerns he should be aware of about the company. Prior to this, Mr. Sunil had not communicated with Mr. Ram. The Board of M Autotech Limited filed ADT-1 with the registrar on 31-08-2022.

Mr. Sunil, after performing the audit, issued his audit report on 31 -05-2023. The registrar, after issuance of the audit report, suo moto initiated an inquiry regarding the appointment of Mr. Sunil as the auditor of the company. After the inquiry, Registrar issued a report to ICAI wherein it was mentioned that Mr. Sunil should be held guilty of professional misconduct. You are required to guide Mr. Sunil with respect to the recommendation of the registrar for him being guilty of professional misconduct **(MTP-Nov-2023)**

Ans.



(i) Provision:

- (a) A member in practice shall be **held guilty of professional misconduct as per clause 9 of Part I of the First Schedule** where he **accepts an appointment** as auditor of a company **without first ascertaining** from it **whether the requirements of Section 225 of the Companies Act, 1956 (1 of 1956)**, in respect of such appointment have been **duly complied with** (corresponding to section 139 and 140 of Companies Act, 2013).
- (b) **Clause (9) of Part I of the First Schedule to Chartered Accountants Act, 1949** provides that a member in practice shall be deemed to be **guilty of professional misconduct** if he **accepts an appointment** as auditor of a Company **without first ascertaining** from it **whether the requirements of Sections 139 and 140 of the Companies Act, 2013**, in respect of such appointment have been **duly complied with**. Under this clause, it is obligatory for the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.
- (c) **As per section 139(8) of the Companies Act, 2013**, any **casual vacancy in the office of an auditor** shall 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 thirty days**, but 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.
- (d) Also, before such appointment is made, the **written consent** of the auditor to such appointment **and a certificate** from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed shall be obtained from the auditor.
 Provided also that the **certificate** shall **also indicate whether the auditor satisfies the criteria provided in section 141**.
 Also, that the company shall **inform the auditor concerned of his appointment and also file a notice of such appointment with the Registrar** within **fifteen days** of the meeting in which the auditor is appointed.
- (e) Also, a member in practice shall be held **guilty of professional misconduct as per clause 8 of Part I of the First Schedule** where he **accepts** a position as auditor previously held by another Chartered Accountant **without first communicating with him in writing**.

(ii) In the current case:

- Mr. Sunil was appointed statutory Auditor of M. Autotech Limited after Mr. Ram resigned from the position of auditor on 31-07-2022 for the financial year 2022-23.
- Mr. Sunil received the appointment letter duly signed by the Board of Directors.
- Mr. Sunil received the letter of appointment on 31-07-2022, which he accepted on 01-08-2022.
- On 15-08-2022, Mr. Sunil fixed a meeting with Mr. Ram to understand the reasons for his resignation and any concerns he should be aware of about the company.
- Prior to this, no communication happened between Mr. Sunil and Mr. Ram.
- The Board of M. Autotech Limited filed ADT-1 with the registrar on 31-08-2022.
- Hence, **Mr. Sunil did not verify whether the requirement of section 139** of the Companies Act, 2013 has been **complied with or not**, as in the current case, there was **no approval** by the company at a general meeting convened within three months of the recommendation of the Board.
- Under Section 139(8), **approval** by a company at general meeting as discussed above **is mandatory requirement**.
- Therefore, he has **not ascertained** from company **whether requirements of section 139 and 140 of Companies Act, 2013** have been **complied with**.
- Moreover, Mr. Sunil **did not communicate with a retiring auditor** in such a manner as to retain in their hands positive evidence of the delivery of the communication to the outgoing/previous auditor.

(iii) Conclusion:

Therefore, **Mr. Sunil is guilty of professional misconduct both under clause 8 and 9 of First Schedule to Chartered Accountants Act, 1949.**

192.

Other Occupation

Mr. S is a practising chartered accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto, (especially from the point of section 8: Entry of name in Register of Members). **(MTP-May-2024, MTP-May-2023, RTP-May-2023)**

Ans.



Given situation can be visualised in following parts:

- (A) **Mr S used to involve himself in equity research and used to advise his friends, relatives and other known people:** As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation.

In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.

- (B) **Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities:** As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

- Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.

- Owning agricultural land and carrying out agricultural activities.

Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

(C) **Mr. S was discharged insolvent: Disabilities for the Purpose of Membership :** Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of Section 8, and he is not debarred from having his name entered in the Register of Members.

193.

MCS

CA R, a Chartered Accountant in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends, CA S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function and train articled assistants. Comment with reference to the provisions of the Chartered Accountants Act, 1949 and schedules thereto. **(July-2021)**

Ans.


Business or occupation other than the profession

(i) Clause (11) of Part I of First Schedule:

- 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.

(ii) Council Guidelines & Decision:

- The Council decided to allow members in practice to **hold the office of Managing Director, Whole-time Director or Manager** of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is **engaged exclusively** in rendering **Management Consultancy and Other Services** permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard.
- The name of the **Management Consultancy Company** is required to be **approved by the Institute** and such Company has to be **registered with the Institute**. The members can retain **full time Certificate of Practice** besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company.
- **There will be no restriction on the quantum of the equity holding** of the members, either individually and/ or along with the relatives, in such Company.
- Such members shall be regarded as being in **full- time practice** and therefore can continue to do attest function either in **individual capacity** or in **Proprietorship/Partnership firm** in which capacity they practice and wherein they are also entitled to train articled/audit assistants.

(iii) Conclusion: - Thus, the **action of CA R is valid.**

[Ans. Assumed that HKC Ltd. In registered with ICAI]
194. Trademark Attorney – ESB Decisions

Mr. Rohan, a Chartered Accountant in full-time practice, is approached by a client who is commencing a new business. The client requests Mr. Rohan's assistance in registration of trademarks and patents for his brand and products. Mr. Rohan agrees to support the client by filing applications and representing him as a Trademark Attorney before the Registrar of Trademarks. However, one of his senior partners reminds him that such activities may be restricted under the Chartered Accountants Act, 1949. Now, Mr. Rohan finds himself in a dilemma for providing such services. Comment. **(MTP-Sept-2025)**

Ans.


As per the recent decisions taken by the Ethical Standards Board of ICAI, a member in practice cannot act as Trademark or Patent Attorney. However, Professional advice in relation to Intellectual Property Rights (IPR) is a routine professional work for a Chartered Accountants in practice and same is permissible under the provisions of the Chartered Accountants Act, 1949.

In the given case, CA. Rohan agrees to support the client by filing applications and representing him as a Trademark Attorney before the Registrar of Trademarks. However, one of his senior partners reminds him that such activities may be restricted under the Chartered Accountants Act, 1949.

Thus, it can be concluded that the senior partner of CA. Rohan is correct as CA. Rohan's action of agreeing to act as a Trademark Attorney before the Registrar of Trademarks would amount to professional misconduct under the Chartered Accountants Act, 1949.

195. Misrepresentation

Hitesh, a Chartered Accountant, applied for obtaining a Certificate of Practice. However, while filling out the application form, he intentionally did not fill the section requiring disclosure of any engagement in other occupations or businesses. Hitesh was actively involved in a business, making this non-disclosure a case of withholding crucial information that was explicitly sought by the Institute.

Analyse whether Hitesh's actions amount to professional misconduct as per the provision of the Chartered Accountants Act, 1949. **(MTP-May-2025)**

Ans.


Disclosure of Information: As per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

In the given case, Hitesh, a Chartered Accountant while applying for a certificate of practice, did not fill in the columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business. Details of engagement in business need to be disclosed while applying for the certificate of practice as was the information called for in the application, by the Institute.

Thus, Hitesh will be held guilty of professional misconduct under Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949.

196. Grossly Negligent and Bringing Disrepute to the Institute

Mr. Yuvi, a Chartered Accountant in practice, is the auditor of Prime Ltd. He advised the Managing Director of the company to include 'orders under negotiation' in sales, to reflect higher profit and better financial position for obtaining bank loans in future. Mr. Yuvi, thereafter, gave clean reports on the balance sheet prepared accordingly without examining the accounts. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. **(MTP-May-2020, MTP-May-2023)**

Ans.


(i) As per Clause:- Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct

- If he does not exercise **due diligence**, or
- is **grossly negligent** in the conduct of his professional duties.

(ii) As per Clause:- Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct,

- If he in the **opinion of the Council, brings disrepute**

	- To the profession or the Institute as a result of his action Whether or not related to his professional work. (iii) In the given case:- Mr. Brainy, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts. Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company. (iv) Conclusion:- Mr. Brainy will be held guilty for professional and other misconduct under abovementioned Clauses to the Chartered Accountants Act, 1949.
197.	Reporting to Regulatory Body TP and Associates were statutory auditors of Deepa Ltd. The audit for the financial years 2023-24 and 2024-25 is still pending due to a dispute between the auditor and the company regarding certain remarks proposed to be included in the audit report for the financial year 2023-24. Subsequently, in a shareholders' meeting held on 06.05.2024, the company removed TP and Associates as auditors after complying with all applicable legal formalities. TP and Associates after coming to know about the removal, intimated the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors etc. Deepa Ltd. complained to ICAI against TP and Associates for their above letter to ROC. Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (MTP-Sept-2025)
Ans. 	Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force. An accountant, in public practice, has access to a great deal of information of his client which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment. In the given situation, TP & Associates complained to the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors, etc. after coming to know about the removal. TP & Associates made voluntary disclosure of the information acquired during the professional engagement without the consent of the client and without there being any requirement in law to disclose the same. Thus, the concerned responsible partner of TP & Associates, being a Chartered Accountant in practice, shall be held guilty of professional misconduct for voluntary disclosure made by him.
198..	Violation of Provision & Punishment The Director (Discipline) of the ICAI received information of alleged misconduct against Mr. Jayprakash, the proprietor of JP & Associates, as follows:- - Audit of a college was accepted by JP & Associates in which Mr. Jayprakash is working as a part-time lecturer and also, he had not taken permission of the ICAI for working as a part-time lecturer in the college. - An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned. On the basis of above information and along with certain evidence against Mr. Jayprakash, he was found guilty and so he was reprimanded and a fine of ₹ 1 lakh was imposed by an order passed against him dated 12th July, 2020. Against the said order, Mr. Jayprakash preferred an appeal with the Appellate Authority on 17th August, 2020 by submitting a statement of appeal along with the application form of appeal. During such appellate proceedings, it was discovered that the said statement of appeal contained some facts which were false to which Mr. Jayprakash admitted it to be false and apologized for it.

- (a) Mr. Jayprakash has violated which of the provisions of the Chartered Accountants Act, 1949?
- (b) Before which authority, the matter of Mr. Jayprakash would have been placed and what maximum punishment could have been imposed on him by the said authority in accordance with the Chartered Accountant Act, 1949?

(RTP-Dec-2021)

Ans.

Professional misconducts in various cases

- (a) Mr. Jayprakash has **violated following provisions** of the Chartered Accountants Act, 1949:
- (i) **Clause: - As per Clause (4) of Part I of the Second Schedule** to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, **if he expresses his opinion on financial statements of any business or enterprise** in which he, his firm, or a partner in his firm **has a substantial interest**.
- Council guidelines :** -In this connection, as per the decision of the Council of the ICAI, a Chartered Accountant **should not by himself or in his firm name accept the audit of a college**, if he is working as a **part-time lecturer** in the college.
- Conclusion: -Thus, by accepting audit of a college** in which he is working as a part-time lecturer, Mr. Jayprakash has **violated the restriction imposed** under Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.
- (ii) **Clause: - 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.
- Council guidelines :** -Members of the Institute in practice **may engage in a part-time or full-time tutorship** under any educational institution other than the coaching organization of the Institute, **after obtaining the specific and prior approval** of the Council in each case.
- Conclusion: -Mr. Jayprakash** had not taken permission of the ICAI for working as a part-time lecturer in the college and so has violated the restriction imposed under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
- (iii) **Clause: - As per Clause (6) of Part I of the First Schedule** to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, **if he solicits clients or professional work either directly or indirectly** by circular, advertisement, personal communication or interview or by any other means.
- In this connection, members sponsoring activities relating to **Corporate Social Responsibility** may mention their **individual name with the prefix "CA"**. However, mentioning a **firm's name** or **CA Logo is not permitted**.
- In the given case: -An event** relating to **Corporate Social Responsibility** was sponsored by **JP & Associates**, whereby in the sponsorship banner, name of Mr. Jayprakash as '**CA Jayprakash, Proprietor, JP & Associates**' was mentioned.
- Conclusion: -Thus, firm's name** was mentioned which is not allowed and thus, **Mr. Jayprakash has violated the restriction imposed** under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
- (iv) **Clause: -As per Clause (3) of Part II of the Second Schedule** to the Chartered Accountants Act, 1949, a member of the ICAI shall be deemed to be guilty of professional misconduct, **if he includes in any information, statement, return or form** to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority, any particulars **knowing them to be false**.
- Conclusion: -Mr. Jayprakash** in the statement of appeal submitted with the Appellate Authority mentioned **some facts knowing them to be false** and thus, he has **violated the restriction imposed under Clause (3) of Part II of the Second Schedule** to the Chartered Accountants Act, 1949.
- (b) **As Mr. Jayprakash has been alleged of misconduct falling in First as well as Second Schedule, so the matter would be placed before the Disciplinary Committee.**

The **maximum punishment** which could have been imposed on him by the said authority would be:-

- (i) **Reprimanding** the member.
- (ii) **Removing name** of the member permanently or for any duration, it thinks fit.
Imposing fine upto ₹ 5,00,000.

199.

IT Representative

CA. P has been representing M/s VS and Associates before Income-tax Appellate Tribunal for a case of income escaping assessment for F.Y. 2016-17. There were unidentified credits in the books of accounts. CA. P was the statutory auditor of the company that time and did not mention any thing about such credit in his audit report. Later, it was found that he had sufficient evidences to believe that these credits were liable to be taxed. In order to make his case stronger, he produces false documents and made witness present false statements.

What do you think are provisions against CA. P under CA Act?

(Nov-2023)

Ans.

Applicable provisions as per the Chartered Accountants Act, 1949:

(i) Provision:

(a) As per Clause (5) of Part I of Second Schedule to the Chartered Accountant Act, 1949,

- a Chartered Accountant in practice is deemed to be guilty of professional misconduct
- if he fails to disclose a material fact known to him
- which is not disclosed in a financial statement,
- but disclosure of which is necessary to make the financial statement not misleading,
- where he is concerned with that financial statement in a professional capacity.

(b) Further, as per Clause (6) of Part I of Second Schedule,

- a Chartered Accountant in practice is deemed to be guilty of professional misconduct
- if he fails to report a material misstatement known to him
- to appear in a financial statement
- with which he is concerned in a professional capacity.

(ii) In the instant case:

- CA. P, a chartered accountant was **appointed as representative** by M/s VS Associates **to appear before Income-tax Appellate Tribunal** in the matter of its Income-tax proceedings of income escaping assessment **for the year 2016-17**.
- As per given facts of the case, it is very much clear that there were **unidentified credits** in its books of accounts, but CA. P **did not mention about that in his audit report** whereas he was having sufficient evidence that those credits were liable to be taxed.
- Also, he **wilfully made or causes to be made any entry or statement which is false** in any books of account or other document relevant to or useful in any proceedings against the M/s VS Associates,
- Under this Act, CA. P shall **be punishable with rigorous imprisonment** for a term which shall **not be less than three months** but which **may extend to three years and with fine**.

Conclusion: In view of the above, CA. P would **be liable under section 277A of the Income-tax Act, 1961** and will **be held liable for professional misconduct under clause 5 and clause 6 of Part I of Second Schedule of the Chartered Accountants Act, 1949**.

200.

Negligence

CA. T, the statutory auditor of Race Limited, a PSU, for the year 2023-24. During the audit, CA. T did not detect any fraud having been committed during that year. However, the C & AG audit staffs, during their routine inspection, found that chief cashier of the company committed fraud in debtor's ledger and absconded with the amount. The investigation made in the fraud revealed that the auditor did not exercise proper skill and care and performed his work improperly.

Comment with reference to the provisions of the Chartered Accountants Act, 1949. **(Model Test Paper)**

Ans.

Failure to Exercise Reasonable Care and Skill: Clause (7) of Part I of Second Schedule to the Chartered



Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

In the given case, CA. T did not detect any fraud. However, the C & AG audit staff, during their routine inspection, found that the chief cashier of the company committed fraud in debtor's ledger and absconded with the amount.

Apparently, it appears that the auditor did not exercise proper skill and care and that he performed his work in an improper manner. In this matter, the test for auditor's liability lies in whether he has applied reasonable care, skill and caution called for in the circumstances of the case and whether he reasonably used all the information that he came across during the audit.

The auditor should have been highly concerned about the cashbook's state due to the unexpected disappearance of the head cashier. This unexplained absence is a major red flag and demands a thorough investigation by the auditor.

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regard to this that fraud has actually taken place during the year committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

As it appears from the facts of the case, CA. T has been grossly negligent in performing his duties which constitutes professional misconduct. Thus, such instances require reference to Disciplinary Committee of the Council of the Institute.

201.

Issuing Certificate without having Certificate of Practice

The manager of Miskin (P) Ltd. approached CA. Rahul in need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Rahul issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute. **(MTP-May-2024, SM)**

Ans.



- (i) **As per Clause:- Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**
- A member of the Institute, **whether in practice or not**, shall be deemed to be guilty of **professional misconduct** :
 - **If he contravenes any of the provisions** of this Act or
 - **The regulations** made there under or
 - **Any guidelines** issued by the Council.
- (ii) **Provision of CA act:- Section 6 of Chartered Accountants Act, 1949** provides that **no member of the Institute** shall be entitled to practice (whether in India or elsewhere) **unless he has obtained from the Council a certificate of practice.**
- (iii) **In the given case:-** CA. Vineet has issued a certificate in respect of a **consumption statement of raw material** to the **manager of ZedEx (P) Ltd.**, as a Chartered Accountant in practice when **he had not even applied for the COP** to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.
- (iv) **Conclusion:-** CA. Vineet will be held **guilty of professional misconduct** in terms of **Clause (1) of Part II of Second Schedule** to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

202.

Contravening Provisions of the Act/Regulations/Guidelines

Mr. Kushal, a practicing Chartered Accountant has signed the Tax Audit Reports u/s 44AB of the Income tax Act, 1961 for the financial year 2021-22 that are filed online using Digital Signature and without generating UDIN on the ground that there is no field for mentioning UDIN on digitally signed online reports. Is the contention of Mr. Kushal valid? Give your comments with reference to the Chartered Accountants Act, 1949

and schedules thereto.

(Nov-2020, MTP-Dec-2021)

Ans.



(i) **As per Clause:- Clause (1) of Part II of the Second Schedule to the Chartered Accountants Act, 1949**

- A member of the Institute, **whether in practice or not**, shall be deemed to be guilty of **professional misconduct** :
- **If he contravenes any of the provisions** of this Act or
- **The regulations** made there under or
- **Any guidelines** issued by the Council.

(ii) **As per Council Guidelines (Chapter XV) :-** In exercise of the powers conferred on it **Part- II of the Second Schedule to the Chartered Accountants Act, 1949**, the Council of the Institute of Chartered Accountants of India **made it mandatory for the members of the Institute in practice to generate Unique Document Identification Number (UDIN) for all Tax Audit Reports w.e.f. 1st April, 2019.**

(iii) **In the instant case:-** Mr. Kushal, a practicing Chartered Accountant has **signed the Tax Audit Reports u/s 44AB** of the Income tax Act, 1961 for the financial year 2019-20 that are filed **online using Digital Signature** and **without generating UDIN** on the ground that there is no field for mentioning UDIN on digitally signed online reports.

(iv) **Conclusion:- Contention of Mr. Kushal is not valid as non-generating of UDIN amounts to professional misconduct** under Clause 1, Part II of Second Schedule.

SJ Note:- Alternatively CA. may be held guilty under Clause 9 Part 1, Schedule 2

203.



Limits for tax audit

M/s JAZZ & Co. is a partnership firm consisting of two partners CA J and CA Z.

CA J is exclusively associated with the firm and is not doing practice in individual capacity, whereas CA Z is doing practice in his individual capacity also.

For the financial year 2023-24, the firm has already undertaken audits and signed audit reports under section 44AB/44AD of the Income Tax Act, 1961 as under:

	Under section 44AB for corporate clients	Under section 44AB for non-corporate clients	Under section 44AD/44ADA
CA J	30	60	20
CA Z	5	10	12

For the financial year 2023-24, CA Z has undertaken audits in individual capacity and signed audit reports under section 44AB/44AD of the Income Tax Act, 1961 as under:

	Under section 44AB for corporate clients	Under section 44AB for non-corporate clients	Under section 44AD/44ADA
CA Z	4	9	8

For the financial year 2023-24, the firm is approached further to take up the following assignments:

3 tax audit assignments under section 44AB for corporate clients

4 tax audit assignments under section 44AD.

Advise whether the firm should accept the further tax audit assignments for the financial year 2023-24 as above in the light of professional code of conduct.

(May-2025)

Ans.

As per Chapter VI, Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961.

Further, in the case of a firm of Chartered Accountants in practice, the "specified number of tax audit assignments" means 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

It may be noted that the audits conducted under Section 44AD, 44ADA, and 44AE of the Income-tax Act,

1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

Furthermore, where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the “specified number of tax audit assignments” in the aggregate. In computing the “specified number of tax audit assignments”, the number of such assignments, which he or any partner of his firm has accepted, whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

According to a clarification on Tax Audit Assignments by Committee on Ethical Standards Board of the Institute, if there are 10 partners in a firm of Chartered Accountants in practice, then all the partners of the firm can collectively sign 600 tax audit reports. This maximum limit of 600 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 600 tax audit reports in case the remaining 9 partners are not signing any tax audit reports.

In the instant case, M/s JAZZ & Co. is a partnership firm of Partner CA J and CA Z. CA Z is also doing practice in individual capacity. In the instant case, 60 tax audit assignments per partner in the firm, whether in respect of corporate or non-corporate assesses, in a financial year, will be considered for “specified number of tax audit assignments”, i.e., 120 tax audits = 2 Partners x 60 tax audits.

In the given situation, the number of tax audit reports signed under section 44AB are 118 (i.e., 90 reports signed by CA J [i.e., 30 reports for corporate clients and 60 reports for non-corporate clients] whereas, CA Z signed 28 reports [15 reports as a Partner of the Firm {i.e., 5 for corporate clients and 10 for non-corporate clients} and 13 Reports in individual capacity i.e. {i.e., 4 for corporate clients and 9 for non-corporate clients}] and number of tax audit reports signed under section 44AD are 40 (i.e., 20 reports signed by CA J and 20 reports signed by CA Z). It may be noted that the 40 audits conducted under Section 44AD of the Income-tax Act, 1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

The firm is also approached further to take up 3 tax audit assignments under section 44AB for corporate clients and 4 tax audit assignments under section 44AD.

In view of the above provisions, partner CA J and CA Z of M/s JAZZ & Co. have undertaken 118 audits, which is not more than 120 tax audits, i.e., “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961. Therefore, the firm can accept 2 more tax audit assignments for corporate clients under section 44AB and all 4 tax audit assignments under section 44AD as there is no limit on assignments under Section 44AD.

204. Council General Guidelines 2008 - Chapter IX

- (a) CA Vaayu is the auditor of Viva Limited having a turnover of more than ₹ 200 Crores. The audit fee for the year is fixed at ₹ 80 Lakhs. During the year, the company offers CA Vaayu an assignment of representation before Income Tax Appellate Tribunal for certain matter for remuneration of ₹ 1.75 crores. CA Vaayu accepted the assignment. Discuss action of CA Vaayu with reference to the provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto. **(SM)**
- (b) Sanjeev & Associates, a firm of Chartered Accountants responded to a tender from a PF Office, Chembur for filing quarterly e-TDS returns. The terms of tender are as follows:
- Earnest Money Deposit of ₹ 7,500/-
 - It is open for all categories
 - Maximum fees of ₹ 7,500/- per quarter

Discuss whether Sanjeev and Associates can respond to the said tender with reference to provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto. **(RTP-Nov-2024, SM)**

Ans.

(a)

(i) Provision:

As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accept the appointment as a statutory auditor of a



PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of ₹ 50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking.

For this purpose, the other work/services include Management Consultancy and all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.

(ii) In the given case: Company offers CA Vaayu, the statutory auditor, an assignment of representation before Income Tax Appellate Tribunal for remuneration of ₹ 1.75 Crores.

(iii) Conclusion: In view of the above provision, it would not be misconduct on Vaayu's part if he accepts the assignment of representation before Income Tax Appellate Tribunal for remuneration of ₹ 1.75 crore.

(b)

(i) Provision:

(a) As per Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949,

- a Chartered Accountant in practice shall be guilty of professional misconduct
- if he solicits clients or professional work
- either directly or indirectly
- by circular, advertisement, personal communication or interview or by any other means.

(b) Provided that nothing herein contained shall be construed as preventing or prohibiting -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence.

(c) However, as per the Guidelines issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organisation or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services.

(d) However, such a restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

(ii) In the given case: Sanjeev & Associates responded to a tender from a PF Office, Chembur for filing quarterly e-TDS returns.

Conclusion: Sanjeev & Associates can respond to the said tender as the tender is open for all the categories i.e. it is open to other professionals along with the Chartered Accountants.

205.

Tax representation services by auditor

CA Dhanush is the auditor of Jivi Limited having a turnover of more than ₹ 300 Crores. The audit fee for the year is fixed at ₹ 2.25 crore. During the year, the company offers CA Dhanush an assignment of representation before Income- tax Appellate Tribunal for certain matter for remuneration of ₹ 2.85 crores. CA Dhanush accepted the assignment. Discuss action of CA Dhanush with reference to the provisions of the Chartered Accountants (Amendment) Act, 2006 and Schedules thereto. (MTP-May-2025)

Ans.



As per the Council General Guidelines 2008, under Chapter IX on appointment as statutory auditor a member of the Institute in practice shall not accept the appointment as a statutory auditor of a PSUs'/Govt company(ies)/Listed company(ies) and other public company(ies) having a turnover of ₹ 50 crores or more in a year and where he accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. For this purpose, the other work/services include Management Consultancy and

all other professional services permitted by Council excluding audit under any other statute, Certification work required to be done by the statutory auditor and any representation before an authority.

In the given case, the company offers CA Dhanush, the statutory auditor, an assignment of representation before Income Tax Appellate Tribunal for remuneration of ₹ 2.85 Crores which exceed the fees payable for audit.

Conclusion: In view of the above provision, it would not be misconduct on Dhanush's part if he accepts the assignment of representation before Income Tax Appellate Tribunal for remuneration of ₹ 2.85 crore since it is covered under exception.

206.

Tender

Mr. Ajit, a practicing Chartered Accountant, started a coaching institute for CA aspirants in Delhi. He displayed large hoardings across the city stating: "Coaching by CA Ajit – Also Undertaking Audit, Tax Audit and Attestation Assignments. Contact for Professional Services."

He also circulated pamphlets in nearby commercial areas inviting businesses to appoint him as statutory auditor.

Further, CA Ajit responded to a tender floated by a listed company for statutory audit work. The tender document did not prescribe any minimum fee. Furthermore, audit and attestation services were exclusively reserved for Chartered Accountants.

Examine whether CA Ajit is guilty of professional misconduct under the Chartered Accountants Act, 1949. Give reasons.

(RTP-May-2026)

Ans.



Advertisement through Hoardings and Pamphlets: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice from soliciting clients or professional work either directly or indirectly by circular, advertisement, personal communication, interview or by any other means.

In the present case, CA. Ajit displayed hoardings advertising his audit and attestation services. He also circulated pamphlets inviting businesses to appoint him as statutory auditor.

Such acts clearly amount to direct solicitation by advertisement and circular, which is expressly prohibited. Further, as per Council Guidelines, advertisement of coaching/teaching activities in a manner that indirectly promotes professional practice (e.g., linking coaching with audit services) amounts to indirect solicitation and is also violative of Clause (6).

Although a member may display a signboard outside coaching premises mentioning the name of the institute, contact details and subjects taught, large hoardings promoting professional services are not permitted.

Responding to Tender for Statutory Audit: Clause (6) permits a member to respond to tenders or enquiries issued by users of professional services.

However, as per Council Guidelines a member shall not respond to any tender in areas exclusively reserved for Chartered Accountants (such as audit and attestation services), unless the tender document prescribes a minimum fee, or the services are open to other professionals also.

In the given case, the tender is related to statutory audit which is exclusively reserved for Chartered Accountants. Also, minimum fee was not prescribed in the tender document.

In view of above, CA Ajit is guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 for directly and indirectly solicitation of professional work through hoardings and pamphlets and responding to the tender for statutory audit.

207.

Mr. Rohan, a practicing Chartered Accountant in Rohan Arjun & Associates is an Associate member of the Institute of Chartered Accountants of India (ICAI) but he started using the designation "FCA" on his visiting cards and professional correspondence to create a better professional image.

During scrutiny of certain records, the ICAI sought clarification from Mr. Rohan regarding activities that appeared unrelated to his professional practice. Despite multiple letters and reminders from the Institute, he failed to respond or provide the requested information.

Mr. Arjun, another partner of firm, whose name had been removed from the Register of Members

of the Institute, continued to train an articled assistant and also failed to respond to the Institute's letters seeking clarification.

Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto.

(MTP-May-2026)

Ans.



As per Clause (1) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be deemed to be guilty of professional misconduct, if a Chartered Accountant, in practice or not, not being a fellow of the Institute, acts as a fellow of the Institute.

Further, as per Clause (2) of Part III of First Schedule to the Chartered Accountants Act, 1949 a member shall be deemed to be guilty of professional misconduct if he, in practice or not, does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.

In the given case, Mr. Rohan being an Associate member of the Institute of Chartered Accountants of India, incorrectly used the designation "FCA" on his visiting cards and professional correspondence. He also failed to respond to the Institute's letters regarding his involvement in activities unrelated to his practice despite multiple reminders.

Further, Mr. Arjun, another partner of the firm, continued to train an articled clerk though his name was removed from the Register of Members of the Institute. Also, he had failed to send any reply to the Institute asking him to send his explanation as to how he was training as his articled clerk when he was not a member of the Institute.

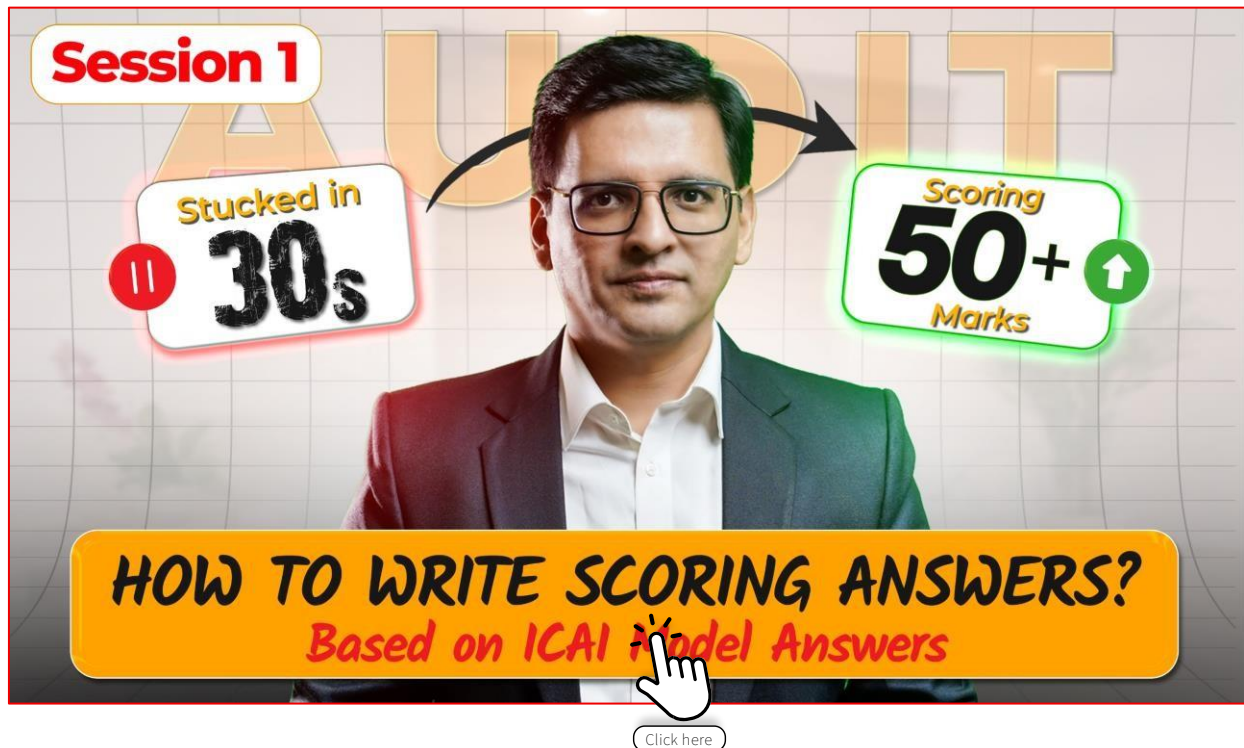
In view of above, Mr. Rohan will be held guilty of professional misconduct under Clause (1) & Clause (2) of Part III of First Schedule of the Chartered Accountants Act, 1949. Whereas Mr. Arjun is guilty of professional misconduct under Clause (2) of Part III of the First Schedule of the Chartered Accountants Act, 1949.

Note:



Also see: [FAST Official YouTube Channel](#)

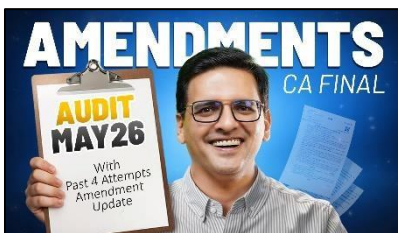
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