

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/HINTS

1. (a) **Minimising Risk of Material Misstatements:** As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates -
- (i) The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
 - (ii) How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
 - (iii) The estimation making process adopted by the management including -
 - (1) The method, including where applicable the model, used in making the accounting estimates;
 - (2) Relevant controls;
 - (3) Whether management has used an expert;
 - (4) The assumptions underlying the accounting estimates;
 - (5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
 - (6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.
- (b) **Compilation of Financial Information:** According to SRS 4410 "Engagements to Compile Financial Information", an accountant would normally have to rely upon the management for information to compile the financial statements in a compilation engagement. If in the course of compilation of financial statements, it is observed that the information supplied by the entity is incorrect, incomplete or otherwise unsatisfactory, the accountant should perform following procedures:
- (i) Make any enquiries of management to assess the reliability and completeness of the information provided;

- (ii) Assess internal controls prevailing in the entity; and
- (iii) Verify any matters or explanations.

The accountant may also request the management to provide additional information. This may be asked in the form of management representation letter. If the management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for such withdrawal.

If one or more accounting standards are not complied with, the same should be brought to the notice of the management and if the same is not rectified by the management, the accountant should include the same in notes to the accounts and the compilation report to the management.

In the given case, inventory of XYZ & Co. is grossly understated. Therefore, XYZ & Co. should be asked to provide additional information. If the company refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for such withdrawal.

- (c) **Audit Programme:** The Internal Audit Programme in connection with Plant and Machinery & Tools and Dies may be on the following lines-
 - (i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects -
 - (a) Maintaining separate register for hired assets, leased asset and jointly owned assets.
 - (b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.
 - (c) All movements of assets are accurately recorded.
 - (d) Authorisation be obtained for –
 - (1) a declaring a fixed asset scrapped.
 - (2) selling a fixed asset.
 - (e) Check whether additions to fixed asset register are verified and checked by authorised person.
 - (f) Proper recording of all additions and disposal.
 - (g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.
 - (h) Regular review of adequate security arrangements.
 - (i) Periodic inspection of assets is done or not.
 - (j) Regular review of insurance cover requirements over fixed assets.

- (ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.
 - (iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.
 - (iv) **Code Register:** To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.
 - (v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.
 - (vi) **Movement Register:** To verify (a) whether a Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.
 - (vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.
 - (viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.
 - (ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.
 - (x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.
 - (xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.
- (d) **Accounting for Long Term Investments:** As per AS 13 "Accounting for Investments", long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

Keeping in view the above, Max Ltd. should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

2. (a) **Internal Control System:** In order to achieve proper internal control over the sale of tickets and its collection by Funtoosh Ltd., following system should be adopted-
- (i) **Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
 - (ii) **Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
 - (iii) **Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
 - (iv) **Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
 - (v) **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.
 - (vi) **Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
 - (vii) **Discounts and free pass:** The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
 - (viii) **Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.
- (b) **Services not to be rendered by Auditor:** Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), as prescribed. The list of the services that has been prohibited to be rendered by the auditor of the company includes investment advisory services.

Further section 141(3)(i) of the Act also disqualify a person for appointment as an auditor of a company whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Additionally, in accordance with section 141(4) of the Act, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the given case, M/s Raga & Co., Chartered Accountants, was appointed as an auditor of R Ltd. Further, the company offered investment advisory services to M/s Swara & Co., an associate of M/s Raga & Co., which has also been duly accepted by the firm. Therefore, M/s Raga & Co. is disqualified to hold office as an auditor of R Ltd. as per the provisions explained above.

Subsequently, M/s Raga & Co. shall have to vacate the office of auditor of R Ltd. accordingly.

- (c) **Branch Audit:** As per section 143(8) of the Companies Act, 2013 if a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (i.e. company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

In the given situation, Alappa Ltd. is a Chennai based company having total turnover of Rs. 10 Crore. The company is having a branch office at an area which is recently affected by tsunami.

Therefore, the company has to get its branch audited. In case no branch audit has been carried out, company's auditor is required to mention this fact in the audit report and deal appropriately. Thus, no reference of above branch in statutory auditor's report is not correct.

- (d) **Control Procedure While Applying Computer Assisted Auditing Techniques (CAATs):** Computer Assisted Auditing Techniques (CAATs) involve performing audit procedures while conducting audit through the computer. Audit software and Test Data are two common types of CAATs. Using CAATs involves taking various measures including monitoring so that the use of CAATs by the auditor provides reasonable assurance that the audit objectives and detailed specifications of CAATs have been met. It is to be seen that CAATs are not manipulated by staff of the entity. The specific procedures necessary to control the use of CAATs will depend on the particular application.

Procedures carried out by the auditor to control CAATs applications may include:

- (i) participating in the design and testing of CAAT;
- (ii) checking, if applicable, the coding of the program to ensure that it conforms with the detailed program specifications;
- (iii) asking the entity's staff to review the operating system instructions to ensure that the software will run in the entity's computer installation;
- (iv) running the audit software on small test files before running it on the main data files;
- (v) checking whether the correct files were used, for example, by checking external evidence, such as control totals maintained by the user, and that those files were complete;
- (vi) obtaining evidence that the audit software functioned as planned, for example, by reviewing output and control information; and
- (vii) establishing appropriate security measures to safeguard the integrity and confidentiality of the data.

When using a CAAT, the auditor may require the cooperation of the entity's staff who have extensive knowledge of the computer installation. In such circumstances, the auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAATs.

3. (a) **Applicability of CARO, 2015 and Reporting for Default in Repayment of Dues:**
The CARO, 2015 specifically exempts a private limited company with a paid up capital and reserves not more than Rs. 50 lakh and which does not have loan outstanding exceeding Rs. 25 lakh from any bank or financial institution and does not have a turnover exceeding Rs. 5 crore at any point of time during the financial year.

In the case of Alora Pvt. Ltd., it has paid capital and reserves of Rs. 40 lakh i.e. less than Rs. 50 lakh. However, it has outstanding loan of Rs. 30 lakh a bank.

Therefore, it fails to fulfill the condition relating to outstanding loan. Thus, CARO, 2015 will be applicable to Alora Pvt. Ltd. and the auditor has to report under CARO accordingly.

As per clause (ix) of Para 3 of CARO, 2015, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

Further, as per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires

specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

In the given case, Alora Pvt. Ltd. has defaulted in repayments of dues (including interest) to a Bank during the financial year 2014-15 which remain outstanding as at 31st March, 2015. However, the company has settled the total outstanding dues on 30th April, 2015 but, the dues were outstanding as at 31st March, 2015. Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:

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

The company has defaulted in repayment of dues including interest to a Bank during the financial year 2014-15 amounting to Rs. XXXX which remained outstanding as at 31st March, 2015. The period of default is XXX days. However, the outstanding sum was settled by the company on 30th April, 2015."

(b) Classification of Frauds by NBFC and its Reporting: In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code-

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

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

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

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

- (c) **Responsibility of Holding Company for Preparation of Consolidated Financial Statements:** As per section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, 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. The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent/holding company. This includes:
- (i) identifying components, and including the financial information of the components to be included in the consolidated financial statements;
 - (ii) where appropriate, identifying reportable segments for segmental reporting;
 - (iii) identifying related parties and related party transactions for reporting;
 - (iv) obtaining accurate and complete financial information from components; and
 - (v) making appropriate consolidation adjustments.

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

4. (a) (1) **Advances to DOT COM Companies:**
- (i) Evaluate the efficacy of internal control system in general to ascertain whether an advance is made only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank. The sanction for an advance must specify, among other things, the limit of borrowing, nature of security, margin to be kept, interest, terms of repayment, etc. Also see that all the necessary documents, e.g., agreements, demand promissory notes, letters of hypothecation, etc. have been executed by the parties before advances are made.
 - (ii) Examine loan documents such as certificate of commencement of business, resolution of board of directors, and resolution of shareholders.
 - (iii) Verify the business plan of the company especially where the revenue model is in place. Verify whether the company depends only on outside funding or can self generate funds.

- (iv) Examine in case the security is in the form of mortgage, apart from mortgage deed (in the case of English Mortgage) or letter of intent to create mortgage (in the case of Equitable Mortgage), the evidence of registration of the charge with the Registrar of Companies.
 - (v) Review the operation of advance account to see that limit is not generally exceeded; that the account is not becoming stagnant; that the customer is not drawing against deposits which are not free from lien; that the account is not window-dressed by running down overdrafts at the year end and again drawing further advances in the new year, etc.
 - (vi) Examine whether there is a healthy turnover in the account. It should be seen that the frequency and the amounts of credits in the account are commensurate with the sanctioned limit and the nature and volume of business of the borrower. Any unusual items in the account should be carefully examined by the auditor. If the auditor's review indicates any unhealthy trends, the account should be further examined. The auditor's examination should also cover transactions in the post-balance sheet date period. Large transactions in major accounts particularly as at the year-end may be looked into to identify any irregularities in these accounts.
 - (vii) Review periodic statements, cash flow statements, latest financial statements, etc. to assess the recoverability of advances.
 - (viii) Verify whether the advance is secured and determine whether the security is legally enforceable, i.e., whether the necessary legal formalities regarding documentation, registration, etc., have been complied with; whether the security is in the effective control of the bank; and to what extent the value of the security, assessed realistically, covers the amount outstanding in the advance.
 - (ix) Ensure that proper provisioning norms have been applied in view of non-observance of terms, coupled with irregular payment of interest and default in repayment of instalments, if any.
- (2) **Balances in Account of a Bank situated in a Foreign Country:**
- (i) Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.
 - (ii) Review the reconciliation statements and pay particular attention to the following.
 - (1) Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken. This should be particularly observed when the bills collected, etc., are credited with net amount and entries for

commission, etc. are not made separately in the statement of account.

- (2) Examine that no cheque sent or received in clearing is outstanding. As per the practice prevalent among banks, any cheques returned unpaid are accounted for on the same day on which they were sent in clearing or on the following day.
 - (3) Examine that all bills or outstanding cheques sent for collection and outstanding as on the closing date have been credited subsequently.
- (iii) Examine the large transactions in inter-bank accounts, particularly towards the year-end, to ensure that no transactions have been put through for window-dressing.
 - (iv) Check original deposit receipts in respect of balances in deposit accounts in addition to confirmation certificates obtained from banks in respect of outstanding deposits.
 - (v) Check whether these balances are converted into the Indian currency at the exchange rates prevailing on the balance sheet date and ensure compliance with AS 11 on "Accounting for the Effects of Changes in Foreign Exchange Rates".
- (b) **Reporting Requirement under Clause (8) and (12) of Form 3CD:** Under Clause (8) of Form 3CD, the tax auditor is required to mention the relevant clause of section 44AB under which the audit has been conducted. If the audit under section 44AB is being conducted by virtue of provisions of section 44AE, 44BB and 44BBB, the auditor is required to mention clause (c).

Further, as per Clause (12) of Form 3CD, if the profit and loss account of the assessee includes any profits and gains assessable on presumptive basis, the tax auditor has to indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section).

In the given case, Liquim Ltd. is a non-resident company which is engaged in the business of extraction of mineral oils, hence, its income is chargeable in accordance with the provisions of section 44BB of the Income Tax Act, 1961. But it has turnover of Rs. 20 lakhs during the financial year 2015-16. Therefore, the company does not need to get its accounts audited under section 44AB of the Income Tax Act, 1961 as it is below the prescribed limit applicable for auditing of accounts. However, company is claiming lower income in comparison to deemed income under section 44BB of the said Act, thus, the company needs to get its accounts audited.

As per the facts of the case, provisions and explanations given above, the tax auditor of Liquim Ltd. is required to mention clause (c) of section 44AB under clause (8) of Form 3CD.

In addition to above, the tax auditor has to indicate under Clause (12) of Form 3CD, the amount of profits and gains assessable on presumptive basis under section 44BB of the Income Tax Act i.e. the amount of profits and gains credited/debited to the Profit & Loss Account.

(c) Main Areas to be covered in the Case of Environment Audit of an Industrial Unit:

- (i) Layout and Design** – The layout to be sketched in the style which will allow adequate provisions for installing pollution control devices, as well as provision for up gradation of pollution control measures and the meeting of the requirements of the regulations framed by the Government. In the course of the audit, the area which requires attention but not attended to by the industry to be pinpointed as well as the future requirements of the environmental measures required in commensuration with the proposed future course of working plan are to be identified.
- (ii) Management of Resources** – Management resources includes air, water, land, energy, raw materials and human resources besides others. The use of all resources is interlinked and the best uses in a synchronised manner results the best output and minimum waste. The waste of resources to the minimum possible extent is good for the health of the industry as well as the environment.
- (iii) Pollution Control System** – An effective system of pollution control should be in existence. One aspect should be whether all required pollution control measures are in vogue or not next aspect should be whether the same is effective or not, further it is to investigate, whether more measures are required, keeping in view the type of industry and its nature of working with respect to its grade of polluting the environment.
- (iv) Emergent Safety Arrangement** – The chemical, gas, etc., industries which are prone to sudden requirement of safety arrangements, must remain alert all the while. The emergency plans are to be reviewed periodically; sufficient staff along with other required safety amenities should be kept ready. The staff, remained so engaged, must possess the required awareness and alertness to meet the contingency. The degree of awareness, however, can be upgraded with proper training provisions.
- (v) Medical & Healthcare Facilities** – The medical services should be maintained. The health of the workers should be a big consideration for the management.
- (vi) Industrial Hygiene** – Proper system should be in vogue to eliminate industrial unhygienic state.
- (vii) Occupational Health** – The requirement for safeguarding against occupational health hazards should be available for all the workers. As the occupational

health hazards varies from industry to industry due to the difference in the nature of working atmosphere and the pollutants present in it, the concerned industry must pay proper weightage to those diseases which are prone to that particular type of industry.

- (viii) **Information Assimilation and Reporting System** – The information system should be strengthened to generate and its reporting system should be proper, keeping in view, the authorities, responsibilities and subsequent delegations. A report of compliance of all statutory environmental laws along with other preventive and precautionary measures should be put to Board at regular intervals.
- (ix) **EIA Methodology** – The Environmental Impact Assessment (EIA) is usually a pre-requisite to start an industry. This is done considering the known spheres of activities on the existing environmental conditions. But the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report, if it is noticed that the degradation to the environment caused on the establishment and running of the industry is much higher than what was predicted, the mitigatory measures suggested must also be furthered.
- (x) **Compliance to the Regulatory Mechanism** – As the persons who are directly working with the system, may be unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities, they should be trained and instructed on regular basis, to avoid making the Board/owner vulnerable to prosecution and penalty.
- (xi) **Concern for the Society** – The industry very often transforms the agrarian environment into an industrial environment. The people so displaced by industrialisation feel alienated and develop a feeling of facing the gaseous, dusty, clumsy state of surroundings. The audit should look into this aspect how the industry is making a balance between its own development and the society's concern.

5. (a) **The following areas need to be verified in case of embezzlement in cash receipts:**
- (i) Issuing a receipt to the payee for the full amount collected and entering only a part of the amount on the counterfoil.
 - (ii) Showing a larger cash discount than actually allowed.
 - (iii) Adjusting a fictitious credit in the account of a customer for the value of goods returned by him.

- (iv) Adjusting a cash sale as a credit sale, and raising a debit in the account of the customer.
 - (v) Writing off a good debt as bad and irrecoverable to cover up the amount collected which has been misappropriated.
 - (vi) Short-debiting the customer's account in the ledger with an intention to withdraw the difference when the full amount payable by him is collected.
 - (vii) Under-casting the receipts side of the Cash Book or over-casting the payment side; carrying over a shorter total of the receipts from one page of the Cash Book to the next or over-carrying the total of the payment from one page of the Cash Book to the next with a view to covering up misappropriation; either short banking of cash collection or apart of the amount withdrawal from the bank.
- (b) Examination of Claims Paid in respect of a General Insurance Company:** The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows-
- (i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies;
 - (ii) that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company. Such claims which have been communicated after the year-end for losses which occurred prior to the year end must be accounted for in the year of audit;
 - (iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;
 - (iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure;
 - (v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims. In such cases, full provision should be made for outstanding claims;
 - (vi) that payment made against claims partially settled have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount;

- (vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and
 - (viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.
- (c) **The factors to be considered to analyse causes for high employee attrition rate are as under:**
- (i) Job Stress & work life imbalance.
 - (ii) Wrong policies of the Management.
 - (iii) Unbearable behaviour of Senior Staff.
 - (iv) Safety factors.
 - (v) Limited opportunities for promotion.
 - (vi) Low monetary benefits.
 - (vii) Lack of labour welfare schemes.
 - (viii) Whether the organization has properly qualified and experienced personnel for the various levels of works?
 - (ix) Is the number of people employed at various work centres excessive or inadequate?
 - (x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?
6. (a) **Bringing Disrepute to the Profession:** A member is liable to disciplinary action under section 21 of the Chartered Accountants Act, 1949, if he is found guilty of any professional or "Other Misconduct". As per Clause (2) of Part IV of the First Schedule to the said Act, 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.
- A member may be found guilty of "Other Misconduct" as per Clause (2) under the aforesaid provisions rendering himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.
- In the given case, CA. X failed to return the books of accounts and other documents of his client without any reasonable cause, therefore, he would be guilty of other misconduct under the aforesaid provisions.

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

Further, regulation 190A of the Chartered Accountants Regulation, 1988 provides that a Chartered Accountant in practice shall not engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. According to the same, specific permission from the council would be necessary for holding office of managing director or a whole-time director of a body corporate.

In the given case, CA. Laxya has immediately joined the office of managing director of Rahi Pvt. Ltd. without obtaining specific or prior approval of the Council.

Therefore, CA. Laxya will be held guilty of professional misconduct under Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949.

- (c) **Failure to Observe Regulations:** As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training.

In the instant case, the articled assistant is not attending office on timely basis and the explanation of the Chartered Accountant that the articled assistant was on audit of the company cannot be accepted particularly in view of the fact that articled assistant is getting monthly salary from that company. Under the circumstances, the Chartered Accountant would be held guilty of professional misconduct in regard to the discharge of his professional duties.

- (d) **Charging of Fees Based on Percentage of Profits:** According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.

In the given case, CA. M, a practicing Chartered Accountant, has acted as liquidator of XYZ & Co. and charged his professional fees on percentage of the realisation of assets.

Therefore, CA. M shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.

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

The Review shall cover:

- (i) Compliance with Technical, Professional and Ethical Standards.
- (ii) Quality of reporting.
- (iii) Systems and procedures for carrying out assurance services.
- (iv) Training programmes for staff (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure.
- (v) Compliance with directions and / or guidelines issued by the Council to the Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records.
- (vi) Compliance with directions and / or guidelines issued by the Council in relating to article assistants and / or audit assistants, including attendance register, work diaries, stipend payments, and such other related records.

- (b) **Principle Methods of Selection of Samples:** According to SA 530 "Audit Sampling", the principal methods of selecting samples are the use of random selection, systematic selection, monetary unit sampling selection, haphazard selection and block selection. Each of these methods is discussed below-

- (i) **Random selection:** This method is applied through random number generators, for example, random number tables.
- (ii) **Systematic selection:** In this method the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables.

- (iii) **Monetary Unit sampling:** This method is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.
 - (iv) **Haphazard selection:** In this method the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.
 - (v) **Block selection:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.
- (c) **Advantages of Cost Audit to Management:** Cost Audit will be advantageous to the management in the following manner-
- (i) Management will get reliable data for its day-to-day operations like price fixing, control, decision-making, etc.
 - (ii) A close and continuous check on all wastages will be kept through a proper system of reporting to management.
 - (iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
 - (iv) Management by exception becomes possible through allocation of responsibilities to individual managers.
 - (v) The system of budgetary control and standard costing will be greatly facilitated.
 - (vi) A reliable check on the valuation of closing inventory and work-in-progress can be established.
 - (vii) It helps in the detection of errors and fraud.
- (d) **Classes of Companies Required to Constitute Audit Committee:** As per section 177 of the Companies Act, 2013 read with the rules, every listed company and the following classes of companies shall constitute an Audit Committee -
- (i) all public companies with a paid up capital of ten crore rupees or more;
 - (ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the said purpose.

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

This section 34 shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

The section 447 of the Companies Act, 2013 provides that, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.