

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

QUESTIONS

1. The Institute has, from time to time, issued 'Statements' and 'Guidance Notes' on a number of matters. Discuss the level of authority attached to these documents and the degree of compliance required in respect thereof.
2. What is an audit engagement letter? What are the principal contents of audit engagement letters?
3. (a) What do you mean by internal check system? What are the main objectives of internal check system?
(b) what are the general conditions pertaining to the internal check system ?
4. What do you understand by Computer Information Systems ? Discuss the requirement of internal control under Computer Information Systems environment.
5. Explain analytical review procedures as an audit techniques .
6. What do you mean by risk based audit? What are the general steps in the conduct of risk based audit?
7. What are the duties of an auditor under Companies Act , 1956 regarding :
 - (a) Register of mortgages and charges
 - (b) Register of investment or loan made, guarantee given or security provided in relation to any body corporate
 - (c) Register of directors, managing director, manager and secretary
8. What are the reporting requirements regarding maintenance of proper records showing full particulars, including quantitative details and situation of fixed assets under the Companies (Auditor's Report) Order,2003?
9. What do you mean by consolidated financial statements? What are the responsibilities of the auditor of the consolidated financial statements?
10. Sekhar, a practicing chartered accountant, has been issued a credit card by State Bank of India.He used the credit card for buying clothes for him for Rs. 1200.Is he eligible for appointment as one of the auditors of the Bank?
11. Mention the duties of Auditor of Cooperative Societies in regard to the following:
 - (a) Observations of the Provisions of the Co-operative Societies Act and Rules
 - (b) Special report to the Registrar
12. What is a Non Banking Financial Company? What are the special points that should be covered in the audit of NBFCs in case of Investment Companies?
13. Explain the major steps required to be undertaken for the preparation for tax audit under VAT.

14. What is energy audit ? What are the key functions of energy auditor?
15. (a) What do you mean by propriety audit? Propriety requires expenditure, to conform to certain general principles. What are those principles?
(b) What are the propriety elements in CARO, 2003?
16. Explain the meaning of the term peer review. What are the objectives of peer review?
17. Explain the term 'other misconduct' as per Chartered Accountants (Amendment) Act, 2006. Give some example where a member may be found guilty of 'other misconduct' under the provisions of Chartered Accountants Act.
18. Briefly describe the auditor's responsibility regarding subsequent events.

SUGGESTED ANSWERS/HINTS

1. The Institute has, from time to time, issued 'Statements' and 'Guidance Notes' on a number of matters. The level of authority attached to these documents and the degree of compliance required in respect thereof has been explained by the Institute through its various announcements issued from time to time.

Statements - The 'statements' have been issued with a view to securing compliance by members on matters which in the opinion of the council of the institute are critical for the proper discharge of their functions. 'statements' therefore are mandatory. Accordingly, while discharging their attest function, it is the duty of the members of the institute.

- (a) to examine whether 'Statements' relating to accounting matters are complied with in the presentation of financial statements covered by their audit. In the event of any deviation from such 'Statements', it is their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and
- (b) to ensure that the 'Statements' relating to auditing matters, are followed in the audit of financial information covered by their audit reports. If, for any reason, a member, has not been able to perform an audit in accordance with such 'Statements' his report should draw attention to the material departures there from.

Guidance Notes - 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

2. In the interest of both client and auditor, the auditor normally send an engagement letter , preferably before the commencement of the engagement, to help avoid any misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit and the extent of the auditor's responsibilities to the client.

Though the objective and scope of an audit and the auditor's obligations are, normally, laid down in the applicable statute or regulations and the pronouncements of the Institute of Chartered Accountants of India, the audit engagement letters would be informative for the clients.

The form and content of audit engagement letter may vary for each client, but it would generally include reference to:

- (i) The objective of the audit of financial statements.
- (ii) Management's responsibility for the financial statements.
- (iii) Management's responsibility for selection and consistent application of appropriate accounting policies, including implementation of the applicable accounting standards alongwith proper explanation relating to material departures from those accounting standards.
- (iv) Management's responsibility for preparation of the financial statements on a going concern basis.
- (v) Management's responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.
- (vi) Management's responsibility for the maintenance of adequate accounting records and internal controls for safeguarding the assets of the company and for preventing and detecting fraud or other irregularities.
- (vii) The scope of the audit, including reference to the applicable legislation, regulations, and the pronouncements of the Institute of Chartered Accountants of India.
- (viii) The fact that having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.
- (ix) Unrestricted access to whatever records, documentation and other information requested in connection with the audit.
- (x) The fact that the audit process may be subjected to a peer review under the Chartered Accountants Act, 1949.

The auditor may also include the following matters in the engagement letter:

- (i) Arrangements regarding the planning of the audit.
 - (ii) Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
 - (iii) Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
 - (iv) Description of any other letters or reports the auditor expects to issue to the client.
 - (v) Basis on which fees are computed and any billing arrangements.
3. (a) Internal Check System - 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. It is a part of overall control system and operates basically as a built-in-device as far as organization and job-allocation aspects of the controls are concerned. The system provides existence of checks on the day to day transactions which operate continuously as part of the routine system whereby the work of each person is either proved independently or is made complimentary to the work of another. The following are the objectives of the internal check system:
- (i) To detect error and frauds with ease.
 - (ii) To avoid and minimize the possibility of commission of errors and fraud by any staff.
 - (iii) To increase the efficiency of the staff working within the organization.
 - (iv) To locate the responsibility area or the stages where actual fraud and error occurs.
 - (v) To protect the integrity of the business by ensuring that accounts are always subject to proper scrutiny and check.
 - (vi) To prevent and avoid the misappropriation or embezzlement of cash and falsification of accounts.
- (b) 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, where ever practicable to prevent loss or misappropriation of cash.
 - (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
 - (viii) For stock 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.
4. A Computer Information Systems environment exists when one or more computer(s) of any type or size is (are) involved in the processing of financial information, including quantitative data. Those computers may be operated by the entity or by a third party. The requirement of internal control under CIS environment may cover the following aspects:
- (1) Organisation And Management Control - Controls are designed to establish an organisational frame work for CIS activities including:
 - a) Policies and procedures relating to control functions.
 - b) Appropriate segregation of incompatible functions.
 - (2) Application System Development and Maintenance Control - Control are designed to provide reasonable assurance that systems are developed and maintained in an authorised and efficient manner, to establish control over:
 - a) testing, conversion, implementation and documentation of new revised system.
 - b) changes made to application system.
 - c) access to system documentation.
 - d) acquisition of application system from third parties.
 - (3) Computer Operation Controls - Designed to control the operation of the system and to provide reasonable assurance that:
 - a) the systems are used for authorised purposes only.
 - b) access to computer operation is restricted to authorised personnel.
 - c) only authorised programs are to be used.

- d) processing errors are detected and corrected.
- (4) System Software Control - Controls are designed to provide reasonable assurance that system software is acquired or developed in an authorised and efficient manner including:
 - a) authorisation, approval, testing, implementation and documentation of new system software and system software modification.
 - b) restriction of access to system software and documentation to authorised personnel.
- (5) Data Entry And Program Control - Designed to provide assurance:
 - a) an authorisation structure is established over transaction being entered into the system.
 - b) access to data and program is restricted to authorised personnel.
- (6) Control Over Input - Control are designed to provide reasonable assurance that:
 - a) transactions are properly authorised before being processed by the computer.
 - b) transactions are accurately converted into machine readable form and recorded in the computer data files.
 - c) transaction are not lost, added, duplicated or improperly changed.
 - d) incorrect transactions are rejected, corrected and if necessary, resubmitted on a timely basis.
- (7) Control Over Processing and Computer Data Files - Controls are designed to provide reasonable assurance that:
 - a) transactions including system generated transactions are properly processed by the computer.
 - b) transaction are not lost, added duplicated or improperly changed.
 - c) processing errors are identified and corrected on a timely basis.
- (8) Control Over Output - Designed to provide reasonable assurance that
 - a) results of processing are accurate.
 - b) access to output is restricted to authorised personnel.
 - c) output is provided to appropriate authorised personnel on a timely basis.
- (9) Other Safeguards - Other safeguards include:
 - a) Offsite back-up of data and program.
 - b) Recovery procedures for use in the event of theft, loss or intentional or accidental destruction.
 - c) Provision of offsite processing in the event of disaster.

5. Analytical Review Procedures - Analytical review procedures may be defined as substantive tests of financial information made by a study of comparisons and relationship among data. Analytical procedures include comparison of financial information with:

- ◆ comparable information for a prior period or periods,
- ◆ anticipated results, such as budgets or forecasts, and
- ◆ similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Essentially these procedures ensure that the various items making up the financial statements are consistent with:

- (a) Each other (for example, the relationship between debtors and sales, or current assets and current liabilities).
- (b) Known trends.
- (c) The auditor's knowledge of the business.

The auditor should ask the following questions:

- (a) What data, ratios and statistics exist which are of significance for the business?
- (b) What should they be compared with (i.e., what yard-stick)?
- (c) Are there any variations between (a) and (b) which the auditors would expect to occur?

Analytical procedures also include study of relationships:

- ◆ among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as a study of gross margin percentages, and
- ◆ between financial information and relevant non-financial information, such as a study of payroll costs to number of employees.

Various methods may be used in performing the above procedures. These range from simple comparisons to complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial information, financial information of components (such as subsidiaries, divisions or segments), and individual elements of financial information. The choice of procedure, methods and level of application is a matter of professional judgment.

The following table summarizes the position:

Types of data, ratios etc.	Comparison with
Financial data (e.g., items in annual statements, management accounts, budgets, etc.)	(i) Corresponding previous period. (ii) Budgets and forecasts (if available).
Non-financial data (e.g., production and employment statistics)	(i) Entries in accounting records. (ii) Other financial data.
Ratios and percentages (developed from financial and non-financial data; for example inventory turnover ratio)	(i) Preceding period. (ii) Budgets and forecasts. (iii) Industry Statistics.

Analytical procedures are used for the following purposes:

- (a) To assist the auditor in planning the nature, timing and extent of other auditing procedures.
- (b) As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions.
- (c) As an overall review of the financial information in the final review stage of the audit.

Analytical procedures should be applied to some extent for the purposes referred to in (a) and (c) above for all audits of financial statements. In addition, in some cases, analytical procedures can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions.

6. Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

The risk based audit is superior to traditional audit approaches for two reasons. First, it focuses on risks, the underlying causes of financial surprises, not just the accounting records. Secondly, the risk based audit shifts the focus from inspecting the quality of the financial information that is recorded in the financial statements to building quality into the financial reporting process and adding value to the organisation's operations.

General Steps in the Conduct of RBA - RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following:

- (i) Understand auditee operations to identify and prioritize risks : Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in

order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

- (ii) Assess auditee management strategies and controls to determine residual audit risk : Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.
 - (iii) Manage residual risk to reduce it to acceptable level : Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.
 - (iv) Inform auditee of audit results through appropriate report : The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.
7. (a) Register of mortgages and charges - Every company under Section 143 is required to keep a Register of charges to enter therein all the charges specifically affecting the property of the company as well as the floating charges on the undertaking or on the property of the company. The particulars of each property charged that should be entered in the register are: (a) a short description of the property; (b) the amount of charge; and (c) the names of the persons entitled to exercise the charge. This register should be examined by the auditor to ascertain whether any of the assets belonging to the company except bearer securities, is subject to charge, and, if so, its nature. Section 143(2) of the Companies Act, 1956, lays down that if any officer of a company knowingly omits, or willfully authorises or permits the omission of any entry required to be made in pursuance of Section 143(l), he may be punishable with fine which may extend to five hundred rupees.
- (b) Register of investment or loan made, guarantee given or security provided

in relation to any body corporate - In pursuance of sub-section (5) (a) of Section 372A, every company shall keep a register showing the following particulars in respect of every investment or loan made, guarantee given or security provided by it in relation to any body corporate under sub-section (1), namely:

(i) the name of the body corporate; (ii) the amount, terms and purpose of the investment or loan or security or guarantee; (iii) the date on which the investment or loan has been made; and (iv) the date on which the guarantee has been given or security has been provided in connection with a loan.

The particulars of investment, loan, guarantee or security referred to in clause (a) shall be entered chronologically in the register aforesaid within seven days of the making of such investment or loan, or the giving of such guarantee or the provision of such security.

The register referred to in sub-section (5) shall be kept at the registered office of the company concerned shall be open to inspection at such office and extracts may be taken therefrom and copies thereof may be required, by any member of the company to the same extent, in the same manner on payment of the same fees as in the case of the register of members of the company; and the provisions of Section 163 shall apply accordingly.

- (c) Register of directors, managing director, manager and secretary - Under the provisions of Section 303 of the Companies Act, it is obligatory for a company to maintain a record, in a register, of the names and addresses and that of other particulars relevant for the administration of the Act in respect of all the officers aforementioned. Under sub-section (2) of the aforesaid Section, any change in the officers or any of the particulars of an officer must be incorporated in the register and notified to the Registrar of Companies within 30 days of the change taking place. Particulars of original appointment also should be notified to the Registrar within 30 days of appointment.

The auditor should refer to this register to find out the names of persons who had held different offices during the year under audit to confirm that various transactions entered into by the company have been authorised by a competent person.

8. Paragraph 4(i)(a) of CARO, 2003 requires the auditor to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. Accounting Standard (AS) 10, "Accounting for Fixed Assets" defines "fixed asset" as an "asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business".

The Order is silent as to what constitutes 'proper records'. In general, however, the records relating to fixed assets should contain, inter alia, the following details:

- (i) sufficient description of the asset to make identification possible;

- (ii) classification, that is, the head under which it is shown in the accounts, e.g., plant and machinery, office equipment, etc;
- (iii) situation;
- (iv) quantity, i.e., number of units;
- (v) original cost;
- (vi) year of purchase;
- (vii) adjustment for revaluation or for any increase or decrease in cost, e.g., on revaluation of foreign exchange liabilities;
- (viii) date of revaluation, if any;
- (ix) rate(s)/basis of depreciation or amortisation, as the case may be;
- (x) depreciation/amortisation for the current year;
- (xi) accumulated depreciation/amortisation;
- (xii) particulars regarding impairment;
- (xiii) particulars regarding sale, discarding, demolition, destruction, etc.

The records should contain the above-mentioned particulars in respect of all items of fixed assets, whether tangible or intangible, self-financed or acquired through finance lease. These records should also contain particulars in respect of those items of fixed assets that have been fully depreciated or amortised or have been retired from active use and held for disposal. The records should also contain necessary particulars in respect of item of fixed assets that have been fully impaired during the period covered by the audit report.

Thus, what constitutes proper records is a matter of professional judgment made by the auditor after considering the facts and circumstances of each case.

It is necessary that the aggregate original cost, depreciation or amortisation to date, and impairment loss, if any, as per these records under individual heads should tally with the figures shown in the books of account.

It is not possible to specify any single form in which the records should be maintained. This would depend upon the mode of account keeping (manual or computerized), the number of operating locations, the systems of control, etc. It may be noted that with the advent of the information technology, many companies are maintaining electronic records. Section 2(1)(t) of the Information Technology Act, 2000 defines the term "electronic record" as data recorded or data generated, image or sound stored, received or sent in an electronic form or computer generated micro fiches. If the records of fixed assets are maintained electronically, they have to be maintained in a manner that they can be retrieved in a legible form (which is different from machine readable form). Records maintained using electronic media should not be construed to be proper if the records are not capable of being retrieved in a legible form. Thus, a condition for valid electronic records of fixed assets is that they can be retrieved in a legible form. The

Information Technology Act, 2000, lays down legal framework for electronic records and digital signatures. Accordingly, where any law requires that any information or matter should be in the typewritten or printed form, then such requirement shall be deemed to be satisfied if it is in an electronic form. However, it will have to be ensured that the information contained in the electronic records remains accessible and unaltered and its origin, destination, date, etc., can be identified. Moreover, paragraph 34 of AAS 6, "Risk Assessments and Internal Control" is also noteworthy in this regard. The paragraph states as follows:

"34. In a computer information systems environment, the objectives of tests of control do not change from those in a manual environment; however, some audit procedures may change. The auditor may find it necessary, or may prefer, to use computer-assisted audit techniques. The use of such techniques, for example, file interrogation tools or audit test data, may be appropriate when the accounting and internal control systems provide no visible evidence documenting the performance of internal controls which are programmed into a computerised accounting system."

The auditor may, therefore, accept electronic fixed assets register if the following two conditions are satisfied:

- (i) The controls and security measures in the company are such that once finalised, the fixed assets register cannot be altered without proper authorization and audit trail.
- (ii) The fixed assets register is in such a form that it can be retrieved in a legible form. In other words, the emphasis is on whether it can be read on the screen or a hard copy can be taken. If this is so, one can contend that it is capable of being retrieved in a legible form.

In case the above two conditions or either of the two conditions are not satisfied, the auditor should obtain a duly authenticated print-out of the fixed assets register. In case the auditor decides to rely on electronically maintained fixed assets register, he should maintain adequate documentation evidencing the evaluation of controls that seek to ensure the completeness, accuracy and security of the register.

In cases where the original cost cannot be ascertained, Schedule VI to the Act provides that the book value as at 1st April, 1956 may be considered as cost. For the limited purpose of determining whether proper records are maintained, it should be considered as sufficient if, in respect of assets acquired prior to 1st April, 1956 where the original cost cannot be ascertained, the book value as on that date is considered as the cost.

Schedule XIV to the Act provides that depreciation on assets, whose actual cost does not exceed rupees five thousand, shall be provided at the rate of hundred percent. The records of fixed assets should include the necessary particulars in respect of such assets also. However, Schedule XIV to the Act further provides that where the aggregate cost of the individual items of plant and machinery costing Rs. 5000/- or less, constitutes more than 10 percent of the total actual cost of the plant and machinery, the same would have to be depreciated as per rates of depreciation provided in Item II, Plant and Machinery, of

the Schedule. The auditor should, therefore, examine whether the company has an appropriate mechanism in place to ensure compliance with this provision of Schedule XIV.

The purpose of showing the situation of the assets is to make verification possible. There may, however, be certain classes of fixed assets whose situation keeps changing, for example, construction equipment which has to be moved to sites. In such circumstances, it should be sufficient if record of movement/custody of the equipment is maintained.

Where assets like furniture, etc., are located in the residential premises of members of the staff, the fixed assets register should indicate the name/designation of the person who has custody of the asset for the time being. In this connection, it may be necessary for the auditor to consider whether there are good reasons for the asset to be so located.

While, generally, the quantity, value and situation have to be recorded item-wise, assets of small individual value, e.g., chairs, tables, etc., may be conveniently grouped for purposes of entry in the register. Similarly, for assets having a common rate of depreciation, it may not be necessary to indicate the accumulated depreciation for each item; instead, depreciation for the group as a whole may be shown.

Quantitative details in respect of fixed assets may be maintained on the following lines:

- (i) Land may be identified by survey numbers and by deeds of conveyance.
- (ii) Leaseholds can be identified by individual leases.
- (iii) Buildings may, initially, be classified into factory buildings, office buildings, township buildings, service buildings (like water works), etc. These may then be further sub-divided. Factory buildings may be further classified into individual buildings which house a manufacturing unit or a plant or sub-plant. Service buildings may be similarly classified according to nature of service and location. Township buildings can be further classified into individual units or into groups of units taking into consideration the type of construction, the location and the year of construction. For example, if a company's township has four categories of quarters, e.g., A, B, C and D, the fixed assets register may not record each individual quarter but may have a single entry for all 'A' type quarters constructed in a particular year and located in a particular area and show only the number of quarters covered by the entry.
- (iv) Railway sidings can be identified by length and location.
- (v) Plant and Machinery may be sub-divided into fixed and movable. For movable machinery, a separate record may be kept for each individual item. Movable machinery would include, for this purpose, items of plant which are for the moment fixed to the shop-floor but which can be moved, e.g., machine tools. In respect of fixed plant and machinery, a sub-division can be made according to the process, a plant for each separate process being considered as a separate identifiable unit. A further sub-division may be useful when within a process, there are plants which are capable of working independently of each other. The

degree to which a sub-division of fixed plant and machinery should be made depends upon the circumstances of each case bearing in mind the twin objectives of sub-division, namely, the determination of individual cost and the facility for physical verification.

- (vi) The Act does not require electrical installations to be shown as a separate asset though a number of companies do so in fact. For purposes of identification, however, it is suggested that the initial sub-division may be made according to the user, e.g., factory buildings, plant, service departments, township buildings, etc. A further sub-division can be made according to the sub-division already made for buildings, plant, etc.
- (vii) Furniture and fittings and assets like office appliances, air-conditioners, water coolers, etc., consist of individual items which can be easily identified. Some difficulty may, however, be faced with regard to the large number of items and their relative mobility. In such cases, a distinction by value may be necessary, individual identification being made for high-value items and by groups for other items.
- (viii) Development of property is an asset head which can be easily sub-divided according to the buildings or plant for which the development work is undertaken.
- (ix) Patents, trade marks and designs are normally identifiable by the purchase agreements or the letters granting patent and by registration references in case of trade marks and designs.
- (x) Vehicles can be identified by reference to the registration books.
- (xi) Intangible assets can be identified by reference to the purchase agreements (in case an intangible asset has been purchased) and by reference to the records and documents that substantiate the costs incurred by the company in the generation and development of an intangible asset.

In cases where the details regarding allocation of cost over identified units of assets are not available, it would have to be made by an analysis of the purchases and the disposals of the preceding years. Among the difficulties which may be faced could be: (i) records for some of the years may not be available; (ii) the description in the records may not be complete; (iii) details of disposals may not have been properly recorded; (iv) subsequent additions to an existing asset may have been shown as a separate asset; (v) a single figure of cost may be assigned to a number of assets which have to be separately identified; (vi) assets purchased for one department may have been moved to other departments, and so on. The management, in consultation with the auditor, should make the best effort possible under the circumstances to identify the cost of each asset. In doing so, reasonable assumptions or approximations may be made, where necessary. For example, when details of disposals are not available, it may be assumed that the asset sold is the asset which was acquired earliest in point of time. Similarly, when the individual cost of a large number of small items is not available, one can estimate the

cost of each item and pro-rate the total cost in the proportion of the estimated cost of the item to the aggregate estimated cost.

It may be useful if initial identification of assets is done by persons who are familiar with them, e.g., the maintenance staff. At the point of identification, a code number may be affixed on the asset which would give sufficient details for future identification.

The initial identification of assets will often reveal a number of discrepancies between the assets as verified and the details compiled from the records. This may be on account of the features already considered above. This may also be due to the fact that assets might have been scrapped in earlier years but proper documentation may not have been made or that assets may have been broken up into smaller units or amalgamated into larger units or otherwise modified without changing the asset records. The degree of further inquiry necessary to reconcile these discrepancies would depend upon the nature of the asset, its cost, the age of the asset, the extent of accounting or other records available and other relevant factors. However, the concept of materiality should be borne in mind in making these further inquiries, greater attention being devoted to assets which are of large value or of relatively recent purchase. Any adjustments that finally have to be made should be properly documented. The auditor should request the appropriate level of management to carry out necessary adjustments.

9. AS 21 'Consolidated Financial Statements' lays down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented for a group of entities under the control of a parent. A 'parent' is an entity that has one or more subsidiaries. A group comprises a parent and its subsidiaries. Thus, consolidated financial statements are the financial statements of a group presented as those of a single entity. AS 21 is applicable to a parent that presents consolidated financial statements. In other words, whenever a parent decides to prepare and present consolidated financial statements, it should do so in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements.

Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, explanatory material that form an integral part thereof, and also consolidated cash flow statement (in case a parent presents its own cash flow statement). Consolidated financial statements are presented, to the extent possible, in the same format as adopted by the parent for its separate financial statements.

Responsibility of the Auditor of the Consolidated Financial Statements : The auditor of the consolidated financial statements is responsible for expressing an opinion on whether the consolidated financial statements are prepared, in all material respects, in accordance with the financial reporting framework under which the parent prepares the consolidated financial statements.

Therefore, the auditor's objectives in an audit of consolidated financial statements are:

- (a) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of Accounting Standard (AS) 21,

Consolidated Financial Statements, Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures; and

- (b) to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements.

Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. The auditor should make plans, among other things, for the following:

- (a) understanding of accounting policies of the parent, subsidiaries, associates and joint ventures;
- (b) determining the extent of use of other auditor's work in the audit;
- (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) coordinating the work to be performed.

A parent which presents consolidated financial statements is required to consolidate all subsidiaries, include all associates and jointly controlled entities in the consolidated financial statements other than those for which exceptions have been provided in the relevant Accounting Standards.

The auditor should obtain a listing of subsidiaries, associates and joint ventures included in the consolidated financial statements. The auditor should review the information provided by the management of the parent identifying the subsidiaries, associates and joint ventures. The auditor should verify that all the subsidiaries, associates and joint ventures have been included in the consolidated financial statements unless a subsidiary, associate or joint venture meets a criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:

- (a) review his working papers for the prior years for the known subsidiaries, associates and joint ventures;
- (b) review the parent's procedures for identification of subsidiaries, associates and joint ventures;
- (c) review the investments to determine the shareholding in other entities;
- (d) review the joint venture and other relevant agreements entered into by the parent;
- (e) review the statutory records maintained by the parent, for example registers under section 302, 372A of the Companies Act, 1956.

The auditor should also identify the changes in the shareholding that might have taken

place since the last audit.

It is also important to note that ownership of voting power is not necessary for an entity to own more than one-half of the voting power of another to control the other enterprise. Control of the composition of the Board of Directors (in the case of a company) or corresponding governing body (in the case of any other enterprise), with a view to obtain economic benefits from its activities, ownership of voting power is not important. For example, an entity holds only 10 percent of the share capital of another entity but it has control over the composition of the Board of Directors/governing body of the second entity. In such a case, the first entity would be considered as a parent of the second entity and, therefore, it would consolidate the second entity in the consolidated financial statements as subsidiary. The auditor, therefore, apart from carrying out above procedures, should verify whether the parent controls the composition of the Board of Directors or corresponding governing body of any entity. There would be various means by which such kind of control can be obtained. In this regard, the auditor may verify the Board's minutes, shareholder agreements entered into by the parent, agreements with the entities to which the parent might have provided any technology or know how, enforcement of statute, as the case may be, etc. The auditor would have to use his professional judgement to determine whether the parent controls the composition of the Board of Directors of any other entity. If yes, whether that entity has been consolidated as a subsidiary in the consolidated financial statements.

Where a subsidiary or an associate or a jointly controlled entity is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion. There could be two reasons for exclusion of a subsidiary, associate or jointly controlled entity – one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be temporary or the subsidiary, associate or joint venture operates under several long-term restrictions which significantly impair its ability to transfer funds to the parent. The auditor should satisfy himself that the exclusion made by the management falls within these two categories. The auditor should verify such long-term restrictions from the relevant laws and regulations, agreements entered by the parent with such entities which prohibit transfer of funds. In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the relevant accounting standards, the auditor should consider its effect on the report to be issued. The auditor should consider the need to issue a modified report on the consolidated financial statements. The auditor should also verify that in consolidated financial statements, investments in such subsidiaries, associates or jointly controlled entities should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

The auditor should also examine whether any subsidiary, associate or jointly controlled entity has ceased to be a subsidiary, associate or jointly controlled entity during the period under audit. It is also possible that a subsidiary might have become an associate or an associate might have become a subsidiary of the parent. The auditor, in such cases, should examine whether these changes have been appropriately accounted for in the consolidated financial statements as required by the respective accounting standards.

In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line by line basis by adding together like items of assets, liabilities, income and expenses and then certain calculations like determination of goodwill or capital reserve, minorities interest and adjustments like elimination of intra group transactions, balances and unrealised profits etc. are made in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements. Investments in associates are accounted for using the Equity Method as prescribed in Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements. A parent that has an interest in a jointly controlled entity, reports its interest in the consolidated financial statements using proportionate consolidation method in accordance with Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures. Many of the procedures appropriate for the application of equity method and the proportionate consolidation are similar to the consolidation procedures set out in Accounting Standard (AS) 21, Consolidated Financial Statements.

The auditor should verify that the adjustments warranted by the relevant accounting standards have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments.

10. Sub-section (1) of section 30 of the banking Regulation Act, 1949 requires that the balance sheet and profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies. Similar provisions are contained in the enactments governing nationalised banks [section 10 of the Banking Companies (Acquisition and Transfer of Undertakings) Act of 1970/1980], State Bank of India [section 41 of the State Bank of India Act, 1955], subsidiaries of State Bank of India [section 41 of the State Bank of India (Subsidiary Banks) Act, 1959], and regional rural banks [section 19 of the Regional Rural Banks Act, 1976].

According to section 226(3)(d) of the Companies Act, 1956, a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees, can not be appointed as an auditor.

It may be noted that in case of indebtedness in excess of the specified limit as mentioned at (d) above, the chartered accountant concerned (or the firm of chartered accountants)

becomes disqualified to audit any branch of the bank; the disqualification is not confined to appointment as auditor of the particular branch to which the debt is owed.

In the context of banks, the expression indebtedness would cover, inter alia, the amounts outstanding in respect of credit cards issued by a bank. Thus, where the credit card outstandings exceed the prescribed limit of Rs.1,000, the chartered accountant in whose name the card is issued as well as the firm of which he is a partner would be disqualified for appointment as auditor of the issuing bank. Therefore CA Sekhar is not eligible for appointment as an auditor of the Bank.

11. (a) Observations of the Provisions of the Co-operative Societies Act and Rules - An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor. For example, under the Maharashtra State Act, the maximum rate of dividend prescribed is 12% but the dividend distributable in cash should not exceed 6% and the balance of 3% in excess of it should be credited to individual share capital accounts of members.
- (b) Special report to the Registrar - During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:
 - (i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
 - (ii) Detection of fraud relating to expenses, purchases, property and stores of the society.
 - (iii) Specific examples of mismanagement, decisions of management against co-operative principles.
 - (iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.
12. As per Section 45-I(f) of the RBI act, "non-banking financial company" means:-
 - (i) a financial institution which is a company;
 - (ii) a non banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
 - (iii) such other non-banking institution or class of such institutions, as the reserve

bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

The term 'company' for the above purpose covers not only a company registered under the Companies Act, 1956 (or any earlier Companies Act), but also a foreign company within the meaning of section 591 of the Companies Act, 1956.

A company cannot commence or carry on business as an NBFC unless it is registered with RBI.

Some special points that should be covered in the audit of NBFCs in case of investment companies are given below :

- (i) Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- (ii) NBFC Prudential Norms stipulates that NBFCs should not lend more than 15% of its owned funds to any single borrower and not more than 25% to any single group of borrower. The ceiling on investments in shares by a NBFC in a single entity and the aggregate of investments in a single group of entities has been fixed at 15% and 25% respectively. Moreover, a composite limit of credit to and investments in a single entity/group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC. Verify that the credit facilities extended and investments made by the concerned NBFC are in accordance with the prescribed ceiling.
- (iii) Verify whether the NBFC has not advanced any loans against the security of its own shares.
- (iv) Verify that dividend income wherever declared by a company, has been duly received by a NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General meeting and its right receives the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.
- (v) Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- (vi) Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- (vii) Check whether the investments have been valued in accordance with Para 6 of the NBFC Prudential Norms Directions and adequate provision for fall in the

market value of securities, wherever applicable, have been made there against, as required by the Directions.

- (viii) Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
 - (ix) Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
 - (x) An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
 - (xi) In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
 - (xii) In the case of securities lent/borrowed under the Securities Lending Scheme of SEBI, verify the agreement entered into with the approved intermediary (i.e. the person through whom the lender will deposit and the borrower will borrow the securities for lending/borrowing) with regards to the period of depositing/lending securities, fees for depositing/lending, collateral securities and provision for the return including pre-mature return of the securities deposited/lent.
 - (xiii) Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.)
 - (xiv) Verify charges received or paid in respect of securities lend/borrowed.
 - (xv) Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
13. A tax auditor has to make certain preliminary preparations before the actual execution of tax audit under the VAT law. The major steps required to be undertaken for the preparation are as under:
- (i) Knowledge of business: After accepting the audit assignment the auditor should familiarize himself with the business of the auditee. In this regard, the auditor should refer to the AAS-20- "Knowledge of the business" issued by the Council of the Institute of Chartered Accountants of India. Before starting the audit, the auditor should have a preliminary knowledge of the industry/ business and of the nature of ownership, management etc. For this purpose the various sources of information may be tapped. The knowledge of business is important not only to the auditor but also to his staff engaged in the audit. The auditor has to ensure that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to carry out the audit work delegated to them and

further they should make effective use of the knowledge about the business and should consider how it affects the tax liability reported in the return. The facts and figures in the returns should be consistent with the auditor's knowledge of the business. The auditor should also make himself familiar with the process of production and the distribution chain. The auditor should also obtain information about whether the auditee is a manufacturer/ importer/ retailer, the details of major customers to whom the sales are effected and the details of sales which are outside the scope of VAT law. Similarly the sources of purchase and the items sold should be listed out. Further it should be ascertained whether the auditee has opted for the composition scheme or not.

- (ii) Obtaining a list of all the accounting records maintained by the auditee: The auditor should obtain a complete list of all the accounting records relating to sale/purchase of goods, stocks, the various registers, the ledgers etc. maintained, in which the transactions are recorded, the various source documents in which the entries are recorded in the books of account and the process of their generation.
- (iii) Ascertaining the major accounting policies adopted by the auditee: The auditor should know the major accounting policies based on which books of account have been prepared. The accounting policy regarding recording of sales, purchases and valuation of inventory must be made known and the auditor should also find out whether there has been any change in those policies during the year covered by audit. If there is any significant change in the accounting policy giving rise to some material effect on the tax liability, the same should be invariably reported.
- (iv) Evaluation of internal control etc. : Before determining the extent of audit checks to be applied i.e. whether to go in- depth or to do only test check, the auditor should ascertain whether there is an internal check system in operation in the entity. He should particularly find out how the purchases and sales gets initiated and finalised. For example, in case of purchase, receipt of indent by the purchase department, determining the need for purchases, initiation of purchase order, receipt of material, preparation of MRN, entries made in the books of accounts etc. should be verified. For sales, receipt of inquiry, acceptance of sales order, execution of sales, preparation of sale invoice and realization of transaction. If the internal control is reliable, the extent of audit may be reduced and should be focused only on those areas where the auditor feels that greater degree of audit risk is involved.
- (v) Knowledge about the VAT law and allied laws: The auditor and his staff should obtain a thorough knowledge of the State VAT law under which the audit is to be conducted. The auditor should study the VAT law starting from the definition of various terms, the procedure to be adopted, the provisions regarding issue of invoices, claiming of input tax credit, composition schedule in the VAT law, the manner in which the output tax is to be calculated the

provisions of audit, the contents of the audit report, the periodicity of the return to be filed, the format of the forms of returns, and the various notifications issued. Further the auditor should know the Central Sales-tax law as he has to comment on the liability under that law also. The auditor should also have some knowledge about the judicial pronouncements made by the Tribunals and the Courts on the various facets of these laws.

14. Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. It is the first step of any energy management programmes. The function of an energy auditor could be compared with that of a financial auditor. At the moment, while energy auditor is not yet a mandatory requirement on an all-India basis, the financial auditor is a pre-requisite for any organisation. The following are some of the key functions of the energy auditor:
 - (i) Quantify energy costs and quantities
 - (ii) Correlate trends of production or activity to energy costs
 - (iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.
 - (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
 - (v) Highlight areas that need attention for detailed investigations.
 - (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis
 - (b) Measurements, mass and energy balances
 - (c) Reviewing energy procurement practices
 - (d) Identification of energy efficiency projects and techno-economic evaluation
 - (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
 - (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.
15. (a) Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct. E.L. Kohler has defined the term propriety as “that which meets the tests of public interest, commonly accepted customs, and standards of conduct, and particularly as applied to professional performance, requirements of law, Government regulations and professional codes”. On an analysis, the tests boil down to tests on economy, efficiency and faithfulness. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness

thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances.

Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:

- (i) that the expenditure is not *prima facie* more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;
 - (ii) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;
 - (iii) that funds are not utilised for the benefit of a particular person or group of persons and
 - (iv) that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.
- (b) Propriety elements in CARO, 2003:
- (i) If the company has given or taken loans, secured or unsecured, to/from companies, firms or other parties listed in the register maintained under section 301 of the Companies Act, whether the rate of interest and other terms and conditions of such loans are *prima-facie* prejudicial to the interest of the company. In this case, the auditor will have to look into the reasonableness of the rate of interest and the terms and conditions of such loans. In other words, he will have to see whether the terms and conditions, including the rate of interest are apparently adverse to the interests of the company, having regard to the circumstances of the company at the time of taking the loans and the terms normally available. He is to exercise his judgment based on commercial considerations like urgency, security offered etc.
 - (ii) If the overdue amount of the loan given to or taken from companies, firms or other parties listed in the register maintained under section 301 of the Companies Act is more than rupees one lakh, what reasonable steps have been taken by the company for recovery/payment of the principal and interest. In making this examination, the auditor would have to consider the facts and circumstances of each case, including the amounts involved. It is not necessary that steps to be taken must necessarily be legal steps. Depending upon the circumstances, period of delay and other similar factors, issue of reminders or sending of advocate's or solicitor's notice may amount to

reasonable steps. The auditor should ask the management to give in writing the steps which have been taken. The auditor should arrive at his opinion only after consideration of the management's representations.

- (iii) Whether the transactions needed to be entered in a register in pursuance of section 301 of Companies Act have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year. Section 301 requires that every company shall keep one or more registers in which it shall be entered separately the particulars of all contracts or arrangements to which sections 297 and 299 of the Companies Act apply. As regards the reasonability of prices, the auditor is not expected to make a roving market inquiry but to examine price lists, quotations, prices for other parties etc. He should also take into account the factors such as delivery period, quality, quantity involved, credit terms etc.
 - (iv) Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employee State Insurance, Income-Tax, Sales Tax, Wealth Tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the day they became payable, shall be indicated by the auditor.
 - (v) Whether the company has made any preferential allotment of shares to parties and companies covered in the register maintained under section 301 of the companies Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company.
16. The term "peer" means a person of similar standing. The term "review" means conduct of re-examination or retrospective evaluation of the subject matter. In general, for a professional, the term "peer review" would mean review of work done by a professional, by another professional of similar standing. 'Peer Review' is defined as, a regulatory mechanism for monitoring the performances of professionals for maintaining quality of service expected of them for enhancing the reliance placed by the users of financial statements for economic decision-making.

As per the Statement of Peer Review (ICAI, 2002) "Peer Review" means an examination and review of the systems and procedures to determine whether they have been put in place by the practice unit for ensuring the quality of attestation services as envisaged and implied/mandated by the Technical Standards and whether these were effective or not during the period under review".

The main objectives of peer review are as discussed below:

- (i) To ensure that members while performing attestation services comply with technical standards laid down by the Institute;

- (ii) To ensure that such a member has in place proper system (including documentation system) for maintaining the quality of attestation services performed by him;
- (iii) To ensure adherence to various statutory and other regulatory requirements; and
- (iv) To enhance the reliance placed by the users of financial statements for economic decision making.

Thus the primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. The Statement of Peer Review also makes it clear that the peer review, "does not seek to redefine the scope and authority of the Technical Standards specified by the Council but seeks to enforce them within the parameters prescribed by the Technical Standards". The peer review is directed towards maintenance as well as enhancement of quality of attestation services and to provide guidance to members to improve their performance and adherence to various statutory and other regulatory requirements. Such an objective of the peer review process makes it amply clear that the reviewer is not going to sit on the judgement of the practice unit while rendering attestation services but to evaluate the procedure followed by the practice unit in rendering such a service. Accordingly, where a practice unit is not following technical standards, the reviewers are expected to recommend measures to improve the procedures. To elaborate further, the key objective of peer review exercise is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature. For instance, absence of formal planning of an audit represents a serious deficiency that needs to be remedied by the practice unit. An instance of the auditor not carrying out physical verification of furniture and fixture may not attract the same comment. However, certain items of assets are best verified through the physical verification process and not adopting the same procedure may rightly be viewed as a systemic failure. The conclusion, therefore, is that the peer review seeks to identify and address patterns of non-compliance with quality control standards.

17. Other Misconduct - A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct". Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule [Newly inserted parts by Chartered Accountants (Amendment) Act, 2006]. As per part IV of the First Schedule to the Chartered Accountants Act, A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he-
 - (1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;
 - (2) 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.

As per Part III of the Second Schedule to the Chartered Accountants Act, A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with

imprisonment for a term exceeding six months.

This provision empowers the Council to inquire into any misconduct of a member even if it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action. For example, a member who is found to have forged the will of a relative, would be liable to disciplinary action even though the forgery may not have been done in the course of his professional duty.

Other misconduct would also relate to conviction by a competent court for an offence involving moral turpitude punishable with cause transportation or imprisonment to an offence not of a technical nature committed by the member in his professional capacity [section 8(v) of the Act].

Some illustrative examples, where a member may be found guilty of "Other Misconduct", under the aforesaid provisions rendering, himself unfit to be member are:

- (i) Where a chartered accountant retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.
 - (ii) Where a chartered accountant makes a material misrepresentation.
 - (iii) Where a chartered accountant uses the services of his articled or audit clerk for purposes other than professional practice.
 - (iv) Conviction by a competent court of law for any offence under Section 8 (v) of the Chartered Accountants Act 1949.
 - (v) Misappropriation by office-bearer of a Regional Council of the Institute, of a large amount and utilisation thereof for his personal use.
 - (vi) Non-replying within a reasonable time and without a good cause to the letter of the public authorities.
 - (vii) Where certain assessment records of income tax department belonging to the client of Chartered Accountant were found in the almirah of the bed-room of the chartered accountant.
 - (viii) Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.
18. Subsequent Events and Auditor's Responsibility: When the auditor draws up his audit plan, checking of subsequent events is an important audit procedure irrespective of the level of test checks employed for checking of the transactions during the year. In fact more detailed check is normally required for subsequent events to confirm certain assertions contained in the financial statements, e.g., the payment made by debtors after the close of accounting period would confirm that outstanding debtors on the date of the balance sheet date have been realised. AAS-19 on "Subsequent Events" establishes standards on the auditor's responsibility regarding subsequent events. AAS-19 on

"Subsequent Events" states that the term "subsequent events" refers to significant events occurring between the balance sheet date and the date of the auditor's report. AS 4 on "Contingencies and Events Occurring after the Balance Sheet Date" deals with all those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and by the corresponding approving authority in the case of any other entity. As per AS 4, events can be identified as adjustable events which provide further evidence of conditions that existed at the balance sheet date; and, non-adjusting events are those which are indicative of conditions that arose subsequent to the balance sheet date. AAS-19 lays down that the "auditor should consider the effect of subsequent events on the financial statements and on the auditor's report". When the time between the close of the year-end and the adoption of accounts is about to take place, examination of subsequent events gains more importance.

AAS-19 further requires that the auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified. The procedures to identify events that may require adjustment of, or disclosure in, the financial statements would be performed as near as practicable to the date of the auditor's report and ordinarily include the following:

- (i) Reviewing procedures that the management has established to ensure that subsequent events are identified.
- (ii) Reading minutes of the meetings of shareholders, the board of directors and audit and executive committees held after the balance sheet date and inquiring about matters discussed at meetings for which minutes are not yet recorded.
- (iii) Reading the entity's latest available interim financial statements and, as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports.
- (iv) Inquiring, or extending previous oral or written inquiries, of the entity's lawyers concerning litigation and claims.
- (v) Inquiring of management as to whether any subsequent events have occurred after the balance sheet date which might affect the financial statements.

When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for in the financial statements. When the management does not account for such events that the auditor believes should be accounted for, the auditor should express a qualified opinion or an adverse opinion as appropriate.