

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS
QUESTIONS

1. What are the factors to be considered while performing test of control during interim visit.
2. As an auditor to what extent you can rely on analytical procedure?
3. As an auditor what are the steps you will take to ensure that the dividend has been paid only out of profits.
4. Can a statutory auditor act as a book-keeper and as an internal auditor?
5. Explain briefly how an auditor will identify related parties.
6. Answer the following questions:
 - (a) State the matters to be specified in Auditor's Report in terms of provisions of Section 227(3) of the Companies Act, 1956.
 - (b) What are the reporting requirements in Companies (Auditor's Report) Order, 2003 in respect of money raised by public issues?
7. As an Auditor, comment on the following situation:

JKT Ltd. having Rs.40 lacs paid up capital, Rs.9.50 lacs reserves and turnover of last three consecutive financial years immediately preceding the financial year under audit, being Rs.4.90 crores, Rs.4.50 crores and Rs.6 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory.
8. Comment on the following with reference to the Chartered Accountants Act, 1949, Code of Ethics and Schedules to the Act:
 - (a) P, a Chartered Accountant in practice provides management consultancy and other services to his clients. In the current scenario, looking to the growing needs of his clients to deal in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients.
 - (b) XYZ & Associates, a firm with 5 partners developed a website www.xyzassociates.com. The website also contained a link to "All India Chartered Accountants Association", a voluntary association where X, a partner of the firm is currently the Vice-president.
9. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:
 - (a) AB & Co., a firm of Chartered Accountants, included the name of P as a partner while filing an application for empanelment as auditor for Public Sector bank branches. It was subsequently noticed that on the date of application, P was not a partner with AB & Co.
 - (b) M, a practicing chartered accountant gives power of attorney to an employee chartered accountant to sign reports and financial statements, on his behalf.

10. Do you approve of the following? If not, why?
- (a) Mr. Z, a Director of M/s. LM Private Ltd., is also a Director of another company viz., M/s. OP Private Ltd., which has not filed the annual accounts and annual returns for last three years 2005-2006 to 2007-2008. Mr. Z is of the opinion that he is not disqualified under section 274(1)(g) of the Companies Act, 1956, and auditor should not mention disqualification remark in his Audit Report.
 - (b) Mr. John, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Deepak, Chartered Accountant, for Rs.5 lakhs. The price also includes right to use the firm name "John and Associates". Can widow of John sell the practice and can Mr. Deepak continue to practice in that name as a proprietor?
11. You have been appointed Management Auditor of a large manufacturing company suffering from working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem.
12. What are the steps to be taken by an auditor for the audit of re-insurance ceded?
13. What are the aspects to be covered while checking the issue of sweat equity share transactions?
14. A state government has appointed you as an investigator to investigate into the affairs of the sick company. Investigation in such a case involves detailed examination of records for several years, collection of information from different sources and analysis of facts and figures. Briefly discuss the major steps involved in such an investigation.
15. As an Auditor, comment on the following situation:
- (a) The offer document of a listed company in which Mr. R, a practising Chartered Accountant is a director mentions the name of Mr. R as a director along with his various professional attainments and spheres of specialisation.
 - (b) Mr. S, a Chartered Accountant in practice, accepts the audit of a company on the basis of an ordinary resolution passed at the annual general meeting of the company. The company attracts the provisions of Section 224A of the Companies Act, 1956.
16. Write short note on - Corporate Debt Restructuring
17. Medical Council of India organised a two-day conference of doctors in Mumbai. You are asked to audit the accounts of the conference. Draft the audit programme for audit of receipt of participation fees from delegates to the conference. Mention any six points, peculiar to situation, which you will like to include in your audit programme.
18. List the major provisions of the Sarbanes-Oxley Act.
19. Write a short note on - Broad objectives of operational audit.
20. (a). Mr. C, a practicing chartered accountant, who is appointed to value the goodwill of a running business for the purpose of its takeover, charged his fees on the basis of a

predetermined percentage of the value of goodwill.

- (b) Mr. J, a practicing chartered accountant and part-time lecturer of a college, has accepted a joint authorship of a book on Cost and Management Accounting along with a colleague who is a cost accountant.
21. What are the role of audit committee under Clause 49 (II) (D) of the listing agreement?
22. As a tax auditor, how would you report on the following:
- (i) Labour charges paid on which tax is deducted at source at an inappropriate rate.
 - (ii) Capital expenditure incurred for Scientific Research Assets.
23. What is a comprehensive audit of public enterprises? Discuss some of the areas to be examined therein.
24. Discuss the scope of "concurrent audit" in the banks.

SUGGESTED ANSWERS/HINTS

1. The auditor may decide to perform some tests of control during an interim visit in advance of the period end. However, the auditor cannot rely on the results of such tests without considering the need to obtain further audit evidence relating to the remainder of the period. Factors to be considered include:
- The results of the interim tests.
 - The length of the remaining period.
 - Whether any changes have occurred in the accounting and internal control systems during the remaining period.
 - The nature and amount of the transactions and other events and the balances involved.
 - The control environment, especially supervisory controls.
 - The nature, timing and extent of substantive procedures which the auditor plans to carry out.
2. Extent of reliance on analytical procedures: The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system. However, reliance to be placed on the results of analytical procedures will depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists. The extent of reliance that the auditor places on the results of analytical procedures depends on the following factors:

- Materiality of the items involved in relation to the financial information taken as a whole (e.g. when inventory balances are significant to the financial information, the auditor does not rely only on analytical procedures in forming his conclusions). On the other hand, he may rely solely on analytical procedures for certain expense items when they are not individually significant to the financial information taken as a whole and there is an absence of unexpected fluctuations.
 - Other audit procedures directed toward the same audit objectives, for example, other procedures performed by the auditor in reviewing the collectability of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an aging of customers' accounts.
 - Accuracy with which the expected results of analytical procedures can be predicted, for example, the auditor will normally expect greater consistency in comparing gross profit margins from one period with another than in comparing discretionary expenses, such as research or advertising.
 - Evaluation of internal controls, for example, if the auditor has concluded that internal controls over sales order processing are weak, he may have to rely more on the tests of details of transactions and balances than on analytical procedures in drawing his conclusion on sales.
3. The auditor may take the following steps to ensure that the dividend has been paid only out of profits:
- (a) Check whether dividend was declared out of profits arrived at after providing for depreciation.
 - (b) If no depreciation was provided, ensure that approval was obtained from the Central Government before declaring dividend [Section 205(1)(c)].
 - (c) Check whether:
 - (i) the depreciation was provided according to provisions of Section 205(2).
 - (ii) the minimum prescribed amount had been transferred to reserves according to the Companies (Transfer of Profits to Reserves) Rules, 1975, before declaring any dividend.
 - (iii) conditions governing transfer of higher percentage complied with.
 - (iv) a board resolution recommending dividend was passed.
 - (v) register of members was closed as per the provisions of Section 154.
 - (vi) the dividend was declared only in the annual general meeting.
 - (vii) dividend has been paid in the prescribed manner within 30 days of time to the registered holder or to their order (Section 207).
 - (viii) Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend.

- (ix) permission of Reserve Bank of India was obtained for payment to non-resident shareholders before the dividend was remitted to them.
 - (x) intimation sent to stock exchange, in case of listed company.
 - (xi) there were any complaints regarding non-payment or delay in payment of dividend? If, so, whether corrective action was taken.
4. Professional integrity and independence is an essential characteristic of all the learned professions but is more so in the case of accounting profession. Independence implies that the judgment of a person is not subordinate to the wishes or directions of another person who might have engaged him, or to his own self-interest. In all phases of a Chartered Accountant's work, he is expected to be independent, but in particular in his work as auditor, independence has a special meaning and significance. Not only the client but in the case of companies, also the shareholders, prospective investors, bankers and government agencies rely upon the accounts of an enterprise when they are audited by a Chartered Accountant. As statutory auditor of the accounts of a limited company, for example, the Chartered Accountant would cease to perform any useful function if the persons who rely upon the accounts, of the company do not have any faith in the independence and integrity of the Chartered Accountant. In such cases he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do.

In view of the above, a statutory auditor either performing as a book-keeper or an internal auditor would not be in a position to act in an independent manner on the subject matter prepared by him. If a person who writes the books of account would not be in a position to express an opinion on the appropriateness or otherwise of the same. Accordingly, the Council has clarified that the members are not permitted to write the books of account of their auditee clients. As back as in 1963, Seventh Annual Report on Working and Administration of Companies Act, 1956 clarified the acceptance of the book-keeping work by the statutory auditor is likely to place the statutory auditor in a rather vulnerable position in the matter of free expression of his professional opinion as an auditor on the annual accounts of the company.

Regarding the internal auditor, the Code of Ethics also recommend that a statutory auditor of a company cannot also be its internal auditor, as it will not be possible for him to give independent and objective report issued under sub-section 4A of Section 227 of the Companies Act, read with the Companies (Auditor's Report) Order, 2003. Further as per circular issued by the Department of Company Affairs in case the statutory auditor of the company is also the internal auditor, it will not be possible for him to give an independent and objective report under Section 227. As such a statutory auditor of a company cannot also be its internal auditor.

5. Identification of Related Parties: The duties of an auditor with regard to reporting of transactions with related parties as required by AS 18 are given in SA 550 on Related Parties. As per SA 550 on "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related

parties. Since it is the management, which is primarily responsible for identification of related parties, SA 550 requires that to identify names of all known related parties, the auditor may carry out the following procedures:

- (i) review his working papers for previous years for names of known related parties;
- (ii) review the entity's procedures for identification of related parties;
- (iii) inquire as to affiliation of directors, key management personnel and officers with other entities, etc.;
- (iv) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a list of principal shareholders from the share register;
- (v) review memorandum and articles of association, minutes of the meetings of shareholders and the board of directors and its committees and other relevant statutory records such as the register of directors' interests;
- (vi) inquire of other auditors such as internal auditor, special auditors appointed under any statute, cost auditors, and concurrent auditors of the entity as to their knowledge of additional related parties and review the report of the predecessor auditors;
- (vii) review the entity's income tax returns and other information supplied to regulatory agencies; and
- (viii) review the joint venture and other relevant agreements entered into by the entity.

In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples include–

- Transactions which have abnormal terms of trade, such as, unusual prices, interest rates, guarantees, and repayment terms.
- Transactions which lack an apparent logical business reason for their occurrence.
- Transactions in which substance differs from form.
- Transactions processed in an unusual manner.
- High volume or significant transactions with certain customers or suppliers as compared with others.
- Rendition of services without receipt or provision of management services at no charge.

Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identifications of related parties.

6. (a) Matters to be reported by auditor under Section 227 (3): Under Section 227(3) of the Companies Act, 1956, the report of the auditor shall state -
 - (i) Whether he has obtained all the information and explanations which to the best

of his knowledge and belief were necessary for the purposes of his audit;

- (ii) Whether, in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of those books; whether proper returns adequate for the purposes of his audit have been received from the branches not audited by him;
 - (iii) Whether the report on the accounts of the branches audited by branch auditors under Section 228 has been forwarded to him and how he had dealt with the same in preparing the auditor's report;
 - (iv) Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts and returns;
 - (v) Whether in his opinion the profit and loss account and balance sheet comply with the accounting standards referred to in Section 211(3C);
 - (vi) In thick type or in italics the observations or comments of auditors which have any adverse effect on the functioning of the company;
 - (vii) Whether any director is disqualified from being appointed as director under Section 274(1)(g);
 - (viii) Whether the cess payable under Section 441 A had been paid and if not details of amount of cess not so paid.
- (b) Money raised by public issues: Companies (Auditor's Report) order, 2003 requires that in case the company has made a public issue of any of its securities like shares, preference shares, debentures and other securities, the auditor is required to report upon the disclosure of end-use of the money by the management in the financial statements. The auditor is also required to state whether he has verified the disclosure made by the management in this regard.

Schedule VI to the Act requires that only unutilized amount of any public issue made by the company should be disclosed in the financial statements of a company. In the absence of any legal requirement of such disclosure, it appears that the clause envisages that the companies should disclose the end use of money raised by the public issue in the financial statements by way of notes and the auditor should verify the same.

Normally, the companies do mention the end-use of the money proposed to be raised through the public issues in the prospectus. An examination of the prospectus would provide the auditor an understanding of the proposed end-use of money raised from public. The auditor should verify that the amount of end-use of money disclosed in the financial statements by the management is not significantly different from the proposed and actual end use. The auditor should obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised by public issues. If the auditor is of the opinion that adequate disclosure with regard to end use of money raised by public issue has not been made in the financial statements, the auditor should state the

fact in his audit report. If, for any reason, the auditor is not able to verify the end-use of money raised from public issues, he should state that he is not able to comment upon the disclosure of end-use of money by the company since he could not verify the same. He should also mention the reasons which resulted in the auditor's inability to verify the disclosure.

7. Internal Audit System and CARO, 2003: As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies. For other companies, it is applicable if either of the following conditions is satisfied:

- a. The company has a paid-up capital and reserves exceeding Rs.50 lakhs at the commencement of the financial year, or
- b. The company has an average annual turnover of Rs.5 crores or more for a period of 3 years preceding the current financial year.

In the instant case, the second condition has been fulfilled by JKT Ltd. Hence, the auditor will have to mention in his report the fact of not having such internal audit in his report by the company.

8. (a) Advising on Portfolio Management Services: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that CAs in practice are not permitted to undertake the activities of broking, underwriting and portfolio management Services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients.

In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949.

- (b) Developing Website: As per the guidelines laid down under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 in respect of websites by chartered accountants in practice, it is permitted that website may provide a link to the website of ICAI, its Regional Councils, Branches and Government Departments and other professional Bodies like AICPA, ICAEW, CICA. In this case, M/s XYZ Associates provided a link to "All India Chartered Accountants Association" which is not permitted. Hence the firm would be liable for misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
9. (a) Under clause 3 of Part II of second schedule, a Chartered Accountant whether in practice or not is guilty of professional misconduct if he includes in any information,

statement, return or form to be submitted to the Institute, Council or any of its committees, Directors (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

In the instant case A B & Co. included another Chartered Accountant name as partner in his firm, in his application for empanelment as Auditor of branches of Public Sector Banks submitted to the Institute. In fact such a member was not a partner of the said firm on the date of application. He will be held guilty of professional misconduct.

- (b) Power of signing reports and financial statements: Under clause 13 of Part I of First Schedule to the Chartered Accountants Act, 1949 a CA in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

This Clause read in conjunction with Section 26 of the Chartered Accountants Act, 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a CA in practice or a firm of CA's in his or its professional capacity.

The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise. Accordingly M is guilty of professional misconduct under clause 13 of part I of First Schedule and also under clause (1) of Part II of Second Schedule for contravening Section 26.

10. (a) Duty of the auditor to report under Section 227(3)

Under Section 227(3) of the Act, the auditor has a duty to report as to whether any director is disqualified from being appointed as director as director under clause(g) of Section 274(1).

The provisions of Section 227(3) are applicable to public as well as private company.

- Disqualification of directors under Section 274(1)(g)

- (i) According to Section 274(1)(g) if a public company has not filed annual accounts and annual returns for any continuous three financial years commencing on or before April 1, 1999, the persons who are the directors of the company on the last due date for filing the annual accounts and annual returns as aforesaid would attract the disqualification i.e. shall not be eligible to be appointed as a director of any other public company for a period of five years from the said date.
- (ii) It may be noted that, the disqualification applies only to appointment or reappointment as director in all public companies and not private companies and Government companies.

- Present case

The auditor may accept the directors' contention because –

- (i) The reporting requirement under Section 227(3)(f) applies to audit of every company, whether public or private.
- (ii) Even the auditor of a private company (M/s. LM Private Ltd., in this case) has to report whether any director (Mr. Z, in the present case) of the private company is disqualified from being appointed as director of a public company. But in this case, the private company, M/s. OP Pvt. Ltd., has not filed the annual accounts and annual returns. Hence, the director, Mr. X is not disqualified under Section 274(1)(g).

- (b) Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to Chartered Accountants' Act, 1949 the Council of the Institute of Chartered Accountants of India had an occasion to consider whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor. It laid down that the sale is permitted subject to certain conditions. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned. Thus in a given case and on the facts, the widow of Mr. John who has sold the practice for Rs. 5 lakhs is nothing but sale of goodwill. Thus the act of Mrs. John is permissible.

11. Adequate working capital is required for liquidity and smooth operations of the company. To ensure an adequate flow of working capital to the manufacturing company, the following action plan may be considered:

- (i) Working Capital Estimation: The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the master budget consisting of projected profit and loss and the balance sheet.
- (ii) Cash Flow Statement / Cash Budget: Month-wise cash budgets showing inflows and outflows of cash heading-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstandings can be traced and acted upon. This is also necessary to reduce the float time.
- (iii) Inventory / Stock Management: Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The caution also need to be exercised that there is no unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scrap generated during storage and

handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.

- (iv) Credit Management: The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale department need to be geared up so that realisation can be made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavour to avail the maximum credit period from its creditors. This would enhance the working capital of the company.
- (v) Funds Flow Analysis: The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.
- (vi) Investment Management: The idle funds of the company, if any, should be invested in short-term securities to augment the income.
- (vii) WIP Analysis: Minimum WIP should be monitored and for the purpose it is necessary to ensure that no bottlenecks develop at any stage during the production process.

12. Steps in Audit of Reinsurance ceded

- (i) Evaluate internal control system in the area of reinsurance ceded to ensure determination of correct amount for reinsurance ceded, proper valuation of assets and liabilities arising out of reinsurance transaction and adherence to legal provisions and regulations.
- (ii) Ascertain whether adequate guidelines and procedures are established with respect to obtaining reinsurance.
- (iii) Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.
- (iv) Examine whether commission on reinsurance ceded is as per the terms of the agreement with the re-insurers.
- (v) Examine the computation of profit commission for automatic treaty arrangements in the light of the periodic accounts rendered and in relation to outstanding loss pertaining to the treaty.
- (vi) Examine whether loss recoveries have been claimed and accounted on a regular basis.
- (vii) Examine whether outstanding losses recoverable have been confirmed by re-insurers.
- (viii) Examine whether remittances to foreign re-insurers are as per foreign exchange regulations.

- (ix) Examine whether confirmations have been obtained regarding balances with re-insurers.
 - (x) Review individual accounts of re-insurers to evaluate whether any provision/write off or write back is required.
13. As per explanation to Section 79A of the Companies (Amendment) Act, 1999, the term "Sweat Equity Shares" means the equity shares issued by the company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The auditor should cover the following aspects while checking the issue of sweat equity share transactions:

- (a) Authorised by a special resolution : The issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.
 - (b) Details about share issues are specified : The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.
 - (c) Minimum time gap for issue : Not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business.
 - (d) SEBI guidelines : The sweat equity shares of a company, whose equity shares are listed on a recognised stock exchange, are issued in accordance with the regulations by the SEBI.
 - (e) Issue out of already issued share type : The sweat equity shares issued by the company should be of a class already issued by the company.
14. An investigation into the affairs of sick company will involve the following major steps:

1. Investigation of documents, books and records

The investigator should examine the different documents, books and records including the books of accounts in order to know the existing position of the business along with different aspects of the business including legal, financial, social, economical and other aspects, which directly or indirectly influenced the functioning of the organisation. The important documents, books and records mainly include the following:

- The Memorandum and the Article of Association
- Audited financial statements
- Different budgets including cash budget
- Stock records
- Debtors and creditors ledger

- Bank statements
- Records for working capital requirement
- Records of cost structure of different products

2. Collection of information from different sources

The investigator should collect information for his proper investigation from different sources including the management of the organisation. He should gather information about the weaknesses and threats of the business from the management. He should also meet the bankers and other financial institutions to know the financial position of the organisation as reflected in its dealings with those institutions. The investigator should also meet with the trade union leaders to identify the basic problems of the organisation. He should visit the Chamber of Commerce and Industry to know the prospects of the organisation and the industry to which it belongs.

3. Measurement of the degree of sickness

The investigator should then measure the degree of sickness of the company with the help of some standard accounting ratios on the basis of last few years' financial statements.

The following are the most accepted ratios for the measurement of sickness:

- EBIT to Sales Ratio
- OCF to Sales Ratio
- EBIT to Total Asset Ratio
- OCF to Total Assets Ratio
- OCF to Net Worth

(EBIT = Earning before interest and taxes, OCF = Operating Cash Flow)

4. Identification of the causes of sickness

After measuring the degree of sickness, the investigator may try to find out the reasons for sickness of the company. Sickness of company may be due to various reasons, out of which some of the reasons are inborn in nature. The company under investigation may be born sick for reasons as given below:

- Selection of technology
- Selection of improper place of business
- Selection of wrong product-mix
- Adoption of defective production policy

Again, the company may be started healthy but subsequently may become sick due to a number of reasons, which include the following:

- Change in the government policy of the country
- Change in the economic scenario of the country
- Change of market condition of the product
- Lack of management effectiveness
- Adoption of wrong market strategy

A company may become sick because of innumerable reasons and the investigator will have to identify the actual causes of sickness.

5. Possible remedies

The investigator will then find out the possible remedies for the survival of the sick company. These remedial measures can be of long-term and short-term basis. He will also ascertain the fund requirement for the implementation of the revival programme. The requirement of fund can again be for working capital purpose or for the purpose of acquiring fixed assets. Usually the revival measures include the following suggestions:

- Modernisation and technology upgradation
- Sound financial management and policy
- Deployment of surplus worker
- Re-organisation of capital structure
- Change of product-mix and design.

6. Socio-economic justification for the continuation of the business

Before taking over any sick industrial unit, the government should consider the aspects of socio-economic factors for the continuation of the business. Socio-economic factors include the following:

- Development of the local economy
- Employment of workers
- Tax revenue of the government
- Economic aspects of persons related to business and
- Environment effect of the business activities.

7. Reporting

On the basis of the above study and evaluation of the position of the sick business unit, the investigator should write his report. The report should be written carefully starting all the relevant information including the symptoms sickness, the causes of sickness, the suggested programme of revival and socio-economic justification for the continuation of the business. Finally, he should offer his opinion as to whether the government should take over the unit or whether the revival of the sick unit is

possible in other ways without taking over it.

15. (a) The Council of the ICAI has in a communication to members stated that if a public company, in which a chartered accountant in practice is a director, issues a prospectus or gives any announcement that gives descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field, it shall constitute a violation of Clauses 6 and 7 of Part I of the First Schedule to the Chartered Accountants Act, 1949. The Council has further stated that in such cases the member concerned has to take necessary steps to ensure that such prospectus or public announcements or public communications do not advertise his professional attainments and also that such prospectus or public announcements or public communications do not directly or indirectly amount to solicitation of clients for professional work by the members. Thus in the instant case, Mr. R would be held to be guilty of professional mis-conduct and liable for disciplinary action.
- (b) Section 224A of the Companies Act, 1956, requires that in the case of company in which not less than 25 per cent of the subscribed share capital is held by certain specified institutions, the appointment or re-appointment of the auditor shall be made by a special resolution. In the above case, therefore, the appointment is not valid. The chartered accountant, i.e. Mr. S is guilty of professional misconduct for not having ascertained compliance with Section 224A as per Clause 9 of the First Schedule (Part-I) of the Chartered Accountants Act, 1949.
16. Corporate Debt Restructuring (CDR) - A corporate debt restructuring system has been evolved for restructuring of the corporate debts of viable entities facing problems, which are out side the purview of BIFR, DRT and other legal proceedings. All the banks have been advised by RBI to follow the corporate debt restructuring mechanism which would be a non-statutory voluntary system based on debtor creditor agreement and inter creditor agreement. The mechanism will apply only to the multiple banking account/syndicate/consortium with an outstanding exposure of Rs.20 crore and above by bank and financial institutions. In respect of restructuring of account through corporate debt restructuring mechanism also, the treatment of account and other requirement shall be as given in 'Reschedulement of Loans' above.
- Corporate Debt Restructuring (CDR) would generally affect the operations both at Branch level as well as the Head Office level, although, in most of the cases the effects of provisioning as envisaged in the Reserve Bank of India's circular due to sacrifice in the interest would be made at the Head Office level.
- In case of restructuring of the principal amount, auditors should verify that adequate security coverage of the loan/credit account is available.
17. The following peculiar points need to be included while drafting the audit programme of a two-day conference:
- Obtain a list of delegates who attended the conference.
 - Vouch the participation fees collected from delegates with reference to cash receipt book and the list of delegates.

- Examine whether uniform rates have been charged from doctors associated with government hospitals or those with private hospital and the doctors carrying private practice.
 - Examine pay-in-slips to ensure cash collected or cheques received have been deposited in the bank.
 - Examine cash register with reference to attendance register to ensure everyone who attend the conference, paid for the same.
 - Examine list of certificates of participation against the cash receipt book.
18. The Sarbanes-Oxley Act's major provisions include the following:
- Creation of the Public Company Accounting Oversight Board (PCAOB);
 - A requirement that public companies evaluate and disclose the effectiveness of their internal controls as they relate to financial reporting, and that independent auditors for such companies "attest" (i.e., agree, or qualify) to such disclosure;
 - Certification of financial reports by chief executive officers and chief financial officers;
 - Auditor independence, including outright bans on certain types of work for audit clients and pre-certification by the company's audit committee of all other non-audit work;
 - A requirement that companies listed on stock exchanges have fully independent audit committees that oversee the relationship between the company and its auditor;
 - Ban on most personal loans to any executive officer or director;
 - Accelerated reporting of insider trading;
 - Prohibition on insider trades during pension fund blackout periods;
 - Additional disclosure;
 - Enhanced criminal and civil penalties for violations of securities law;
 - Significantly longer maximum jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements, although maximum sentences are largely irrelevant because judges generally follow the Federal Sentencing Guidelines in setting actual sentences;
 - Employee protections allowing those corporate fraud whistleblowers who file complaints with OSHA within 90 days to win reinstatement, back pay and benefits, compensatory damages, and congressional page abatement orders, and reasonable attorney fees and costs.
19. Broad objectives of operational audit:
- (i) Appraisal of controls: Operations and the results in which management is interested

are largely a matter of control. If controls are effective in design and are faithfully adhered to the result that can be attained will be subject to the other limiting constraints in the organisation.

- (ii) Evaluation of performance: In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards. The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining or appraising performance or reports of performance, the operational auditor's mind is invariably fixed on control aspects.
 - (iii) Appraisal of objectives and plans: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.
 - (iv) Appraisal of organisational structure: Organisational structure provides the line of relationships and delegation of authority and tasks. This is an important element of the internal control design. In evaluating organisational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. He should also analyse whether line of responsibility has been fixed, whether delegation of responsibility or authority is clear and there is no overlapping area.
20. (a) Clause 10 of the First Schedule (Part-I) of the Chartered Accountants Act, 1949 restrains a chartered accountant from charging fees contingent upon his findings. This clause has been included, as the professional fees of a chartered accountant should always be based on time, skill and the responsibility involved in the assignment. It helps in maintaining the dignity of the profession.

In the above case, Mr. C will be held guilty of professional misconduct, as he has related his professional fees to the valuation of the business goodwill.

- (b) Clause 11 of the 1st Schedule of the Chartered Accountants Act, 1949 prohibits a practicing chartered accountant to engage in any business or occupation other than the profession of chartered accountancy. However, there are some occupations, which do not affect the dignity of a chartered accountant, which are included in the general resolution as well as in the special resolution of the Council of the Institute of Chartered Accountants.

In the above case, Mr. J will not be held guilty of professional misconduct if he has already taken prior permission for part-time lecturership in college from the Institute. He is not required to take prior permission for co-authorship of book. It is important to note in this regard that the general resolution is in fact silent about co-authorship. But it is implied from the spirit of the resolutions that co-authorship with another dignified member of the society will not tarnish the image of a chartered accountant.

21. The role of the audit committee under Clause 49 (II) (D) shall include the following:
- (a) Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
 - (b) Recommending the appointment and removal of external auditors, fixation of audit fee and also approval for payment of any other services.
 - (c) Reviewing with management the annual financial statements before submission to the Board, focusing primarily on:
 - (i) Any changes in accounting policies / and practices;
 - (ii) Major accounting entries based on exercise of judgments by management;
 - (iii) Qualification in draft audit report;
 - (iv) Significant adjustments arising out of audit;
 - (v) The going concern assumption;
 - (vi) Compliance with accounting standards;
 - (vii) Compliance with stock exchanges and legal requirements concerning financial statements.
 - (viii) Any related party transactions.
 - (d) Reviewing with the management, external and internal auditors, the adequacy of internal control system.
 - (e) Reviewing the adequacy of internal audit function, if any including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
 - (f) Discussion with internal auditors any significant findings and follow-up thereon.
 - (g) Reviewing the findings of any internal investigation by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
 - (h) Discussion with external auditors before the audit commences, nature and scope of audit as well as have post audit discussion to ascertain any area of concern.
 - (i) Reviewing the company's financial and risk management policies.
 - (j) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividend) and creditors.
 - (k) Carrying out any other function as is mentioned in the terms of reference of the audit committee.

The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18 "Related Party Transactions", issued by the Institute of Chartered Accountants of India.

If the company has set up an audit committee as per section 292A of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

22. (i) Section 40(a) of the Income-tax Act, 1961 specifies that amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply or labour for carrying out any work) on which tax is deductible under Chapter XVII-B and such tax has not been deducted or after deduction has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200, shall not be deducted in computing the income. Therefore, if tax is deducted at an inappropriate rate, the amount is disallowable under section 40(a)(ia) of the Income-tax Act. This fact needs to be reported in Clause 17(f) of Form 3CD where all amounts inadmissible under section 40(a) are to be reported. In case, the assessee submits that the rate is proper, though in the auditor's view it is improper, the tax auditor should exercise his judgement and accordingly report in Clause 17(f) of Form 3CD.
 - (ii) Clauses 15(a) and (b) of Form 3CD requires that expenditure on Scientific Research (capital as well as revenue) covered under section 35 of the Income-tax Act, 1961 reported of the amount debited to the profit and loss account showing the amount debited and deduction allowable and not debited to the profit and loss account. Accordingly, the auditor should exercise his judgement and accordingly report in Clause 15(b) the amount of capital expenditure not debited to the profit and loss account which is eligible for deduction under section 25 as Scientific Research Expenditure.
23. Comprehensive Audit of Public Enterprises : Areas to be examined: The scope and extent of audit of public sector enterprises is determined by the Comptroller and Auditor General of India. Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals. Another aspect of such audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Comprehensive audit involves assessing efficiency and effectiveness of public enterprises in its entirety to be conducted on the basis of certain standards and criterion. Public enterprises have been set-up with socio-objectives. An objective assessment with reference to such objectives' fulfillment would require comprehensive audit.

The starting point of a comprehensive audit of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the

annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers. These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis and criteria, the data required for such analysis and the sources of such data, the extent of the audit analysis including the test checks to be applied and the instructions to the audit parties assigned to the work.

The areas covered by comprehensive audit are those of investment decisions, project formulation and management, organisation, delegation of powers and management information systems, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, development of complementary ancillary small scale industries, materials management, sales and credit control, budgetary and internal control systems, etc. The areas covered in comprehensive audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below:

- Comparison of overall capital cost of the project with the approved planned costs.
 - Production or operational outputs vis-a-vis under-utilisation of the installed capacity.
 - Systems of project formulation and implementation.
 - Cost control measures.
 - Research and development programmes.
 - System of repairs and maintenance.
24. **Scope of Concurrent Audit:** Concurrent audit is an examination which is contemporaneous with the occurrence of transactions. It attempts to shorten the interval between a transaction and its examination by an independent person not involved in its documentation. There is an emphasis in favour of substantive checking in key areas rather than test checking. This audit is essentially a management process integral to the establishment of effective control to preclude incidence of serious errors and fraudulent manipulations. The concurrent audit system is regarded as part of bank's early-warning system to ensure timely detection of irregularities and lapses which helps in preventing fraudulent transactions at branches. It is, therefore, necessary for the bank's management to bestow serious attention to the implementation of various aspects of the system such as selection of branches/coverage of business operations, appointment of auditors, appropriate reporting procedures, follow-up/rectification processes and utilisation of the feedback from the system for appropriate and quick management decisions.

As early as in 1993, certain guidelines on concurrent audit system in commercial banks were issued, setting out the scope and coverage of concurrent audit system and its reporting procedures and calling upon banks to introduce/revamp their concurrent audit system based on these guidelines. Thereafter, the Reserve Bank of India has reviewed,

inter alia, the working of concurrent audit system in banks and given its recommendations for improving it. Further, some of the public sector banks have sought additional guidelines on the system's scope, coverage, reporting procedures, etc. A need was, therefore, felt to have a re-look at the existing guidelines and review certain norms to ensure that the system is more compact and focused in its approach and also facilitate effective implementation. These guidelines are mandatory and all banks are required to cover 50 percent of total deposits and 50 per cent of total advances under this audit. This will mean that all banks will have to put their large branches under this audit. Further, the following may be noted:

- (1) The scope of concurrent audit should be wide enough to cover certain fraud-prone areas like handling of cash, deposits, safe custody of securities, investments, overdue bills, exercise of discretionary powers, sundry and suspense accounts, inter-branch reconciliation, clearing differences, foreign exchange business including Nostro accounts, off-balance sheet items like letters of credit and guarantee, treasury functions and credit-card business.
- (2) The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Bank's Inspector and Audit Department in consultation with the Bank's Audit Committee of the Board of Directors.
- (3) In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving small amounts.

The scope of concurrent audit can further be defined with reference to several banking operations such as treasury, investment banking, etc. As far as activities are concerned, it would include cash, investments, deposits, advances, foreign exchange transactions, house keeping high value transaction, safe custody etc. It is however, contemplated by RBI that, "a concurrent auditor may not sit on judgement of the decisions taken by the branch manager or an authorized official. However, the auditor will have to see whether, the transactions are within the parameters laid down by the Head Office and do not violate the instructions of the RBI, and are within the delegated authority".

LIST OF INSTITUTE PUBLICATIONS - NOVEMBER, 2009

I. Professional Topics/Subjects

1. Code of Ethics

(The Chartered Accountants (Amendment) Act, 2006 is applicable for November, 2008 Final Examination)

II. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
2. Standards on Auditing as given below. (All these SAs have been hosted in the Institute's website)

S.No.	Standards on Auditing and Number
1.	Basic Principles Governing an Audit (SA 200)
2.	Objectives and Scope of the Audit of Financial Statements (SA 200A)
3.	Terms of Audit Engagement (SA 210)
4.	Quality Control for Audit Work (SA 220)
5.	Audit Documentation (230) (Revised)
6.	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (SA 240) (Revised)
7.	Consideration of Laws and Regulations in an Audit of Financial Statements (SA 250) (Revised)
8.	Communication of Audit Matters with Those Charged with Governance (SA 260) (Revised)
9.	Responsibility of Joint Auditors (SA 299)
10.	Planning an Audit of Financial Statements (300)
11.	Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment (SA 315) (Newly issued)*
12.	Audit Materiality (SA 320)
13.	The Auditor's Responses to Assessed Risks (SA 330) (Newly issued)*
14.	Audit Considerations Relating to Entities Using Service Organisations (SA 402)
15.	Audit Evidence (SA 500)
16.	Audit Evidence - Additional Considerations for Specific Items (SA 501)
17.	External Confirmations (SA 505)
18.	Initial Engagements – Opening Balances (SA 510) (Revised)
19.	Analytical Procedures (SA 520)
20.	Audit Sampling (SA 530) (Revised)
21.	Auditing of Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (SA 540) (Revised)
22.	Related Parties (SA 550) (Revised)
23.	Subsequent Events (SA 560) (Revised)

24. Going Concern (SA 570) (Revised)
25. Written Representations (SA 580) (Revised)
26. Using the Work of Another Auditor (SA 600)
27. Relying Upon the Work of an Internal Auditor (SA 610)
28. Using the Work of an Expert (SA 620)
29. The Auditor's Report on Financial Statements (SA 700)
30. Comparatives (SA 710)
31. Engagements to Compile Financial Information (SRS 4410)
32. Engagements to Perform Agreed- upon Procedures Regarding Financial Information (SRS 4400)
33. Engagements to Review Financial Statements (SRE 2400)
34. The Examination of Prospective Financial Information (SRE 3400)

NOTE: 1

* Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

** SA 315 & SA 330 – become effective in April, 2008. For November 2009 Final (Old) Examination 34 standards on Auditing as given in the Annexure – I. The Standard on Auditing (SA) 400, "Risk Assessments and Internal Control", SA 310, "Knowledge of the Business", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, would stand withdrawn.

NOTE: 2

Newly issued SA 450 "Evaluation of Misstatements Identified during the Audit" effective for all audits relating to accounting periods beginning on or after April 1, 2010. It is not applicable for the November 2009 examination.

3. Statement on Reporting under Section 227(1A) of the Companies Act, 1956
4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].

III. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Independence of Auditors
2. Internal Control Questionnaire.
3. Guidance Note on Audit Reports and Certificates for Special Purposes

4. Guidance Note on Audit of Fixed Assets.
5. Guidance Note on Audit under Section 44AB of the Income Tax Act [2005 Edition].
6. Guidance Note on Audit of Abridged Financial Statements.
7. Guidance Note on Audit of Inventories.
8. Guidance Note on Audit of Debtors, Loans and Advances.
9. Guidance Note on Audit of Investments.
10. Guidance Note on Audit of Miscellaneous Expenditure.
11. Guidance Note on Audit of Cash and Bank Balances.
12. Guidance Note on Audit of Liabilities.
13. Guidance Note on Audit of Revenue.
14. Guidance Note on Audit of Expenses.
15. Guidance Note on Section 227 (3) (e) and (f) of the Companies Act, 1956.
16. Guidance Note on Certificate of Corporate Governance [2006 Edition].
17. Guidance Note on Revision of Audit Report.
18. Guidance Note on Computer Assisted Audit Techniques (CAATs).
19. Guidance Note on Audit of Payment of Dividend.
20. Guidance Note on Audit of Capital and Reserves.