

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I : ACADEMIC UPDATE (SIGNIFICANT NOTIFICATIONS AND CIRCULARS)

General Circular No: 15/2011 issued by MCA dated 11-04-2011: Revised procedure for appointment of cost auditor by companies under section 233B of the Companies Act, 1956 - Audit of cost accounts in certain cases –

1. Ministry has reviewed the existing procedure followed by the companies for seeking prior approval of the Central Government for appointment of cost auditor under section 233B(2) of the Companies Act, 1956. In supersession of any earlier order/circular issued in this regard, the revised procedure to be followed by the companies and cost auditor shall be as under:
 - (a) The company required to get its cost records audited under section 233B (1) of the Companies Act, 1956 shall appoint a cost auditor who is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and includes a firm of cost accountants.
 - (b) The Audit Committee of the Board shall be the first point of reference regarding the appointment of cost auditors.
 - (c) The Audit Committee shall ensure that the cost auditor is free from any disqualifications as specified under section 233B (5) read with section 224 and sub-section (3) or sub-section (4) of section 226 of the Companies Act, 1956.
 - (d) While a cost auditor shall have prime responsibility to ensure that he does not violate the limits specified under section 224(1-B) of the Companies Act, 1956, the Audit Committee shall also be responsible for such compliance by the cost auditor.
 - (e) The Audit Committee shall obtain a certificate from the cost auditor certifying his/its independence and arm's length relationship with the company.
 - (f) The company shall e-file its application with the Central Government on www.mca.gov.in portal, in the prescribed Form 23C within ninety days from the date of commencement of each financial year, along with the prescribed fee as per the Companies (Fees on Applications) Rules, 1999 as amended from time-to-time and other documents as per existing practice i.e., (i) certified copy of the Board Resolution proposing appointment of the cost auditor; and (ii) copy of the certificate obtained from the cost auditor regarding compliance of section 224(1B) of the Companies Act, 1956.
 - (g) On filing the application, the same shall be deemed to be approved by the Central Government, unless contrary is heard within thirty days from the date of filing such application.

- (h) If within thirty days from the date of filing such application, the Central Government directs the company to re-submit the said application with such additional information or explanation, as may be specified in that direction, the period of thirty days for deemed approval of the Central Government shall be counted from the date of re-submission by the company.
 - (i) After expiry of thirty days, as the case may be, the company shall issue formal letter of appointment to the cost auditor, as approved by the Board.
 - (j) Within thirty days of receipt of formal letter of appointment from the company, the cost auditor shall inform the Central Government in the prescribed form, along with a copy of such appointment. An e-form for the same is being developed and will be notified shortly.
 - (k) The company shall disclose full particulars of the cost auditor, along with the due date and actual date of filing of the cost audit report by the cost auditor, in its Annual Report for each relevant financial year.
 - (l) In those companies where constitution of an Audit Committee of the Board is not required by law, the words "Audit Committee" shall stand substituted by the words "Board of Directors".
2. If a company contravenes any provisions of this circular, the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Act, shall be punishable as provided under sub-section (2) of section 642 read with sub-sections (5) and (7) of section 209 and sub-section (11) of section 233B of Companies Act, 1956.
 3. If default is made by the cost auditor in complying with the aforesaid provisions, he shall be punishable with fine, which may extend to five thousand rupees.
 4. The modified procedure contained in this circular shall be effective from the financial year commencing on or after the 1st day of April, 2011.

(Source : <http://www.mca.gov.in>)

General Circular No: 10/2011 issued by MCA dated 04-04-20011: Interpretation of the word "Partnership" for the purpose of Chartered Accountants Act, 1949, Cost and Works Accountants Act, 1959 and Company Secretaries Act, 1980.

The Acts governing the three professional Institutes i.e. ICAI, ICWAI and ICSI define in Section 2 members who are deemed to be in practice. In all the three Acts, there is a provision for a member to be in practice when he is in partnership with certain others. In the case of Chartered Accountants and Cost & Works Accountants, such persons must be member of the same Institute, while in the case of Company Secretaries; it is provided that the partnership could also be with members of such other recognised professions as may be prescribed.

2. At the time of enactment of the three Acts governing the professional Institutes, only one form of partnership existed in India, namely Partnerships under Indian Partnership Act, 1932. Subsequently, Parliament has enacted the Limited Liability Partnerships Act, 2008. Though Limited Liability Partnerships are bodies corporate under Section 3(i) of the LLP Act, the fact that LLPs are basically partnerships may be seen from the definition in Section 2(i) (n) :-

"Limited Liability Partnerships means a partnership formed and registered under this Act. Section 2(i)(q) defines a partner as "any person who becomes a partner in the limited liability partnership in accordance with the Limited Liability Partnership Agreement"

It is thus clear that a Limited Liability Partnership is also a partnership and its members are also partners.

3. The matter of permitting member of ICAI, ICWAI and I ICSI was been examined in this Ministry. Acts governing these professionals were passed at a time when limited liability partnership did not exist. It is also clear from the definitions in the Limited Liability Partnership Act that such entities are also partnerships and their members are also partners. In the context of Section 2 of the Acts governing the professional Institutes, this interpretation is also not repugnant to the context. Accordingly, it is clarified that the words "partnership" wherever occurring in the Chartered Accountants Act, 1949, the Cost and Works Accountants Act, 1959 and the Company Secretaries Act, 1980 shall mutatis mutandis be construed as including those Limited Liability Partnerships where all the other partners are natural persons(individuals). The word "partner" shall also be construed accordingly. This clarification shall apply only to these three Acts and not to any other enactment where the word "partnership" occurs.

(Source : http://mca.gov.in/Ministry/latestnews/Circular_04Apr2011.pdf)

Amendment in Council General Guidelines , 2008

The Chapter-XII Minimum Audit Fee in respect of Audit of the Council General Guidelines, 2008 appended to the ICAI publication titled " The Chartered Accountants Act, 1949" has been repealed with effect from 7th June, 2011

(Source : http://www.icai.org/new_post.html?post_id=7493&c_id=219)

Announcements - Definition of Relative in Chapter-IV of the Council General Guidelines, 2008

The Council of the Institute of Chartered Accountants of India, in terms of the decision taken at the 299th meeting held in October, 2010 has decided that the term "relative" for the purpose of Chapter-IV of Council General Guidelines, 2008 (Opinion on Financial Statements when there is substantial interest) will have the same meaning as assigned to it in AS-18.

Accordingly, the Chapter IV of the Council General Guidelines, 2008 as appended to the ICAI publication titled "The Chartered Accountants Act, 1949 " is modified and modified version shall read as under -

“Chapter IV: Opinion on financial statements when there is substantial interest

4.0 A member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons who are his “relatives” within the meaning of Accounting Standard (AS - 18) has / have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise.

Explanation: For this purpose and for the purpose of compliance of Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, the expression “substantial interest” shall have the same meaning as is assigned thereto under Appendix (9) to the Chartered Accountants Regulations, 1988. “

This decision shall be in force with effect from 28th June, 2011

(Source : http://www.icai.org/new_post.html?post_id=7494&c_id=219)

PART – II : QUESTIONS AND ANSWERS**QUESTIONS****Standards on Auditing, Statements and Guidance Notes**

1. You are the principal auditor of Silver Shining Co., a listed company, which has subsidiaries in the USA and overseas, many of which are audited by other firms. All subsidiaries are involved in the manufacture or distribution of metal goods and have the same accounting period as Silver Shining Co.

Outline:

- (a) Why you would wish to review the work of the other auditors of subsidiaries not audited by your firm?
 - (b) Detail the work you would carry out in that review.
2. Comment on the following:
 - (a) You are appointed to compile financial statements of Z & Co. for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing the same, the partners of Z & Co. tell you that since you are not conducting an audit, the said figures duly certified by the firm should be accepted.
 - (b) While conducting statutory Audit of ABC Ltd., you come across IOUs amounting to ₹ 2 crores as against a cash balance shown in books of ₹ 2.10 crores. You also observe that despite similar high balances throughout the year, small amounts of ₹ 50,000 are withdrawn from the bank to meet day-to-day expenses.

Audit Strategy Planning and Programming

3. (a) You have been appointed the statutory auditor of a private limited company for the

first time. Apart from adopting the conventional audit procedures such as posting, casting and vouching, what other auditing techniques would you employ for conducting the statutory audit?

(b) Write short notes on the following:

(i) Walk through Tests

(ii) Cut-off Procedures.

Risk Assessment and Internal Control

4. Vishnu Ltd. is a retailer of fashion accessories. It has a turnover of 54 million and 150 shops throughout the India. It also has six regional warehouses from which the shops are supplied with goods.

The company has an internal audit department which is based at the company's head office in Delhi. Internal auditors make regular visits to the shops and warehouses. This is the first year that your firm has acted as auditor for Vishnu Ltd. The partner in charge of the audit has expressed his opinion that the internal audit department might be able to assist the external audit team in carrying out its work.

You are required to:

- (a) State, with reasons, the information that you would require to make an assessment of the likely effectiveness and the relevance of the internal audit function.
- (b) Describe four typical procedures that might be carried out by the internal auditors during their visits to the shops and warehouses and on which you might wish to rely.
- (c) Assuming that you intend to rely on the work of the internal audit department of company's financial statements, state impact on audit.

Audit under CIS Environment

5. A limited company having turnover of approximately ₹ 50 crores uses a tailor made accounting software package. In the said package, all transactions are recorded, processed and the final accounts generated from the system. The management tells you that in view of the voluminous nature of day books, there is no need to print them and that audit can be conducted on the computer itself. The management further assures you that any 'query based reports' as required can be generated and printed.

As a statutory auditor of the company, enumerate the procedures you would adopt to conduct the audit.

The Company Audit

6. As an auditor, how would you react to the following situations:
- (a) The company entered into "an agreement for sale" to purchase an office space in a commercial complex. The company with the consent of the promoters started

operations from the said place upon signing of the said agreement and included under fixed assets the total consideration payable.

- (b) Yuki Ltd. wishes to obtain a machine tool costing ₹ 20 lakhs by way of lease. The effective life of the machine tool is 12 years but the company requires it only for the first five years. It enters into an agreement with Ross Ltd. for a lease rental of ₹ 2 lakhs p.a.

The Finance Director of Yuki Ltd. is not sure about the treatment of these lease rentals and hence requests your assistance in proper disclosure of the same. For calculation purposes, the implicit rate of interest may be taken at 15%. Discount factors : 0.87, 0.76, 0.66, 0.57 and 0.50.

7. (a) When can a company be said to have 'Not maintained' proper books of account? What is the role of the statutory auditor for the same?
- (b) As an Auditor of Fact East Ltd. what steps will you take to ensure that the dividend has been paid only out of profit?

Liabilities of Auditors

8. You are the auditor of a company, which raised finance from the capital market on the basis of a prospectus issued a few years back. The main object for raising the finance was specified to be setting up a project on information technology.

The company advanced monies so raised to various parties 'related' to directors. These parties had no standing whatsoever with information technology. In the Balance Sheet, these advances appeared as a current asset under the head "loans unsecured – considered good". There was no mention in the notes to accounts about nature and purpose of such advances. You have given routine audit report without any qualifications. One fine morning the directors and these 'related' parties disappear. The company has just vanished.

Can you be hauled up for professional misconduct? Do you have any liability under any law?

Audit Report

9. XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-11 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:
- (I) Income Tax relating to Assessment Year 2007-08 ₹ 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-09.
- (II) Customs duty ₹ 85 lakhs - Demand notice received on 15-9-10 but no action has been taken to pay or appeal.

As an auditor, how would you bring this fact to the members?

10. SRS Ltd. has drawn the financial statement as on 31-3-12 and presented to you alongwith additional information:

Balance Sheet of SRS Ltd. as on 31-3-12

Liabilities	Amount	Assets	Amount
Share capital	50,00,000	Fixed Assets	
Reserves & Surplus		Gross block	
Profit and Loss Alc	4,00,000	Less: Depreciation	1,00,00,000
Secured Loans	75,00,000	Investments	Nil
Current Liabilities and Provisions		Current Assets	
Creditors for trade	3,00,000	Loans & Advances	
Advance received	3,00,000	Debtors	25,00,000
		Advance Paid	10,00,000
	1,35,00,000		1,35,00,000

Additional Information:

- Entire pre-operative expenses of ₹ 7,00,000/- was charged to Profit and .Loss Account whereas for the purpose of Income Tax, only what is allowable is claimed.
- Depreciation as per Books - ₹ 35,00,000/-
Depreciation as per Income tax - ₹ 50,00,000/-
- Losses to be carried forward as per Income Tax Act - ₹ 16,00,000/-
- Donation disallowed while computing tax - ₹ 50,000/-

Considering the additional information, can you certify that the company has complied with the Accounting Standards and issue an unqualified report?

Audit of Banking Company

- Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:
 - The bank is a consortium member of Cash Credit Facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.
 - In case of all such advances which have been classified as non-performing for the first time during the current financial year, only the last date of the financial year has been reckoned as the date of account becoming non-performing.

Audit of General Insurance Company

12. You are appointed as an auditor of Unique Insurance Company. As the auditor of Unique Insurance company state the audit procedure you would follow to verify outstanding premium and agents balances.

Audit of Co-operative Societies

13. Mention the duties of Auditor of Co-operative Societies in regard to the following:
- (a) Over-due interest.
 - (b) Compliance with provisions of Co-operative Act and Rules thereunder.
 - (c) Special Report to Registrar of Co-operative Societies.

Audit of Non Banking Financial Companies

14. (a) What is a Non-Banking Financial Company (NBFC)?
(b) What are the different types of NBFCs registered with RBI?

Audit under Fiscal Laws

15. Answer the following:
- (a) ABC Printing Press, a proprietary concern, made a turnover of above ₹ 43 lacs for the year ended 31.03.2012. The Management explained its auditor Mr. Z, that it undertakes different job work orders from customers. The raw materials required for every job are dissimilar. It purchases the raw materials as per specification/requirements of each customer, and there is hardly any balance of raw materials remaining in the stock, except pending work-in-progress at the year end. Because of variety and complexity of materials, it is rather impossible to maintain a stock-register. Give your comments.
 - (b) A Co-operative Society having receipts above ₹ 60 lakhs gets its accounts audited by a person eligible to do audit under Co-operative Societies Act, 1912, who is not a Chartered Accountant. State with reasons whether such audit report can be furnished as tax audit report under Section 44 AB of the Income-tax Act, 1961?
16. T Ltd's previous year ended on 31st March 2012. During that period it made a claim for refund of customs duty which was admitted as due by the customs authorities during April 2012. T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 13(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year. Further T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 11(b) of Form 3CD which requires reporting on change in accounting method employed. Comment.

Cost Audit

17. You are appointed as cost auditor of Bird Cement Limited. Briefly explain the advantages that accrue because of a Cost audit.

Internal Audit, Management and Operational Audit

18. (a) Luv Kush Ltd., requires you to organize a Management audit program. Briefly state a plan of action.
- (b) Briefly explain the Summary Written Report.

Investigation and Due Diligence

19. A nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in charge of Advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

List out the points you will cover in your investigation before submitting your report to the General Manager.

Professional Ethics

20. Comment on the following with reference to the Chartered Accountants Act, 1949, Code of Ethics and Schedules to the Act:
- (a) M/s XYZ, a partnership firm carrying on business has complained to the Institute of Chartered Accountants of India (ICAI) that Mr. Modi, a Chartered Accountant has charged the firm excessive fees for a professional assignment.
- (b) Pratiq, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2012, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients.
- (c) 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.
- (d) M/s Lions, a firm of Chartered Accountants responded to a tender from a State Government for computerization of land revenue records. For this purpose, the firm also paid ₹ 50,000 as earnest deposit as part of the terms of the tender.

SUGGESTED ANSWERS/HINTS

1. (a) **Reason for reviewing the work of the auditors** : The main consideration which concerns the audit of all group accounts is that the parent company's, auditors (the 'principal' auditors) are responsible to the members of that company for the audit opinion on the whole of the group accounts.

It may be stated (in the notes to the financial statements) that the financial statements of certain subsidiaries have been audited by other firms, but this does not absolve the principal auditors from any of their responsibilities.

The auditors of a parent company have to report to its members on the truth and fairness of the view given by the financial statements of the company and its subsidiaries dealt with in the group accounts. The principal auditors should have powers to obtain such information and explanations as they reasonably require from the subsidiary companies and their auditors, or from the parent company in the case of overseas subsidiaries, in order that they can discharge their responsibilities as parent company auditors.

SA 600 "Using the Work of Another Auditor", clarifies how the principal auditors can carry out a review of the audits of subsidiaries in order to satisfy themselves that, with the inclusion figures not audited by themselves, the group accounts give a true and fair view.

The scope, standard and independence of the work carried out by the auditors of subsidiary companies (the 'other' auditors) are the most important matters which need to be examined by the principal auditors before relying on financial statements not audited by them. The principal auditors need to be satisfied that all material areas of the financial statements of subsidiaries have been audited satisfactorily and in a manner compatible with that of the principal auditors themselves.

- (b) **Work to be carried out by principal auditors in reviewing the other auditor's work**

- (i) Send a questionnaire to all other auditors requesting detailed information on their work, including
- An explanation of their general approach (in order to make an assessment of the standards of their work)
 - Details of the accounting policies of major subsidiaries (to ensure that these are compatible within the group)
 - The other auditor's opinion of the subsidiaries' overall level of internal control, and the reliability of their accounting records.
 - Any limitations placed on the scope of the auditors' work

- any qualifications, and the reasons for them, made or likely to be made to their audit reports
- (ii) Carry out a detailed review of the other auditors' working papers on each subsidiary whose results materially affect the view given by the group financial statements. This review will enable the principal auditors to ascertain whether (*inter alia*):
 - An up-to-date permanent file exists with details of the nature of the subsidiary's business, its staff organization, its accounting records, previous year's financial statements and copies of important legal documents.
 - The systems examination has been properly completed, documented and reported on to management after discussion.
 - Tests of controls and substantive procedures have been properly and appropriately carried out, and audit programmes properly completed and signed
 - All other working papers are comprehensive and explicit.
 - The overall review of the financial statements has been adequately carried out, and adequate use of analytical procedures has been undertaken throughout the audit.
 - The financial statements agree in all respects with the accounting records and comply with all relevant legal requirements and accounting standards.
 - Minutes of board and general meetings have been scrutinized and important matters noted.
 - The audit work has been carried out in accordance with auditing standards.
 - The financial statements agree in all respects with the accounting records and comply with all relevant legal and professional requirements.
 - The audit work has been properly reviewed within the firm of auditors and any laid-down quality control procedures adhered to.
 - Any points requiring discussion with the parent company's management have been noted and brought to the principal auditors' attention (including any matters which might warrant a qualification in the audit report on the subsidiary company's financial statements).
 - Adequate audit evidence has been obtained to form a basis for the audit opinion on both the subsidiaries financial statements and those of the group.

If the principal auditors are not satisfied as a result of the above review, they should arrange for further audit work to be carried out either by the other auditors on their behalf or jointly with them. The other auditors are fully responsible for their own work and additional tests are those required for the purpose of the audit of the group financial statements.

2. (a) According to SRS 4410, "Engagement to Compile Financial Information" if an accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other compiled financial information.

If such amendments are not made and the financial statements are still considered to be misleading the accountant should withdraw from the engagement.

Hence, in this case, there is a clear violation of SRS 4410.

- (b) According to SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" when the auditor comes across such circumstances indicating the possible misstatements resulting from the fraud then the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report.

In this case, the circumstances indicate that the possible misstatement in financial statements is due to fraud and error and the auditor must investigate further to consider effect on financial statements.

The Guidance Note on Audit of Cash and Bank balances also mentions that if the entity is maintaining an unduly large balance of cash, he should carry out surprise verification of cash more frequently to ascertain whether it agrees. If cash in hand is not in agreement with the book balance, he should seek explanations and if the same are not satisfactory should state the said fact appropriately in his Audit Report.

3. (a) A statutory auditor conducting audit of a private company for the first time would do well in case he obtains knowledge of the business of the company to understand and assess the kind of audit procedures to be employed by him as per SA 315 and SA 330 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and "The Auditor's Responses to Assessed Risks". Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists the auditor in:
- (i) Assessing risks and identifying problems.
 - (ii) Planning and performing the audit effectively and efficiently.
 - (iii) Evaluating audit evidence.

Such knowledge would enable the auditor to identify and understand the events, transactions and practices that, in the auditor's judgement, may have a significant effect on the financial statements or on the examination or audit report. As far as adoption of conventional audit procedures is concerned, it would normally involve lot of time without commensurate benefits. In any case, if size of the business is large, the application of conventional procedure would involve extraordinary more time resulting into more cost and even then the auditor would not get the required satisfaction as to the figures contained in the financial statements. There may however, be some instances, say, where internal control systems are quite weak, it may perhaps be advisable to stick to conventional audit procedures such as vouching, etc. in detail. In any case, application of compliance procedure to evaluate the internal control systems in operations would enable the auditor to determine nature, extent and timing of substantive procedures.

Depending upon various factors including size of the business, it is advisable to reduce the extent of checking by adopting test check approach. Test-check approach is an accepted auditing procedure, which aims to test transactions on the basis of selection of samples from the entire population. Audit sampling means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population. It is important to recognise that certain testing procedures do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population. The auditor would also consider the specific audit objectives to be achieved and the audit procedures which are likely to best achieve those objectives. In addition, when audit sampling is appropriate, consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes an error and what population to use for sampling. For example, when performing tests of control over an entity's purchasing procedures, the auditor will be concerned with matters such as whether an invoice was clerically checked and properly approved. On the other hand, when performing substantive procedures on invoices processed during the period, the auditor will be concerned with matters such as the proper reflection of the monetary amounts of such invoices in the financial statements.

After performing vouching, it is necessary for an auditor to perform verification of balances contained in the financial statements. Verification and valuation of assets and liabilities contained in the balance sheet would involve obtaining evidence through methods like physical observations, confirmation, computation, inspection of documents and analytical reviews. Direct confirmation procedure provides an independent audit evidence to analyse the financial information contained in the accounting records. For example, confirmation may be done for debtors, creditors, investments lying with third parties, bank balances, etc.

Apart from conducting audit procedures like vouching and verification, it is quite useful to employ analytical review procedures; In fact, analytical review procedures would provide substantive audit evidence to support various assertions in the financial statements. Over a period of time, the analytical review as a method of obtaining evidence has emerged as a significant auditing procedures. As per SA 520, analytical procedures means the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts. Analytical procedures in planning the audit use both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. The auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular audit objective is based on the auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions. It further states that when analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.

Therefore, a statutory auditor who has been appointed for the first time must resort to evaluation of internal control system through performance of compliance procedures based on the knowledge of the client's business followed by vouching on a selected basis having regard to sampling. Physical observation and direct confirmation are also useful audit techniques in the verification of items contained in the financial statements. Ratio analysis or analytical procedures would also provide audit evidence as to various assertions contained in the financial statements.

- (b) (i) **Walk through Tests:** A walk through is a procedure in which an auditor traces a transaction from its initiation through the company's information systems to the point when it is reflected in the financial reports. The auditor should perform one walk through, at a minimum, for each major class of transactions. A walk-through provides evidence to confirm that the auditor understands (1)

the process flow of transactions, (2) the design of identified controls for internal control components, including those related to preventing and detecting fraud, and (3) whether all points in the process have been identified at which misstatements related to relevant financial statement assertion could occur. Walk through also provide evidence to evaluate the effectiveness of the controls' design and confirm that the controls have been placed in operation.

When performing a walk-through, the auditor should:

1. Be sure that the walk-through encompasses the complete process (initiation, authorization, recording, processing and reporting) for each significant process identified, including controls intended to address fraud risk.
2. Ask the entity's personnel, at each of key stage in the process, about their understanding of what the company's prescribed procedures require.
3. Determine whether processing procedures are performed as expected on a timely basis, and look for any exceptions to prescribed procedures and controls.
4. Evaluate the quality of evidence provided and perform procedures that produce a level of evidence consistent with the auditor's objectives. The auditor should follow the whole process, using the same documents and technology that company staff use, asking questions of different personnel at each significant stage and asking follow-up questions to identify any abuse of controls or fraud indicators.

Once a walk-through is performed, the auditor may carry forward the documentation, noting updates, unless significant changes make preparation of new documentation more efficient. If such significant changes occur in the process flow of transactions or supporting computer applications, the auditor should evaluate the nature of changes and the effect on related accounts. The auditor should determine whether it is necessary to walk through transactions that were processed both before and after the change.

- (ii) **Cut-off Procedures:** Cut-off procedures mean procedures employed to ensure the separation of transactions at the end of one year from those in the commencement of the next year. Usually, the problem of overlapping is found in inventory accounting since quite often goods are sold but passed on to the buyer only after the year is over or goods are bought but received only after the close of the year. This situation may create considerable problem for the proper stock taking of inventory. Therefore, the principal areas of application of cut-off procedures involve sales, purchases and stock. The auditor should satisfy himself by examination and test check that these procedures adequately ensure that:

- (a) Goods purchased for which property has passed to the client have in fact

been included in inventories and that the liability if any, has been provided for.

- (b) Goods sold have been excluded from the inventories and credit has been taken for sales.

The auditor may examine a sample of documents evidencing the movement of stocks into and out of stores, including documents pertaining to period shortly before and shortly after the cut-off date, and check whether the stocks represented by those documents were included or excluded, as appropriate, during the stock-taking.

4. (a) Information to make an assessment of the likely effectiveness and the relevance of the internal audit function:

Information	Reason
The organizational status and reporting responsibilities of the internal auditor and any constraints and restrictions thereon.	The degree of objectivity is increased when internal audit. -Is free to plan and carry out its work and communicate fully with the external auditor. - Has access to the highest level of management.
Areas of responsibility assigned by management to internal audit, such as review of - Accounting systems and internal controls - Implementation of corporate plans	Not all areas in which internal audit may operate will be relevant to the external auditor. Relevant Not relevant
Routine tasks carried out by internal audit staff such as authorization of petty cash reimbursements.	In these respects staff are not functioning as internal audit (simply as an internal control)
Internal auditors formal terms of reference	Internal auditor's role will be most relevant where it: - Has a bearing on the financial statements. - Involves a specialization
Internal audit documentation such as an audit manual and audit plans	It is more likely that due professional care is being exercised where the work of internal audit is properly planned, controlled, recorded and reviewed.

Professional membership and practical experience (including computer auditing skills) of internal audit staff.	Unless internal audit is technically competent it is inappropriate to place reliance on it.
Internal audit reports generated and feedback thereon.	How the company responds to internal audit findings may be regarded as a measure of the department's effectiveness.
Number of staff, computer facilities and any other resources available to internal audit.	The effectiveness of internal audit (and hence the reliance placed thereon) will be limited if the department is under-resourced.

(b) Typical procedures (four only) :

- (i) **Inspection of tangible non-current assets:** Assets seen at the warehouses should be noted and subsequently agreed to the fixed asset register maintained at head office (HO). Assets recorded in the register (e.g. shop fixtures and fittings) should be selected for inspection prior to visits to ensure their existences.
- (ii) **Attendance at inventory counts:** Periodic counts (e.g. monthly) should be attended
 - On a rotational basis
 - At warehouses and larger shops
 to ensure adherence to the company's procedures. Test counts should be made to confirm the accuracy and completeness of the inventory counts
- (iii) **Cash :** Cash counts should be carried out on each register takings (and petty cash floats) whenever shops (and warehouses) are visited on a 'surprise' basis.
- (iv) **Goods dispatch:** Internal control procedures should be observed to be in operation, for example to ensure that all dispatches are documented and destined for the company's retail outlets.
- (v) **Employee verification:** Payroll procedures are likely to be carried out at HO, warehouses and shops informing HO on a weekly basis of hours worked by employees, illness and holiday etc. However, new employees, especially in the shops (and probably also in the warehouses) will be recruited locally and their details notified to HO.

Internal audit will be able to select a sample of employees from HO records and ensure on the visits to shops and warehouses that these represent bona fide employees.

(c) Effect on audit

- (i) **Systems documentation:** The accuracy of systems documentation which has been prepared by internal audit need only be confirmed using 'walk-through tests', this saves time (if the systems documentation is correct) since only copies will be required for the audit file.
- (ii) **Tests of controls:** The level of independent testing (i.e. by the external auditor) can be reduced where controls have been satisfactorily tested by internal audit, especially if error rates are found to be similar. In particular, attendance at stocktaking at the year end may be limited to those locations with the highest stockholdings.
- (iii) **Substantive procedures:** Internal audit's evidence (e.g. concerning the existence of tangible non-current assets), will reduce sample sizes for year end verification work. Substantive procedures may also be reduced where the internal audit checks reconciliations' (e.g. of supplier's statements to ledger balances, receivable and payables control accounts and bank reconciliations.)

5. A key feature of the accounting software package used by the company definitely involves the absence of a clear audit trail. In other words, transactions cannot be easily traced or co-related from the individual supporting documents of those transactions. Moreover, the management does not wish to print the daybooks in view of the voluminous nature since it may involve extensive costs. This has naturally led to extensive dependence by management upon the "exception reporting" principle.

From the auditor's point of view, it must also be conceded, the exception reports in the form of 'query-based reports' which isolate the above data provide him with the very material that he requires for most of his verification work. The only problem which it raises, and it is a serious one, is that he cannot simply assume that the programmes which produce the exception reports are reliable in respect of the following factors:

- (i) operating accurately;
- (ii) printing out all the exceptions which exist; and
- (iii) bound by programmed control parameters which meet the company's genuine internal control requirements.

In view of the above, whether management relies upon exception reports, it effectively eliminates the audit trail between input and output and the auditor is forced to test the invisible processes which purport to embody the controls, and produce the output such as it is. These tests, which invariably involve the use by the auditor of the computer itself, are known as tests through the machine. In the 'through the machine' approach, the auditor starts by proving the accuracy of the input data, and then thoroughly examines (by applying tests) the processing procedures with a view to establishing the following that:

- (i) all input is actually entered into the computer.

- (ii) neither the computer nor the operators can cause undetected irregularities in the final reports.
- (iii) the programmes appear, on the evidence of rejection and exception routines, to be functioning correctly.
- (iv) all operator intervention during processing is logged and scrutinised by the DP manager.

The auditor in such circumstances will have to first evaluate the existing controls. For the same, he has to do the following:

- (i) Evaluate the internal control system especially the controls and checks existing for recording the transactions, i.e., he has to verify at what level transactions can be entered into the system and what checks are available to prevent any unauthorised data entry and for rectifying errors/omissions in the transactions entered.
- (ii) Evaluate at what level there is authority given for modification of transactions already entered. Is there any authority given only to a senior employee to carry out modifications? Or is it that once transactions are entered and validated no further modifications are possible thereto.
- (iii) Whether there is a provision in the software for carrying out an on line audit of transactions, i.e. whether there a separate module in the package, where a separate password given to the auditor and once he has seen and approved a particular transaction/set of transactions, the same would be locked and no modifications would be possible by anyone (including the senior most employee) in the company.
- (iv) Whether there are proper procedures for backup of data on a regular basis and whether the said procedures are being strictly followed.
- (v) In case of any loss of data whether there is a clear defined recovery procedure to minimize the loss of data due to power failures or any human errors.
- (vi) The auditor may introduce some dummy data into the system and see the results obtained.

After the auditor has evaluated the above procedures, he has to prepare an audit plan depending on the results obtained from his earlier evaluation. Since the daybooks are not being printed, the plan can contain procedures wherein data is verified directly on the computer from the vouchers/invoices, etc. The audit plan will also require a lot of analytical procedures to be performed. Depending on the importance of various expense heads and other important account heads, the auditor will also obtain various reports from the system depending on various queries that he would have to identify. Some illustrative reports can be:

- (i) To check whether proper classification is done for revenue/capital - a report can be obtained of all purchases (not being raw materials or other routine purchases) exceeding ₹ one lakh.
- (ii) To check whether all freight outward bills are accounted for a report containing a month-wise co-relation between goods dispatched and freight amount paid. The same can be further co-related with the freight rates obtained from the bills.

Once the auditor has performed the above procedures, he would be able to form an opinion whether reliance can be placed on the accounting systems and the data recorded. If the auditor finds that reliance cannot be placed on the systems he can inform the management about the fact and also that the daybooks, etc., will need to be printed to allow him to conduct the audit. The finalisation procedures to be followed even under this system would remain more or less similar to other accounting systems. The auditor can obtain reports of depreciation on fixed assets, inventory valuation and using the normal procedures find out whether reliance can be placed on them, e.g., if while valuing stocks the system is using the LIFO method, the same would not be acceptable and will need to be modified. Similarly depreciation calculations will have to be verified on a random basis to find out its reliability.

6. (a) An agreement for sale does not transfer the title of an asset to the buyer from the seller. The title is passed when the conveyance deed is duly registered. The agreement to sell only reflects intention of parties to enter into a contract. Moreover, as per the requirements of AS 10 "Accounting for fixed assets" cost of a fixed asset should include the consideration payable i.e. purchase price and any directly attributable expenditure of bringing the asset to its working condition for its intended use.

In the given case, the company has entered into an "agreement for sale" only. The conveyance deed has not been registered. Hence, the title has not yet been passed to the client company. Occupancy and operation from the said office space does not confer the ownership upon the company.

Therefore, the auditor should suggest the company to make necessary changes in the financial statements. The cost of fixed asset, as stated above, should include consideration payable and additional expenses on acquisition. If the management refuses to make the necessary changes in the financial statement, the auditor may qualify the auditor report.

- (b) The fair value of asset is ₹ 20 lacs and the present value of lease rentals is 6.72 lacs. The machine is required for five years only which is less than 50% of the economic life. In view of having regard to substance of the transaction, as per AS 19 on Leases, the lease will be classified as an operating lease.

As per AS 19, following disclosures are required in the Balance Sheet of the Company:

Future minimum lease payments – Not later than 1 year ₹ 2 lacs

Future minimum lease payments – Later than 1 year and
not later than 5 years ₹ 4.98 lacs

7. (a) Section 209(1) of the Companies Act, 1956 requires that every company shall keep proper books of account with respect to the following items:
- (i) all sums of money received and expended by the company and the matters in respect of which the receipts and expenditure take place;
 - (ii) all sales and purchases of goods by the company;
 - (iii) the assets and liabilities of the company; and
 - (iv) in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account.

Proper books of account shall not be deemed to be kept if such books of accounts are not kept on accrual basis of accounting and according to double entry system of accounting. . In addition, proper books of accounts should be made following the accounting standards.

In case proper books of account are not kept, the auditor is required to specifically refer to violation of the section 227(3) Companies Act, 1956 in the auditor's report and shall also state that in his opinion proper books of account as required by law have not been kept by the company so far as appears from his examination of those books and, he has to further give either qualified opinion or disclaimer of opinion.

Further, the books also have to be maintained under accrual system. If the statutory auditor finds the books not maintained or are not maintained properly, he will have to modify his report.

- (b) The auditor may take the following steps to ensure that the dividend has been paid only out of profits.
1. Check whether the dividend was declared out of profits arrived at after providing for depreciation.
 2. If no depreciation has been provided, ensure that the approval was obtained from the Central Government before declaring dividend.
 3. Check whether
 - (i) The depreciation was provided according to provision of section 205(2).
 - (ii) The minimum prescribed amount has been transferred to reserves before declaring any dividend.

- (iii) Conditions governing transfer of higher percentage is complied with.
 - (iv) A board resolution recommending dividend was passed.
 - (v) Dividend was declared (resolution was passed) only in the Annual General Meeting.
 - (vi) Dividend has been paid in the prescribed manner within 30 days of time to the registered holder or their order.
 - (vii) Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend.
 - (viii) Permission of Reserve Bank of India has been obtained for payment to non-resident shareholders before the remittance of dividend to their account.
 - (ix) Intimation sent to Stock Exchange in the case of listed company.
 - (x) There were any complaints of non payment/delayed payment of dividend and the corrective action taken.
8. Revised Schedule VI to the Companies Act, 1956 requires specific disclosure of loans granted by the company to its directors or parties such as firms or private companies in which director is a member or a director or a member. Thus, the company has failed to comply with the requirements of schedule VI vitiating true and fair view.
- Further, the Companies Act, 1956 specifically deals with transactions in which particular directors are interested. Section 297 specifies that Board's consent is required for certain contracts in which particular directors are interested i.e. a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, for the sale, purchase or supply of any goods, materials or services. Section 299 requires disclosure of interest by a director as also lays down the procedure to be followed in this regard. Section 301 of the Companies Act, 1956 requires that every company shall keep one or more registers in which shall be entered separately particulars of all contracts or arrangements to which Section 297 or Section 299 applies, including the following particulars to the extent they are applicable in each case, namely:
- (a) the date of the contract or arrangement;
 - (b) the names of the parties thereto;
 - (c) the principal terms and conditions thereof;
 - (d) in the case of a contract to which Section 297 applies or in the case of a contract or arrangement to which sub-section (2) of Section 299 applies, the date on which it was placed before the Board;
 - (e) the names of the directors voting for and against the contract or arrangement and the names of those remaining neutral.

Thus, it is quite natural that all these particulars should have been recorded in such registers since the company advanced monies to various parties "related" to directors.

Still further, CARO, 2003 specifically requires the auditor to comment on the rate of interest and other terms and conditions of loans granted by the company (whether secured or unsecured) to companies, firms or other parties listed in the register maintained under Section 301 of the Act. There may be situations where the company has not properly maintained the register required to be maintained by it under Section 301. In such a case, the auditor should obtain the necessary information regarding the loans taken by the company from companies, firms or other parties in which the directors are interested, from the management of the company. However, while reporting on this clause, the auditor is required to clearly mention the fact of non-maintenance/improper maintenance of the aforesaid register. The auditor's duty is to determine whether, in his opinion, the rate of interest and other terms and conditions of the loans are prima facie prejudicial to the interest of the company.

The aforesaid provisions aim to prevent siphoning off of funds as also exercise propriety in case of transactions with related parties and disclosure of the same. It appears that the auditor did not perform his duties properly. In the case of Deputy Secretary of the Government of India, Ministry of Finance vs. S.N. Dasgupta, the learned judge made certain observation as regards the duties of the auditor and method they should follow for discharging them satisfactorily and stated that, "verifying not merely the arithmetical accuracy of the statements of account but also their substantial accuracy by confirming that they include all the particulars requiring disclosure by the Articles or the Companies Act and otherwise represents true and fair state of affairs of the company."

Therefore, the auditor has specific obligation to report under the Companies Act, 1956. Thus, he is liable under the Companies Act, 1956 and may be penalised under section 233 since he has performed his duties in a negligent manner. The auditor would also be held liable for professional misconduct under clause 7 of Second Schedule to the Chartered Accountants Act, 1949.

9. Reporting under Paragraph 4 (ix) of CARO, 2003:

- (I) As per Paragraph 4(ix)(b) CARO, 2003 "In case dues of Income Tax/Sales Tax/Service Tax/ Customs Duty/ Wealth Tax/ Excise Duty/ Cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. However, a mere representation to the Department shall not constitute the dispute."

The auditor should also obtain a management representation about the disputed dues, the amounts involved and the forum where the dispute is pending. The auditor should carry out necessary audit procedures to verify the information provided by the management.

The information may be reported in the Statement of Disputed Dues as nature of the dues, amounts, period to which the amount relates and forum where dispute is pending.

In the present case, there is Income Tax demand of ₹ 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis. Therefore, As per AS 29 partly to the extent the company considered that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of members by reporting under Paragraph 4(ix) (b) of CARO, 2003 as per the requirement mentioned therein;

- (II) As per Paragraph 4 (ix) (a), the auditor has to report upon the regularity of the company in depositing undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth-tax, service tax, custom duty, excise duty, cess and any other statutory dues to appropriate authorities. If the company is not regular in depositing the above mentioned undisputed statutory dues, the auditor is required to state the extent of arrears of statutory dues which have remained outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable.

With reference to the regularity, in case of custom duty on import of goods or demands arising on account of assessment orders etc., which a company is required to pay as and when an event giving rise to the liability of the company occurs. Such dues should be construed to have been paid regularly if the company deposits them as and when they become due. However, the auditor would be required to comment upon the regularity of the company in depositing the installments, if any, granted by an authority in respect of a demand against the company.

In the instant case, the demand notice has been received for Custom Duty of ₹ 85 Lacs on 15.09.2010 and is outstanding for more than 6 months, for which no action has been taken by the management, leads to the irregularity which should be brought to notice of members by reporting under Paragraph 4(ix)(a) of CARO, 2003.

10. **Compliance with the Accounting Standards:** As per AS 26 "Intangible Assets", when an expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised, then such an expenditure is recognised as an expense when it is incurred. Therefore, expenditures for commencing new operations or launching new products or processes (pre-operating costs) should be expensed off in the year of incurrence as no asset is created.

Further, as per AS 22 "Accounting for Taxes on Income", tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the

net profit or loss for the period. It may also be noted that Deferred Tax is the tax effect of timing difference. Hence deferred tax should be recognised for all the timing differences, however, permanent differences do not result in deferred tax assets or deferred tax liabilities. Thus, Tax Expense = Current Tax + Deferred Tax.

Point no. (a) of additional information is in compliance with AS 26 hence no qualification is required in view of AS 26. But at the same time it leads to timing difference which will require the creation of DTA/ DTL as per AS 22. (DTA – Deferred Tax Assets, DTL – Deferred Tax Liabilities)

Similarly, point no. (b) and (c) of additional information are also the case of timing differences which creates DTA/ DTL as per AS 22.

Creation of DTA / DTL on account of such timing differences needs to be reported in the Financial Statements.

However, point no. (d) is a situation of permanent difference as per AS 22. Hence no DTA/DTL is required to be accounted for.

A prima facie look to the given balance sheet states that no tax expense has been provided for. Accordingly, qualification in audit report is required in view of non compliance of AS 22.

Further, presentations of Fixed Assets are also not in compliance with disclosure requirement of AS 6 and AS 10. In addition, presentation of financial statements is also not in compliance with Revised Schedule VI. Therefore, as an auditor, we cannot certify that the company has complied with all the Accounting Standards.

11. (a) The bank is a consortium member of cash credit facilities of ₹ 50 crores to X Ltd. Bank's own share is ₹ 10 crores only. During the last two quarters against a debit of ₹ 1.75 crores towards interest, the credits in X Ltd's account are to the tune of ₹ 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.
- (b) It is wrong to take the Balance Sheet date for purposes of classification. In this context, it is important to note the concept of past due. An amount should be considered as past due when it remains outstanding for 30 days beyond due date. For example, if any SSI loan amount, the repayment of term loan installment falls due for payment on December 31 and is not paid; the amount would become past due if it remains unpaid for 30 days beyond that date. In case of terms loans, if interest or installment of principal is in arrears for any two quarters out of four

quarters although default may not be continuously for two quarters during the year by applying past due test, it should be classified as non-performing asset and from that date provision should be made. In the case of other advances, outstanding in the last two quarters would be enough to classify the amount as such non-performing asset if no transaction appears in the last two quarters.

As per RBI Circular dated January 29, 1997, if the account of the borrowers have been regularised before the balance sheet date by repayment of overdue amounts through genuine sources and not by sanction of additional facilities, the account need not be treated as NPA in spite of payment of interest and installment were in arrear for two quarters. Bank should, however, ensure that the account remains in order subsequently and a solitary credit entry made in the account on or before the balance sheet date which extinguished the overdue amount of interest or instalment of principal is not reckoned as the sole criterion for treating the account as a standard asset.

It has been further clarified that in respect of accounts where there are potential threats of recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, it will not be prudent for banks to classify them first as sub-standard and then as doubtful after expiry of two years from the date of account has become NPA. It should be straight way classified as doubtful asset or loss asset, as appropriate, irrespective of the period for which it has remained as NPA.

12. The following are the audit procedure to be followed for verification of outstanding premium and agents balances in the case of Insurance Company.
 - (1) Scrutinise and review control account debit balances and their nature should be enquired into.
 - (2) Examine in operative balances and treatment given for old balances with reference to company rules.
 - (3) Enquire the reasons for returning the old balances.
 - (4) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
 - (5) Check age-wise, sector-wise analysis of outstanding premium.
 - (6) Verify whether outstanding premiums have since been collected.
 - (7) Check the availability of adequate bank guarantee or premium deposit for outstanding premium.
13. (a) **Overdue interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

- (b) **Compliance with provisions of the Act and Rules:** An auditor of a co-operative society is required to point out the infringement with the provisions of the relevant Co-operative Act Rules and bye-laws. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departure from the provision of the Act, rules framed thereunder and the bye-laws of the society. The financial implications of such infringements should be properly assessed and quantified by the auditor and they should be reported. Some of the State laws contain restrictions on the payment of dividends, which should be noted by the auditor and if dividend is declared in excess of the prescribed percentage, the fact should be reported by the auditor. Auditor should also ensure that various provisions in the Co-operative Societies Act, such as, restriction on borrowings, investment of funds, contribution to education funds, restriction on loans, etc are also complied with.
- (c) **Special Report to the Registrar:** The auditors are required to report on number of matters as prescribed in various states. In addition to the main report, the auditors are also required to submit by way of schedules/audit memorandum information on the working of the company as well. 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 mis-management. 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.
14. (a) Section 45 I(f) of Reserve Bank of India (Amendment) Act, 1997 defines a non-banking financial company as:
- (i) A financial institution which is a company;
 - (ii) A non banking institution which is a company with principal business of 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 with the previous approval of the Central Government may specify by notification in the Official Gazette.

For purposes of RBI Directions relating to Acceptance of Public Deposits, non-banking financial company means only the non-banking institution which is a –“Loan company, Investment company, Hire purchase finance company, Equipment leasing company and Mutual benefit financial company”.

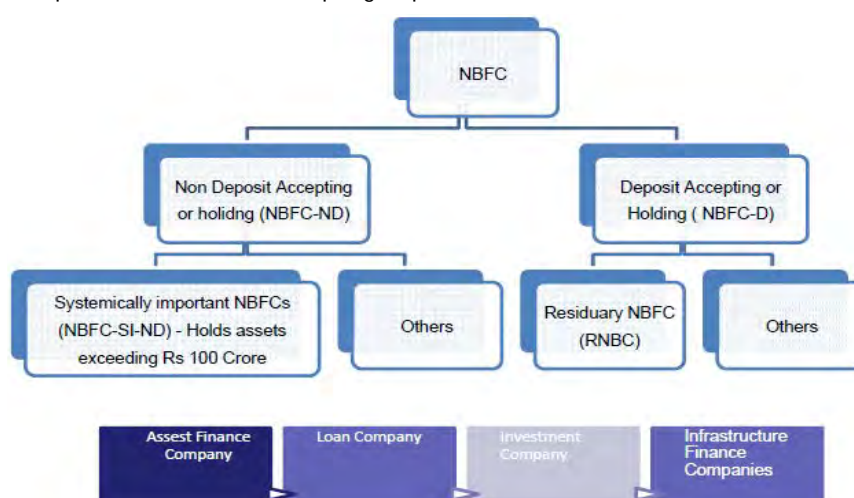
- (b) **Non-Banking Financial Company** - In terms of the Section 45-I(f) read with Section 45-I (c) of the RBI Act, 1934, as amended in 1997, NBFC is one whose principal business is that of receiving deposits or that of a financial institution, such as lending, investment in securities, hire purchase finance or equipment leasing. Consequent upon to RBI Circular December 6, 2006, companies financing real/physical assets for productive/ economic activity will be classified as Asset Finance Company (AFC) as per the specified criteria. The remaining companies would be continued to be classified as loan/investment companies. In the proposed structure the following categories of NBFCs will emerge:

Currently, NBFCs registered with RBI are being classified as:

- **Asset Finance Company (AFC):** The main activity of an AFC is financing of physical assets supporting productive / economic activity. These may be in the areas such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments and general purpose industrial machines.
- **Investment Company (IC):** which mainly deal in acquisition of shares and securities of other companies. A core investment company would be a company which acquires shares and securities of Group companies.
- **Loan Company (LC):** Loan companies primarily provide finance (whether by making loans or advances or otherwise for any activity), other than its own activity.
- **Infrastructure Finance Companies:** This category of NBFCs deploys a minimum of three-fourths of their total assets in infrastructure loans. The net owned funds of this category of NBFCs are more than ₹ 300 crores and they should have a minimum credit rating of 'A' or equivalent and the Capital to Risk-Weighted Assets Ratio (CRAR) is 15% (with a minimum Tier I Capital of 10%).
- **Core Investment Company (CIC):** These are NBFCs which carry on the business of acquisition of shares and securities in group companies and satisfies four conditions stated in the regulatory framework for Core Investment Companies issued by RBI.

- **Infrastructure Debt Fund:** Non- Banking Financial Company (IDF-NBFC) - Infrastructure Debt Funds (IDFs) are funds set up to facilitate the flow of long-term debt into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust based IDF would normally be a Mutual Fund (MF) while a company based IDF would normally be a NBFC.
- **Non-Banking Financial Company:** Micro Finance Institution (NBFC-MFI) - An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils certain conditions.

The above type of companies may be further classified into those accepting deposits or those not accepting deposits.



Core Investment Companies, Infrastructure Debt Fund NBFC and NBFC – Micro Finance Institution (other than Companies Act, 1956 - Section 25 companies) are non deposit holding Companies.

Others

Housing Finance Companies: National Housing Board set up by the Government of India is the Apex authority regulating the housing finance companies. The Housing Finance Companies (NHB) Directions, 2010 deals with matters relating to acceptance of deposits by housing finance companies, prudential norms for income recognition, accounting standards, asset classification, provision for bad and doubtful assets, capital adequacy and concentration of credit/ investments to be observed by the housing finance companies and matters to be included in the auditors report by the auditors of such housing finance companies and matters ancillary and incidental thereto and amended the said directions from time to time.

15. (a) The explanation of the entity for the use of varieties of raw materials for different jobs undertaken may be valid. But the auditor needs to verify the specified job-orders received and the different raw materials purchased for each job separately. The use of different papers (quality, quantity and size) ink, colour etc. may be examined. If possible, the auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom. At the same time, he has to report and certify under the Para 28(b) and Para 9(b) of Form 3CD read with the Rule 6G(2) of the *Income-tax Act, 1961*, about the details of stock and account books (including stock register) maintained. He (or his deputy) must verify the closing stock of raw materials, work-in-progress and finished goods of the concern, at least on the date of its balance sheet. In case the said details are not properly maintained, he has to specifically mention the same with reasons for non-maintenance of stock register by the entity.

- (b) As per Section 44AB read with Explanation to Section 288 of the Income Tax Act, 1961, "accountant" means a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949), and includes, in relation to any State, any person who by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), is entitled to be appointed to act as an auditor of companies registered in that State.

Accordingly, the person who is not a Chartered Accountant as mentioned in the question, though is eligible to act as auditor of Cooperative Society under the Cooperative Society Act, 1912, but is not eligible to carry out tax audit under Section 44AB of the Income Tax Act, 1961.

Hence, such audit report cannot be furnished as tax audit report under Section 44 AB of the Income-tax Act, 1961.

16. **Reporting requirement under Form 3CD:** As per Clause 13(b) of Form 3CD, the details of the Refund duty of custom, if admitted as due by the concerned authorities but not credited to the profit and loss account, are to be stated. But the Credits/Claims which have been admitted as due after the relevant previous year need not be reported in Form 3 CD.

In the instant case, the action of T Ltd in not crediting the claim to the profit and loss account and also not reporting of the same in Clause 13(b) of Form 3CD is in order.

Further Clause 11(b) requires reporting when there has been any change in the method of accounting employed vis-a-vis the accounting method employed in the immediately preceding year. However, change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under Clause 11(b). It may be noted that change in the method of valuation of stock will amount to a change in accounting policy. However, it should be disclosed in the financial statements.

In the instant case, non-reporting of the change in the method of determination of cost formula of valuation of stock from FIFO to Weighted average Cost basis, in clause 11(b) of Form 3CD is in order.

Hence in the above situation, there is no reporting requirement under Clause 13(b) and Clause 11(b).

17. Cost Audit will be advantageous to the stockholders in the following manner:

(1) To Management -

- (i) Management will get reliable data for its day-to-day operations like price fixing, control, decision-making, etc.
- (ii) A close and continuous check on all wastages will be kept through a proper system of reporting to management.
- (iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
- (iv) Management by exception becomes possible through allocation of responsibilities to individual managers.
- (v) The system of budgetary control and standard costing will be greatly facilitated.
- (vi) A reliable check on the valuation of closing stock and work-in-progress can be established.
- (vii) It helps in the detection of errors and fraud.

(2) To Society -

- (i) Cost audit is often introduced for the purpose of fixation of prices. The prices so fixed are based on the correct costing data and so the consumers are saved from exploitation.
- (ii) Since price increase by some industries is not allowed without proper justification as to increase in cost of production, inflation through price hikes can be controlled and consumers can maintain their standard of living.

(3) To Shareholder - Cost audit ensures that proper records are kept as to purchases and utilisation of materials and expenses incurred on wages, etc. It also makes sure that the valuation of closing stocks and work- in-progress is on a fair basis. Thus the shareholders are assured of a fair return on their investment.

(4) To Government -

- (i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.
- (ii) Cost audit helps in the fixation of ceiling prices of essential commodities and thus undue profiteering is checked.

- (iii) Cost audit enables the government to focus its attention on inefficient units.
- (iv) Cost audit enables the government to decide in favour of giving protection to certain industries.
- (v) Cost audit facilitates settlement of trade disputes brought to the government.
- (vi) Cost audit and consequent management action can create a healthy competition among the various units in an industry. This imposes an automatic check on inflation.

18. (a) **Organizing a Management Audit for Luv Kush Ltd.:** The key requirement for a successful Management audit program would be the approval and support of the top management to initiate. Accordingly the following shall be the matters that should be considered while organizing the Management Audit of K. Ltd.

Devising the statement of policy: The management's support must be reflected clearly and categorically in the company's highest policy statement. The policy statement should be quite specific. It should spell out clearly the scope and status of the management/operational auditing within the enterprise, its authority to carry out audits, issue reports, make recommendations, and evaluate corrective action. The statement of policy should lay down in clear terms the scope of activities to be performed by the management auditor. The scope of activities is the most basic requirement for building up a successful management audit programme both for small as well as a large organisation. Thus, a comprehensive statement of policy provides definite understanding to management concerning the nature of audit to be performed and the scope and details of audit work to be carried out. This then will become the charter under which the management auditor should operate. In this charter, will be set forth, for the rest of the company to see, how executive management regards the purpose, mission and authority of the function of management auditor within the company. The statement must afford the auditor all the authority he needs but does not assign responsibility which he cannot conceivably carry out. The statement must categorically say that the management auditor is capable of reviewing administrative and management controls over any activity within the company. However, he should not be expected to extend his activities to the evaluation of performance of professional and technical activities calling for specialised knowledge and skills and suggest remedies unaided by people competent to undertake such evaluation.

Location of audit function within the organization: Some organisations depending upon their size and nature have established a separate department of audit specialists where the head of the department reports directly to the top executive. In certain cases, the audit group may be a part of the activities of management services department, administrative control department or some other unit of organisation. The more important question, however, is that the function should be as entirely independent as possible of pressure from various groups in

the enterprise. The greater the independence, greater is the freedom to work effectively. Therefore, it is better to place the auditing function quite high in the organisation. The minimum requirement for the auditing organisation is to report to an officer whose status is such that he can command prompt and proper consideration of the auditor's opinion and recommendations. Preferably that officer should be a member of the Board. One of the controversies that is usually raised is whether the management auditor should report to the finance director, to whom he may be administratively responsible or to the managing director where he has no administrative responsibility. A third opinion would like the auditor to report to an audit committee, comprising of senior executives of the company who are preferably Board members. A different school of thought would like auditors to report to both the finance director and the audit committee. Though the controversy rages and no definite solution can be arrived at, it is felt that the controversy regarding which of these persons the management auditor should report to is not much substance where independence exists. Independence of the management auditor is not necessarily related to the person/persons he reports. His independence is entirely dependent on the management's attitude towards audit, the credibility the management auditor has with the management and the management's positive will to listen to criticism for self betterment.

Allocation of personnel: Whatever be the size of the enterprise, it is important that all persons selected and assigned to audit possess a good understanding of auditing theory, a thorough knowledge of the fundamentals of both organisation and management, the principles and effective methods of control, and the requirements for conducting scientific appraisal. "General Guidelines on Internal Auditing" issued by the Institute also emphasis these qualifications for an auditor whose area extends beyond the review of financial controls. As the management auditor is expected to evaluate operational performance and non-monetary operational controls, he should possess basic knowledge of the technology and commercial practices of the enterprise, an enquiring, analytical, pragmatic and imaginative approach and a thorough understanding of the control system. The management auditor should also have a basic knowledge of commerce, law, taxation, cost accounting, economics, quantitative methods and EDP systems. Knowledge in these areas would be adequate for him to identify problems and to determine steps to be taken when a problem is identified. It does not mean that management audit should be assigned to engineers, computer experts and others. Rather persons having sound accounting background alongwith general knowledge of other relevant disciplines are best suited to perform this job. Because the profession of accountancy basically teaches a systematic and analytical approach to a problem, it is this methodical approach which is the guiding note to an audit function of review of controls. In personal characteristics individuals assigned to the job should have an inclination towards analysis, a high degree of imagination and an ability to write and express themselves clearly and logically.

Staff training programme: A continuous training programme is necessary to achieve quality in performing audit assignments because the management auditor must keep a breast of new ways to improve auditing standards. An effective training programme enables staff to assume additional responsibilities and advancements in the organisation. Thus the programme acts as an incentive for drawing capable people into the department and keeping them.

Time and other aspects: The time required to carry out a management audit will vary, depending upon the extent and nature of assignment. For example, the time required to perform an audit of the entire activities of an organisation's purchasing department might take a few weeks, while an audit of the entire business could take several months. Much depends upon the size of the activity. An appraisal of a plant's standard cost system might also simultaneously include an appraisal of the departmental budgetary control system. In a study of the results of sales contacts and selling efforts in the field, one might find it feasible to study the expense reports and other costs incurred in making contacts. In the evaluation of the method of scheduling production in a plant, one might well take a good look at the sales department's method of compiling and preparing the sales forecast. The time and cost will vary for each assignment, depending upon the nature of the assignment, the number of auditors assigned to perform the work, and whether or not more specialists in a particular field are required. An audit of a production planning and control department, for example because of its size and other factors, could require an audit staff of several persons and, in addition, a specialist in production planning and one in production control. If an assignment is one which requires technical assistance of a nature unavailable within the audit group, it might be advisable to seek a qualified outside consultant to perform the work.

Frequency: Having specified various approaches to management audit, including its scope and its staffing requirements the last item that should be considered before undertaking such an audit is its frequency. Prime consideration should be given to the nature of the organisation. Is the company in a fast-changing industry where there is great accent on the latest technology in the company's products and/or services? When the organisation is subject to rapid change or the total resources utilised are expensive, the frequency of management auditing should be greater than when it does not undergo rapid changes or the resources employed are not high in value. In essence, management audits should be made often enough to provide protection against growing problems. On the other hand, they should not be so frequent as to lead to repetitious results of questionable value.

To get an idea of the optimum frequency of such an audit, it might be worthwhile to look at financial audits. Customarily, financial audits are conducted annually. They are highly programmed, since an internal control questionnaire is utilised to attest to accounting methods and procedures. By contrast, a management audit should be considered from a longer time frame. For an organisation, that is subject to rapid

changes or consumes a great amount of high-cost resources, a two-years basis might be adequate to protect it from managerial and operational problems becoming entrenched or too large. For those organisations in a relatively stable industry, the frequency of audit can be every three years. In no case should the interval be allowed to exceed three years.

- (b) **Summary written reports:** These are known as flash reports. They are significant highlights for immediate attention of top management. Generally suspected defalcations are reported briefly to the appropriate management official on the 'flash' basis, often ending up in referral for criminal investigation and legal action. It is common practice in number of companies of issuing a report quite frequently summarising the various individual reports issued and describing the range of their contents in a very brief and comprehensive manner where only important points are highlighted. Such reports are primarily issued for audit committees of Board of Directors and for other top level managers who do not have sufficient time to go through the elaborate reports and matters which are required to be brought to their notice for immediate action.

19. Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

- (i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.
- (ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.
- (iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.
- (iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (v) The history of growth and development of the company and its performance during the past 5 years.
- (vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of

assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (I) Prepare a condensed income statement from the Profit and Loss Accounts for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.
- (II) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (1) Sales to Average Stocks held.
 - (2) Sales to Fixed Assets.
 - (3) Equity to Fixed Assets.
 - (4) Current Assets to Current Liabilities.
 - (5) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (6) Equity to Long Term Loans.
 - (7) Sales to Book Debts.
 - (8) Return on Capital Employed.
- (III) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank - The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

- (1) **Fixed assets** - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.
- (2) **Stock** - The value of different types of stocks held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of stock subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any stock has been pledged as a security for a loan the amount of loan should be disclosed.

- (3) **Sundry debtors, including bills receivable** - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

- (i) debts due in respect of which the period of credit has not expired;
- (ii) debts due within six months; and
- (iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated

- (4) **Investments** - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.
- (5) **Secured Loans** - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.
- (6) **Provision of Taxation** - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears to be inadequate, the fact should be stated along with the extent of the shortfall.
- (7) **Other Liabilities** - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade

creditors should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

- (8) **Insurance** - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.
- (9) **Contingent Liabilities** - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.
- (10) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

20. (a) The contention of the client of Mr. Modi that he has charged an excessive fee for a professional assignment does not constitute professional misconduct in the context of the provisions of the Chartered Accountants Act, 1949 and regulation made there under since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between them.

Moreover, scales of fee recommended by the Council of the Institute are recommendatory only.

Therefore Mr. Modi is not liable for any professional misconduct under the Chartered Accountants Act, 1949.

- (b) **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 Chartered Accountants 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, Pratiq would be guilty of misconduct under the Chartered Accountants Act, 1949.

- (c) **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.
- (d) **Responding to Tenders:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. As per the guidelines if a matter relates to any services other than audit, members can respond to any tender. Further, in respect of a non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits.

In the instance case, since computerization of land revenue records does not fall within exclusive areas for chartered accountants, M/s Lions can respond to tender as well as deposit ₹ 50,000 as earnest deposit and shall not have committed any professional misconduct.