

MOCK TEST PAPER - 2
FINAL (NEW) COURSE: GROUP – I
PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory.

*Attempt any **five** questions from the Rest.*

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment.
- (b) XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-18 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:
- Income Tax relating to Assessment Year 2014-15 Rs. 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-16.
- Customs duty Rs. 85 lakhs - Demand notice received on 15-9-17 but no action has been taken to pay or appeal. Comment.
- (c) In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.
- (d) CA. Mack, a recently qualified practicing Chartered Accountant got his first audit assignment of Captura (P) Ltd. for the financial year 2017-18. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Mack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs. 145 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Mack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment. **(5 x 4 = 20 Marks)**
2. (a) Mr. Anil, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2015-16, the investment appeared in the Balance Sheet of the company of Rs. 10 lakhs and was the same amount as in the last year. Later on, it was found that the company's investments were only Rs. 25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.
- (b) AB Ltd. is a company in which public are not substantially interested. During the previous year 2017-18, the company issued shares to residents of India and provides you the following data related to such issue:
- | | |
|----------------------|------------------|
| No. of shares issued | 1,00,000 |
| Face Value | Rs. 10 per share |

Fair Market Value (FMV) Rs. 60 per share

Consideration received Rs. 80 per share

The management of the company contends that, it is a normal issue of shares, thus, needs not to be reported. As the tax auditor of AB Ltd., how would you deal with the matter in your tax audit report?

- (c) MSY & Co. is an Audit Firm having partners CA Mukti, CA Shakti and CA Yukti. CA Mukti, CA Shakti and CA Yukti are holding appointment as an Auditor in 4, 6 and 10 companies respectively.
- (i) Provide the maximum number of audits remaining in the name of MSY & Co.
 - (ii) Provide the maximum number of audits remaining in the name of individual partner i.e. CA Mukti, CA Shakti, CA Yukti.
 - (iii) Can MSY & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than Rs. 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the of the Companies Act with the Registrar, 2 small companies and 1 dormant company?
 - (iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of Rs. 110 crore each?
- (d) X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

(5 x 4 = 20 Marks)

3. (a) Mr. Mohan is a practising Chartered Accountant. He issued a certificate of consumption which did not reflect the correct factual position of the consumption of raw material by the concerned entity. It is found that the certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors. Comment on above with reference to the Chartered Accountants Act, 1949, and Schedules thereto.
- (b) A German Company engaged in the business of manufacturing and distribution of industrial gases, is interested in acquiring a listed Indian Company having a market share of more than 65% of the industrial gas business in India, request you to conduct a "Due Diligence" of this Indian Company and submit your Report. As due Diligence Auditor, discuss the key areas you will cover in your review.
- (c) Zed Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are encashed and transferred to current accounts. As of 31st March, 2018 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances. Comment.
- (d) Moon Ltd. acquired 51% shares of Star Ltd. during the year ending 31-3-2017. During the financial year 2017-18 the 20% shares of Star Ltd. were sold by Moon Ltd. Moon Ltd. while preparing the financial statements for the year ending 31-3-2017 and 31-3-2018 did not consider the financial statements of Star Ltd. for consolidation. As a statutory auditor how would you deal with it?

(5 x 4 = 20 Marks)

4. (a) CA. X, a practicing Chartered Accountant, failed to return the books of account and other documents of ABC Ltd. despite many reminders from the company. The company had settled his entire fees dues also. Comment with reference to the Chartered Accountants Act, 1949.
- (b) In the course of audit of QRT Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information.
- (c) High Life Insurance is into life insurance business and has established presence in this field since last 25 years. Your firm, SR & Co. are appointed auditors of the High Life Insurance company. While conducting its audit, you come across several important actuarial processes being followed in accordance with general regulatory guidelines. You also understand & realise that the actuarial department is calculating and modelling hub of the company. In the above context explain the role of auditors.
- (d) A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay. It has several critical IT components that enable anytime, anywhere transactions to take place. You are required to name the components and its example of real-time environment.
- (e) The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees. In view of above, you are required to list down any four role. **(4 x 5 = 20 Marks)**
5. (a) A Chartered Accountant in practice certified in requisite Form that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 10 a.m. and 6 p.m. on a monthly salary of Rs. 17,000 and attended the office of the Chartered Accountant thereafter until 7 p.m. The Chartered Accountant pleaded that the articled assistant was on audit of the company. Comment with reference to the Chartered Accountants Act, 1949.
- (b) XYZ Yarns Ltd. is a manufacturing company engaged in manufacturing of different types of yarns. Its annual turnover is Rs. 100 Crores and net profit Rs. 10 crores. It has two manufacturing units. Company is facing difficulties in maintaining adequate system of internal control. Company wants to appoint Internal Auditor who would help in the above task and also various other functions including compliance. In view of above, you are required to explain the main responsibility of Internal Auditors.

OR

CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishor, the statutory auditor of the Company, for his view and reporting. Can CA. Kishor rely on such report?

- (c) Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. State the items contained in the SEBI's check list for auditors in respect of contract notes issued by a Stock Broker.
- (d) Some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance. Give four examples of such situations.
- (e) During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system. **(4 x 5 = 20 Marks)**

6. (a) Ganpati Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of Ganpati Ltd. as to how he can obtain an understanding of how Ganpati Ltd. uses the services of the outsourced agency in its operations.
- (b) Indicate the precise nature of auditor's liability in the following situations and support your views with authority, if a misstatement had occurred in the prospectus issued by the company.
- (c) MIM & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by MIM & Co. to examine the projected financial statements and give report thereon. What audit evidence will be obtained for reporting on projected financial statements?
- (d) Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year. Comment.
- (e) Arpit, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas Arpit should review in the assessment of independence of the practicing unit? **(4 x 5 = 20 Marks)**

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SUGGESTED ANSWERS/HINTS

1. (a) **Review by Engagement Partner:** As per SA 220, “Quality Control for an Audit of Financial Statements”, the engagement partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed;
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- Not date the auditor’s report until the completion of the engagement quality control review.

SA 700, “Forming an Opinion and Reporting on Financial Statements”, requires the auditor’s report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor’s opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer’s satisfaction on or before the date of the auditor’s report.

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor’s report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.

Thus, in the given case, signing of auditor’s report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.

- (b) **Non-Compliance of Laws and Regulations:** As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2016 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii)(b) of Para 3 of CARO, 2016, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 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 "Provisions, Contingent Liabilities and Contingent Assets", partly to the extent the company considers 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 the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

- (c) **Auditor's Responsibilities Relating to Fraud:** As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580 "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is Rs. 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs. 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated .

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
 - (iii) If the auditor withdraws:
 - (1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
- (d) **Verification of Accounts Receivable:** As per SA 510 "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-
- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 580 "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Captura (P) Ltd. has restrained CA. Mack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Mack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Mack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

2. (a) **Grossly Negligent in Conduct of Duties:** As per Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he, certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice, under Clause (2); does not exercise due diligence, or is grossly

negligent in the conduct of his professional duties, under Clause (7); or fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, under Clause (8).

The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation.

In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation, the auditor has failed to perform his duty.

Accordingly, Mr. Anil, will be held liable for professional misconduct under Clauses (2), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

- (b) Reporting for issue of shares for value exceeding fair market value:** In this case, AB Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, it receives consideration for issue of shares (i.e. Rs. 80 per share) which exceeds the face value (i.e. Rs. 10 per share) and fair market value of the shares (i.e. Rs. 60 per share).

A tax auditor has to furnish the details of shares issued during the previous year, under clause 29 of Form 3CD, in case, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib) of the Income Tax Act, 1961.

Section 56(2)(viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

Since section 56(2)(viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assesseees. The auditor should obtain from the auditee, a list containing the details of shares issued, if any, by him to any person being a resident and verify the same from the books of accounts and other relevant documents.

As per the facts of the case, provisions and explanations given above, the income generated by AB Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961.

Therefore, the tax auditor of AB Ltd. is required to furnish the details of shares issued under clause 29 of Form 3CD. The contention of the management of the company, behind non-reporting, that it is a normal issue of shares, is not acceptable.

- (c) Ceiling on Number of Audit:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs. 100 crore private company (which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered

accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

In the given case, CA Mukti is holding appointment in 4 companies, whereas CA Shakti is having appointment in 6 Companies and CA Yukti is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

(i) Therefore, MSY & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm	= 20*3	=	60
Number of Audits already taken by all the partners in their individual capacity	= 4+6+10	=	<u>20</u>
Remaining number of Audits available to the Firm		=	<u>40</u>

(ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor. Hence (1) CA Mukti can hold: 20 - 4 = 16 more audits. (2) CA Shakti can hold 20-6 = 14 more audits and (3) CA Yukti can hold 20-10 = 10 more audits.

(iii) In view of above discussed provisions MSY & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than Rs. 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar), 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

(iv) As per fact of the case, MSY & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition, they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than rupees 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). In the given case, out of the 60 private companies, MSY & Co. is offered 45 companies having paid-up share capital of Rs. 110 crore each.

Therefore, MSY & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than Rs. 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.”.) and 40 private companies having paid-up share capital of Rs. 110 crore each in addition to above 20 company audits already holding.

(d) As per SA 620 “Using the work of an Auditor’s Expert”, the auditor shall agree, in writing when appropriate, on the following matters with the auditor’s expert:

- (i) The nature, scope and objectives of that expert’s work;
- (ii) The respective roles and responsibilities of the auditor and that expert;
- (iii) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and
- (iv) The need for the auditor’s expert to observe confidentiality requirements.

In the instant case X Ltd. had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor’s expert to audit valuation of derivatives. Considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor’s expert were new to each other,

auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him in accordance with SA 220.

3. (a) According to Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949 a chartered accountant is held guilty of professional misconduct if he certifies or submits a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or employee in his firm or any other chartered accountant in practice.

Mr. Mohan has issued a certificate of consumption which does not reflect the correct factual position of the consumption of raw material by the concerned entity. He has failed in his duty of examining the record. He has relied on the minutes of Board of director's meeting which is not proper evidence to show the consumption of raw material. The relevant record of production and stock register should have been scrutinized thoroughly and properly.

Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 also applies to this case which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Mr. Mohan will be held guilty of Professional Misconduct under Clause (2) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

- (b) **Due Diligence – Key Areas:** The German company engaged in the business of manufacturing and distribution of industrial gases wishing to acquire a listed Indian company has commissioned the Due Diligence Audit to assess the strengths and weaknesses of this company. It is quite important for the acquirer to assess the proposal from different angles and specifically as per terms of the assignment and also see whether proposed merger would create operational synergies. On the other hand, financial due diligence review would be performed after the commercial valuation. Accordingly, while a preliminary review might be performed during initial stages of the restructuring exercise and may in fact, be performed simultaneously with the commercial evaluation, at a later stage, financial due diligence may be performed on the books of account and other information directly pertaining to the financial matters of the entity. In addition, a legal due diligence may be required where legal aspects of functioning of the entities are reviewed; for example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws. Like other due diligence exercises, environmental and personnel due diligence are also carried out in order to establish whether various propositions with regard to environment and personnel of the enterprise under review are appropriate. In any case, it is quite important to look behind the veil of initial information provided by the company and to assess the benefits and costs of the proposed acquisition/merger by inquiring into all relevant aspects of the past, present and future of the business to be acquired. Some of the significant key areas which shall be covered under the review are as under:

- (1) **Historical Background:** The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. An eye into the history of the company may reveal its turning points, survival strategies adopted from time to time, the market share enjoyed by and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the said company. This could, inter alia, include the nature of business(es), location of production facilities, warehouses, offices, products or services and markets.
- (2) **Significant Accounting Policies:** The accountant should study the accounting policies being followed by the target and ascertain whether any accounting policy is inappropriate. The accountant should also see the effects of the recent changes in the accounting policies. The

target might have changed its accounting policies in the recent past keeping in view its intention of offering itself for sale.

The overall scope has to be based on the accounting policies adopted by the management. The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is reiterated that the accountant should mainly look at all material changes in Accounting Policies in the period subjected to review very carefully.

The accountant's report should include a summary of significant accounting policies used by the target, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the target are different from those adopted by the acquiring enterprise, the effect of such differences.

- (3) **Review of Financial Statements:** An evaluation of the profit reported by the company would be largely based upon its operating results. Any extraordinary item of income or expense that might have affected the operating results would require close examination. It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period. It is important that the trading results for the past four to five years are compared and the trend of normal operating profit arrived at. The normal operating profits should further be benchmarked against other similar companies. Besides the above, and based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business. The exercise to evaluate the balance sheet of the company has to take into consideration the basis upon which assets have been valued and liabilities have been recognised. The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.
- (4) **Taxation** - Tax due diligence is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. It is important to check if the company is regular in paying various taxes to the Government. The accountant has to also look at the tax effects of the merger or acquisition.
- (5) **Cash Flow:** A review of historical cash flows and their pattern would reflect the cash generating abilities of the target company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. **It is necessary to check that:**
 - (a) Is the company able to honour its commitments to its trade payables, to the banks, to government and other stakeholders
 - (b) How well is the company able to turn its trade receivables and inventories
 - (c) How well does it deploy its funds
 - (d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
- (6) **Financial Projections:** The accountant should obtain from the target company the projections for the next five years with detailed assumptions and workings. He should ask the target to give projections on optimistic, pessimistic and most likely bases.
- (7) **Management and Employees** - In most of the companies which are available for take over the problem of excess work force is often witnessed. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these match the requirements of the new incumbents. Due to complex set of labour laws applicable to them, companies often have to face protracted litigation from its workforce and it is important to gauge the likely impact of such litigation. The aspects whether all employee benefits like PF, Gratuity, ESI and superannuation have been properly paid/funded. The pay packages of the key employees will

be thoroughly reviewed since this can be a crucial factor in future employee costs.

- (8) **Statutory Compliance:** During a due diligence this is one aspect that has to be investigated in detail. It is important therefore, to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance it could lead to punitive charges under the law. These may have to be quantified and factored into the financial results of the company.
- (c) **Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013:** The instructions in accordance with which current assets being “cash and cash equivalents” should be made out to Part I of Schedule III to the Companies Act, 2013 states as follows:
- (i) Cash and cash equivalents shall be classified as:
 - (a) Balances with banks;
 - (b) Cheques, drafts on hand;
 - (c) Cash on hand;
 - (d) Others (specify nature).
 - (ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
 - (iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
 - (iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
 - (v) Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts. The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

- (d) **Consolidation of Financial Statements:** Accounting Standard 21 “Consolidated Financial Statements”, states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are acquired & held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 “Accounting for Investments”.

In the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, in the near future, existed at the time of acquisition of the subsidiary. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

As per Ind AS 110, there is no such exemption for ‘temporary control’, or “for operation under severe long-term funds transfer restrictions” and consolidation is mandatory for Ind AS compliant financial statement in this case.

However, as per section 129(3) of the Companies Act, 2013 where a company having subsidiary, which is not required to prepare consolidated financial statements under the applicable Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In the given case, Moon Ltd. has acquired 51% shares of Star Ltd. during the year ending 31.03.2017 and sold 20% shares during the year 2017-18. Moon Ltd. did not consolidate the financial statements of Star Ltd. for the year ending 31.03.2017 and 31.03.2018.

The intention of Moon Ltd. is quite clear that the control in Star Ltd. is temporary as the former company disposed off the acquired shares in the next year of its purchase. Therefore, Moon Ltd. is not required to prepare consolidated financial statement as per AS 21 however, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, Moon Ltd. is required to made disclosures in the financial statements as per the provisions provided in Schedule III to the Companies Act' 2013.

However, if the Moon Ltd. is required to prepare its financial statements under Ind AS, it shall have to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" is not available under Ind AS 110. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

4. (a) **Bringing Disrepute to the Profession:** A member is liable to disciplinary action under section 21 of the Chartered Accountants Act, 1949, if he is found guilty of any professional or "Other Misconduct". As per Clause (2) of Part IV of the First Schedule to the said Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

A member may be found guilty of "Other Misconduct" as per Clause (2) under the aforesaid provisions rendering himself unfit to be member if he retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.

In the given case, CA. X failed to return the books of accounts and other documents of his client without any reasonable cause, therefore, he would be guilty of other misconduct under the aforesaid provisions.

- (b) **Identification of possible sources for Related Parties' information:** As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. However, it is the management, which is primarily responsible for identification of related parties. The duties of an auditor with regard to reporting of related party transaction as required by Accounting Standard 18 "Related Party Disclosures" is given in SA 550.

- (i) SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity's principal shareholders, statements of conflicts of interest from management and those charged with governance, records of the entity's investments and those of its pension plans, contracts and agreements with key management or those charged with governance, significant contracts and agreements not in the entity's ordinary course of business, specific invoices and correspondence from the entity's professional advisors, life insurance policies acquired by the entity, significant contracts re-negotiated by the entity during the period, internal auditors' reports, documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

- (ii) Some arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions as an arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the establishment of a business relationship through appropriate vehicles or structures, the conduct of certain types of transactions under specific terms and conditions or the provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include participation in unincorporated partnerships with other parties, agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business, guarantees and guarantor relationships etc.

- (iii) Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement. In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples of transactions outside the entity's normal course of business may include complex equity transactions, such as corporate restructurings or acquisitions, transactions with offshore entities in jurisdictions with weak corporate laws, the leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged, sales transactions with unusually large discounts or returns, transactions with circular arrangements, for example, sales with a commitment to repurchase, transactions under contracts whose terms are changed before expiry etc.
- (iv) Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identification of related parties.

- (c) **Actuarial Process:** Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

Role of Auditor: Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA.

Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

- (d) **Real Time Environment: IT Components:** To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. A real-time environment has several critical IT components that enable anytime, anywhere transactions to take place. Any failure even in one component could render the real-time system unavailable and could result in a loss of revenue. IT Components include:
 - (i) **Applications:** For example, ERP applications SAP, Oracle R12, Core banking applications.
 - (ii) **Middleware.:** For example, Webservers like Apache, ATM switches.
 - (iii) **Networks:** For example, Wide Area Networks, Internet hosting.

(iv) **Hardware:** For example, Data centers, Backup and Storage devices, Power supply.

(e) **C&AG's Role** – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

(i) His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;

(ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;

(iv) The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.

The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;

(v) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

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

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

(b) **Main responsibility of internal auditor must be :**

✎ to maintain adequate system of internal control by a continuous examination of accounting procedures, receipts and disbursements and to provide adequate safeguards against misappropriation of assets.

✎ to operate independently of the accounting staff and must not in any way divest himself of any of the responsibilities placed upon him.

✎ Not to involve himself in the performance of executive functions in order that his objective outlook does not get obscured by the creation of vested interest.

✎ to observe facts and situations and bring them to notice of authorities who would otherwise never know them; also, they critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.

✎ to associate closely with management and his knowledge must be kept up to date by his being kept informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies. He must enjoy an independent status.

In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

It may also be noted that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

OR

Using the Work of Internal Auditor: As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-

- (a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
- (b) The level of competence of the internal audit function; and
- (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:

- (a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- (b) The function lacks sufficient competence; or
- (c) The function does not apply a systematic and disciplined approach, including quality control.

In the instant case, CA. Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check few items and he can also observe the procedures performed by the internal auditors.

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

(c) SEBI's check list for auditors in respect of contract notes issued by a Stock Broker: The auditor should apply appropriate audit procedures to satisfy himself that -

- ◆ Contract notes have been serially numbered.
- ◆ No serial number has been left blank.
- ◆ Format of the Contract Note is as prescribed by the Regulations of the Exchange.
- ◆ Duplicate copies / counterfoils of contract notes are maintained.
- ◆ Brokerage charged in contract notes is within the permissible limits and is indicated separately including service tax.
- ◆ Contract notes have been signed by an authorised person.
- ◆ Contract notes have been issued in respect of all transactions.
- ◆ Transaction Identification, Trade Identification and Trade Execution time has been printed on the contract note issued.
- ◆ SEBI Registration number, Settlement number, Settlement dates have been mentioned.
- ◆ PAN number of the member and client has been mentioned on Contract Note where if required.
- ◆ All clauses specified by the Exchange have been printed on the reverse of the contract notes.

- (d) **Adverse or Qualified Statement:** Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for e.g.,
- (i) The number of non-executive directors is less than 50% of the strength of Board of directors.
 - (ii) A qualified and independent audit committee is not set up.
 - (iii) The Chairman of the audit committee is not an independent director.
 - (iv) The Audit Committee does not meet four times a year.
 - (v) The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.
 - (vi) The time gap between two Board meetings is more than one hundred and twenty days.
 - (vii) A director is a member of more than ten committees or acts as Chairman of more than five committees across all companies in which he is a director.
 - (viii) The information of quarterly results is neither put on the listed entity's website nor sent in a form so as to enable the stock exchange on which the entity's securities are listed to enable such stock exchange to put it on its own website.
 - (ix) The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.

- (e) **Important Points to be kept in Mind While Drafting Letter of Weakness:** As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

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

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

6. (a) As per **SA 402 on "Audit Considerations Relating to an Entity Using a Service Organisation"**, when obtaining an understanding of the user entity in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;

- (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
- (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation .

(b) Under section 35 of the Companies Act, 2013 -

- (1) Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—
 - (a) is a director of the company at the time of the issue of the prospectus;
 - (b) has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
 - (c) is a promoter of the company;
 - (d) has authorised the issue of the prospectus; and
 - (e) is an expert referred to in sub-section (5) of section 26,
 shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.
- (2) No person shall be liable under sub-section (1), if he proves—
 - (a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent, or
 - (b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
- (3) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Under section 448, an auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material. If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act.

- (c) Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

- (1) the sources of information,
- (2) basis of forecasts,
- (3) the assumptions made in arriving the forecasts,

- (4) hypothetical assumptions, evidence supporting the assumptions,
 - (5) management representations regarding the intended use and distribution of the information, completeness of material assumptions,
 - (6) management's acceptance of its responsibility for the information,
 - (7) audit plan,
 - (8) the nature, timing and extent of examination procedures performed, and,
 - (9) in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.
- (d)** It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.
- (e) Review in the Assessment of Independence of the Practicing Unit** –The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.
- A, a practicing Chartered Accountant should review following controls in respect of assessment of independence of the practicing unit:
- (i) Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
 - (ii) Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?
 - (iii) Does the practice unit monitor compliance with policies and procedures relating to independence?
 - (iv) Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?