PAPER – 3 : ADVANCED AUDITING

QUESTION

1. Discuss the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

   (a) A Chartered Accountant in practice has been suspended from practice for a period of 6 months and he had surrendered his Certificate of Practice for the said period. During the said period of suspension, though the member did not undertake any audit assignments, he undertook representation assignments for income tax whereby he would appear before the tax authorities in his capacity as a Chartered Accountant.

   (b) Mr. L, a Chartered Accountant in practice has been elected as the treasurer of a Regional Council of the Institute. The Regional Council had organized an international tour through a tour operator during the year for its members. During the audit of the Regional Council, it was found that Mr. L had received a personal benefit of Rs.50,000 from the tour operator.

   (c) Mr. M a Chartered Accountant in practice as a proprietor died in a road accident. His widow sold the practice of her husband to another Chartered Accountant in practice for Rs.5 lakhs. The price also included right to use the firm name of Mr. M.

   (d) M/s Surya, a firm in practice, develops a website "surya.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site.

2. Comment on the following:

   (a) You are the internal auditor of Amarnath Manufacturing Co. Ltd. The MD has asked you to enquire into the causes of abnormal wastage of raw materials during the month of September, 2009. The wastage percentages are 1.2%, 1.1%, 1.3% and 3.6% for June, July, August and September, 2009 respectively. How will you proceed to carry out the assignment?

   (b) An auditor of a limited company did not verify the investment; he inserted a note in the balance sheet – "investments not verified". The shareholders approved and adopted the accounts at the annual general meeting. Subsequently, it transpired that the investments were misappropriated and the company suffered a loss. Can the auditor be sued for damages for negligence or otherwise in the discharge of his duties?

   (c) While auditing the accounts of a company, you are unable to verify the cash in hand at the date of the balance sheet. How would you satisfy yourself as to its correctness?

   (d) You have been appointed the sole statutory auditor of a company where you were one of the joint auditors in the immediately preceding year. The concerned joint auditor has not been reappointed. What are the various steps you would take to ascertain the compliance of the requirements of the Companies Act, 1956 before accepting the audit?

3. Sriram is above 75 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. M Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business.

   What procedures you would adopt before you could render any advice to M Ltd.?

4. As Chartered Accountant you are required to give your reports on various financial statements under Companies Act, 1956 which are as under:

   (i) Report to the shareholders under Section 227;

   (ii) Report to be set out in prospectus under Section 60(3);

   (iii) Report to be given on voluntary winding up under Section 488(1)

   Explain the significance of each of these reports and your functional approach very briefly.

5. (a) Your client, proprietor of a big retail store, wants protection against losses of sale proceeds.

   The client deals mainly in cash sales. Suggest a suitable system of internal check for the same.

   (b) As a Statutory Auditor, of a bank, how would you verify the "Sacrifice" on Non-Performing Assets for which Corporate Debt Restructuring has been undertaken?

   (c) Indicate the matters to be included in a Cost Audit Programme.

6. Answer the following:

   (a) What are the steps for the Audit under the State level 'Value Added Tax' (VAT)?

   (b) Illustrate, as a statutory auditor, how would you give a report where all qualifications are *not quantifiable.*

   (c) Under CARO, 2003 how, as a statutory auditor would you comment on the following:

      (i) Fixed assets comprising 1/3rd of the total assets have been disposed off during the year.

      (ii) A Term Loan was obtained from a bank for Rs.75 lakhs for acquiring R&D equipment, out of which Rs.12 lakhs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

7. (a) Enumerate the steps to be taken by an auditor for the verification of the premium income received by a general insurance company.

   (b) Disclosure under "Basis of Issue Price" in prospectus.

   (c) What are the important steps involved while conducting investigation on behalf of an incoming partner?

8. (a) A limited company having turnover of approximately Rs.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.

   (b) What are the main aspects covered in the probable format of environmental statement ?

9. Write short notes on of the following:

   (a) Financial indications to be considered for evaluating the assumption of going concern

   (b) Auditor's responsibilities regarding comparatives.

   (c) Sampling Risk

   (d) Reporting on a compilation engagements

   (e) Maintenance of branch offices by a Chartered Accountants in practice.

   (f) Other Misconduct.

10. As an auditor of a company, state your views on the following:

    As a Statutory Auditor, how would you deal with the following cases?

    (a) During the course of audit of ABC Ltd. it is noticed that out of Rs. 12 lakhs of provident fund contribution accounted in the books, only Rs. 2 lakhs has been remitted to the authorities during the year. On enquiry the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as and when the position improves.

    (b) National Tourism Ltd., a wholly owned Government Company approaches you to give a revised report on the revised accounts, as the original accounts has undergone changes consequent to the audit of Comptroller and Auditor General of India.

    (c) M/s. XYZ 's group gratuity scheme's valuation by actuary shows wide variation compared to the previous year's figures.

    (d) In the books of accounts of M/s CDE Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year.

11. Comment on the following with reference to the Chartered Accountants Act, 1949, Code of Ethics and Schedules to the Act:

    (a) P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2008, 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.

(b) B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.

(c) M/s Meera & Associates, 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 Rs.70,000 as earnest deposit as part of the terms of the tender.

12. (a) What are the specific advantages could be reaped by government due to Cost Audit.

(b) Report to be given to the Central Government as special auditor under Section 233A;

Explain the significance of the report and your functional approach very briefly.

13. Briefly furnish your views in connection with the following:

(a) T Pvt. Ltd.'s paid up Capital & Reserves are less than Rs. 50 lakhs and it has no outstanding loan exceeding Rs. 25 lakhs from any bank or financial institution. Its sales are Rs. 6 crores before deducting Trade discount Rs. 10 lakhs and Sales returns Rs.95 lakhs. The services rendered by the company amounted to Rs. 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

(b) List the matters to be included in the 'Auditors' report' in the case of Non Banking Financial Companies (NBFCs) accepting or holding public deposits.

14. (a) Explain the scope of concurrent audit of a bank with reference to Reserve Bank of India *guidelines.*

(b) Briefly list the specific areas, the auditor has to examine on Areas of propriety audit under Section 227(1A) of the Companies Act, 1956.

15. (a) Enumerate the steps to be taken by an auditor for the verification of Re-insurance outward by a General Insurance Company.

(b) What are the procedures to be followed while Reporting on the compilation engagement.

(c) Mr. Clean who proposes to buy the proprietary business of Mr. Perfect, engages you as investigating accountant. Specify the areas which you will cover in your investigation.

16. (a) Write short note on Vostro and Nostro Accounts.

(b) Briefly discuss the compliance procedures and their use in evaluation of internal controls.

17. In the context of Audit of members of Stock Exchanges, explain what is Rolling Settlement?

18. How are investments to be classified in the financial statements of a Bank?

19. Auditor's liability to third parties in relation to issue of Prospectus.
20. Write short notes on the following:
    (a) Decision Tree
    (b) Utility Routine
    (c) Test Packs
    (d) Record of Audit Assignments (as required by ICAI regulations)
    (e) Environmental audit.
    (f) Steps involved in the Indirect Tax Audit.

SUGGESTED ANSWERS/HINTS

1. **(a) Undertaking Tax Representation Work:** In the instant case, a chartered accountant not holding certificate of practice cannot take up any other work because it would amount to violation of the relevant provisions of the Chartered Accountants Act, 1949. In case a member is suspended and is not holding Certificate of Practice, he cannot in any other capacity take up any practice separable from his capacity to practises as a member of the Institute. This is because once a member becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act, 1949 and its Regulations. If he appears before the income tax authorities, he is only doing so in his capacity as a chartered accountant and a member of the Institute. Having bound himself by the said Act and its Regulations made thereunder, he cannot then set the Regulations at naught by contending that even though he continues to be a member and has been punished by suspension, he would be entitled to practice in some other capacity. Thus in the instant case, a chartered accountant would not be allowed to represent before the income tax authorities for the period he remains suspended.

   (b) Embezzlement of Funds: Section 21 of the Chartered Accountants Act, 1949 provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct." Though the term "Other Misconduct" has not been defined in the said Act, this provision enables the Council to enquire into any misconduct of a member even if it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards even in his non-professional work, would expose him to disciplinary action. The Council has also laid down that among other things "misappropriation by an office-bearer of a Regional Council of the Institute of a large amount and utilization thereof for his personal use" would amount to "other misconduct". Thus, in the instant case, Mr. L would be liable for disciplinary action.

   (c) Sale of Goodwill: The Council of the Instituted considered the issue whether the goodwill of a proprietary firm of chartered accountant can be sold/transferred to another eligible member of the Institute, after the death of the proprietor concerned and came to the view that the same is permissible. The Council resolved that the sale/transfer of goodwill in the case of a proprietary firm of chartered accountant to another eligible member of the Institute shall be permitted. It further laid down that in cases where the death of proprietor occurs after 30/8/1998, the goodwill of the deceased member's practice can be sold to another member and permission of the Institute has to be obtained within a year of the death of the proprietor concerned. It is even laid down that in such cases the name of the proprietary firm concerned would not be removed upto a period of one year from the death of the proprietor. Thus, in the instant case, when the widow of Mr. M sells the practice to another member, it is nothing but goodwill sold to another member. The sale of the practice and the right to use the name is also allowed in terms of the above decision of the Council. Thus the above act of the widow of Mr. M is permissible.

(d) **Posting of Particulars on Website:** The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by M/s Surya are:

- No restriction on the colours used in the website;
- The websites are run on a "pull" technology and not a "push" technology
- Names of clients and fees charged not to be given.

In view of the above, M/s Surya would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

2. **(a)** (i) Get a list of raw materials used by the company; (ii) obtain the standard consumption figures and ascertain the basis for working out normal wastage figures; (iii) assess whether the personnel employed are properly trained and working efficiently; (iv) examine the quality control techniques and preventive maintenance programme of machinery; (v) examine the laboratory reports and inspection reports as to the quality of raw materials procured; (vi) check the machine utilization statements; (vii) examine the possibility of theft, fine or other losses in storage; (vii) examine if any new production line has been taken up for which the standard input output norms have yet to be laid down.

(b) In case of audit of a limited company, an auditor has to comply with the statutory duties as prescribed in the Companies Act, 1956. Verification of investments is a very important function of an auditor, since, it is an important asset shown in the balance sheet. The auditor cannot be expected to give a report on the 'truth and fairness' of the financial statements of the company without verifying its investment. If he specifically mentions in his audit report the fact that, he did not verify the investments, he would not be relieved from his statutory duties. Such statutory duties can never be curbed, though they may be extended.

Under Section 543 of the Companies Act, 1956 the auditor may also be held guilty for misfeasance or breach of duty in relation to the company in the event of winding up, provided such misfeasance has directly resulted in damages to the company.

Thus, the auditor will be held liable in this case as the company suffered a loss because of such breach of duty.

(c) If it is not at all possible to verify the cash in hand at the end of the year, it would be better for the auditor to instruct the client to deposit the whole amount of cash in hand into the bank on that date and withdraw the amount on the next day. But, if the time is over and such instruction cannot be communicated to the client, the cash book of the next period up to the date of the audit should be vouched and cash in hand on that date should be verified. If required, there should be a surprise check of the balance of cash in hand on some other date.

(d) Compliance with Requirements of Companies Act, 1956: When one of the joint auditors of the previous year is appointed as the sole auditor for the next year, it is similar to new re-appointment of one of the retiring joint auditors. The provisions of Section 225 of the Companies Act, 1956, relating to non-reappointment of the other person also need to be considered. The following points should be taken into account:

(i) Special notice u/s 225(1) was duly received by the company from a member at least 14 days before AGM containing a proposal for appointing a sole auditor expressly.

(ii) Verify notice sent to all the members at least 7 days before the AGM. [u/s 190(2)]

(iii) Verify that special notice has been sent to retiring auditor forthwith. [u/s 225(2)]

(iii) Any representation received from the retiring auditor was sent to the members [u/s 225(3)].

(iv) Verify from the minutes whether the representation received from the retiring joint auditor was considered at the AGM.

(v) Examine that proposed resolution was properly passed.

(vi) Ensure that provisions of Section 224(2) are complied fully.

(vii) Ascertain special resolution u/s 224A, if any, is passed accordingly.

(viii) Obtain a certified copy of the relevant minutes of AGM and a written communication of the appointment within 7 days.

3. A due diligence audit on behalf of M Ltd. with a view to acquiring the business shall involve following steps:

(1) **Studying Business History:** The principal objective of financial due diligence, is usually to look behind the initial information provided by the entity and to assess the benefits and costs of the proposed acquisition by inquiring into all relevant aspects of the past, present and future of the business to be acquired. The accountants

should begin the financial due diligence review by looking into the history of the entity and the background of the promoters. The details of how the company was set up and who were the original promoters has to be gone into, before verification of financial data in detail. An eye into the history of the target may reveal its turning points, survival strategies adopted by the entity from time to time, the market share enjoyed by the entity 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 entity. Broadly, the accountant should make relevant enquiries about the history of business – products, markets, suppliers, expenses and operations.

(2) **Studying the Overall Picture:** It is necessary to see whether the business is engaged in manufacture of one or two important lines of products; whether raw material is available without difficulty; whether products are marketable and have a ready market; whether there is scope for expansion of the market; whether full capacity is being utilised or whether there is scope for utilisation of idle capacity – all those factors are non-financial in nature but an enquiry into them is essential for formulation of a decision to buy or not.

(3) **Economic environment:** The study of the impact of economic forces is important for determining factors that have been responsible for the rise or fall in the sales and profits of the business. At times, political or economic factors also may affect the fortunes of a business; for example, labour distrubances, changes in government policies in the matter of levy of excise and custom duties, imports, etc. It is therefore necessary that the impact of all these factors should be studied and their effect on the business judged on a consideration of the profits in the past.

(4) **Examining Profit and Loss Account:** The Profit and Loss Account for the last few years should be considered – exceptional or non-recurring expenses, incomes should be eliminated to know normal profit and trends in profits. Also to be seen is the trend in sales whether the same is on the increase or decrease after allowing for unusual factors influencing sales. It should be seen whether the business is regular in payment of taxes; both Central and State Taxes; whether taxes are in arrears; whether what arrangement are to be made to clear off the arrears; if taxes and duties are in arrear whether the vendor will undertake to pay the taxes upto the point of sale.

(5) **Examining Net-worth:** The net worth of the business should be ascertained. If the accounts are regularly audited, reliance can be placed on the books; for valuation of tangible assets, the assistance of known expert in the field may be sought; enquiries should be made whether there are unrecorded liabilities of the business; similarly about unrecorded assets. On the basis of net worth of the business, the purchase consideration may be agreed upon.

In addition to the above steps, the following further points have to be seen:

(i) Reason for sale of business and the effect on turnover and profits due to the exist of the present proprietor.

(ii) The length of the lease under which business has been operating.

(iii) The unexpired period of patents if any held by the vendors.

(iv) The age of managerial staff and prospects of their continuing in service in the new environment; the effect of trained managerial staff learning the organisation in production/sales/administrative and the financial liability to pay terminal benefits/compensation, etc.

(v) If bulk sales are to a few limited customers, the profitability should be discounted greatly, because any substantial withdrawal of customers might cause business crashes.

(vi) A company with a sound financial structure can better withstand the stresses and strains of business. A low debt-equity ratio would indicate an ability to grow through debt financing without raising equity.

(vii) The cash generated from operations; the need for redeployment of resources and funds needed for repayment of loans become major factors in determining growth potential.

(viii) The valuation of goodwill if any should be on reasonable basis having regards to all factors mentioned above.

4. (a) Auditor's report on the Companies Act, 1956 (the Act)

(i) Report to Shareholders U/s 227: Section 227 of the Act lays down powers and duties of the auditor. Sub-sections (2), (3), (4) and (4A) of Section 227 deal with reporting requirements. Sub-section (2) states that the auditor of a company shall make a report to the members on the accounts examined by him and on every balance sheet and profit and loss account which are laid before company in general meeting during the tenure of his office. The significance of the report lies in the fact that it requires that the report shall state whether in his opinion and to the best of his information and according to the explanations given to him the said accounts give the information required by the Act in the manner so required and give a true and fair view.

The functional approach by the auditor for making a report u/s 227 of the Act, requires him to perform compliance and substantive audit procedures to verify the information contained in the financial statements. Having regard to the materiality of the items involved, the auditor also determines whether the relevant information is properly disclosed in the financial statements.

(ii) Report to be set out in the prospectus u/s 60(3): Section 60(3) of the Act provides that a prospectus should be accompanied *inter alia* by the consent in writing of the person named therein as the auditor of the company or intended company to act in that capacity. Part II of Schedule II to the Act prescribes the reports to be set out in a prospectus. The report contains particulars about profit and losses of the company for five preceding year, assets and liabilities, rates of dividend, etc. The significance of the report lies in the fact that a prospectus is issued by a company when it seeks to raise funds from the public and gives detailed information about the company to enable prospective investors to take a well-informed decision. The functional approach on the part of auditor involves obtaining information from the management, particularly, in respect of estimation of current and future profits. He has to also ensure that all adjustments have been made properly.

(iii) Report on the accounts prepared on voluntarily winding up u/s 488 (1): Section 488(1) of the Act requires that where it is proposed to wind up a company voluntarily, its directors, or in case the company has more than two directors, the majority of the directors, may at a meeting of the Board, make a declaration verified by an affidavit, to the effect that they have made a full inquiry into the affairs of the company, and that, having done so, they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration. Such declaration has to be accompanied by a copy of the report of the auditors of the company (prepared, as far as circumstances admit, in accordance with the provisions of this Act) on the profit and loss account of the company for the period commencing from the date up to which the last such account was prepared and ending with the latest practicable date immediately before the making of the declaration and the balance sheet of the company made out as on the last mentioned date and also embodies a statement of the company's assets and liabilities as at the date.

5 **(a)** With a view to protect against the misappropriation of cash out of the sale proceeds by the salesmen, the following system of internal check is suggested :

(i) There should be complete segregation of responsibilities of the salesmen, the cashier and the accountant. Nobody should be allowed to do the job of others.

(ii) For each section, counter or department, separate salesman should be appointed.

(iii) As far as possible, mechanical cash register should be maintained.

(iv) The salesman should issue sales bills in triplicate. He should hand over two copies to the customer and retain the other copy.

(v) These two copies of the bill should be presented by the customer to the cashier.

(vi) The cashier should check the bill, receive the payment and stamp the bill as 'Paid'. Original copy of the bill should be handed over to the customer.

(vii) The customer should collect the goods purchased on presentation of the original bill, stamped as paid from another counter near the gate.

(viii) Each salesman should prepare the summary sheet with the help of the copy of the bill that remains with him and submit it to the accountant.

(ix) The cashier should enter the day's total sales in the cash sales sheet with the help of bill retained by him and report it to the accountant.

(x) Any discrepancy found by the accountant should be immediately reported to the general manager.

(b) Corporate Debt Restructuring and Sacrifice Element: The Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism specified that in case of rescheduling of accounts, the element of interest to be computed in present value terms. The guidelines state that the sacrifice should be computed as the difference between the present value of future interest income reckoned based on the current BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring and the interest charged as per the restructuring package discounted by the current BPLR as on the date of restructuring plus appropriate term premium and credit risk premium as on the date of restructuring. Accordingly, the following steps may be taken in this regard:

(i) Check that the appropriate credit risk premium for the specific borrower category for all restructured accounts.

(ii) Ascertain appropriate rate of discount.

(iii) Check the computation of present value interest and the sacrifice amount.

(iv) See that the entire amount should be written off or provided for in case sacrifice is positive.

(v) Verify provision of adequate security coverage of the loan in case restructuring of principal amounts.

(c) Matters to be included in Cost Audit Programme: It is a true statement that like any other audit a systematic planning for cost audit is also necessary. Therefore, the cost audit programme should include all the usual broad steps that a financial auditor includes in his audit programme. This would require that the various aspects like what to be done, when to be done and by whom to be done are adequately takes care of. However, looking to the basic difference in cost audit and financial audit as allocation and apportionment of expenses, statutory requirement etc. should require special consideration. Cost audit, in order to be effective, should be completed at one time as far as practicable. Based on above factors a set of procedures and instructions are evolved which may be termed the cost audit programme. Matters to be included in the Cost Audit Programme may be divided into following two stages:

(i) Review of Cost accounting record: This will include:

- Method of costing in use
- Method of accounting for raw material, stores and spares, wastage
- System of recording wages, salary, etc.
- Basic of allocation of overheads to cost centres and absorption by product and services
- Treatment of expenses on finance, R&D, royalty, etc.
- Method for depreciation accounting
- Method of stocktaking and valuation
- System of budgetary control

(ii) Verification of cost statement and other data: This will mainly cover:

- Licensed, installed and utilized capacity
- Operating and financial ratio
- Production data
- Consumption of material and actual expenses
- Sales realization
- Abnormal non-recurring and special cost
- Reconciliation with financial books

Some other factors which need to be brought into cost audit programme includes system of cost accounting, range of products, areas to be covered etc. indicating allocation of manpower and the time to be taken for computing the audit.

6. (a) VAT is a tax on the value added to the commodity at each stage in the production and distribution chain. VAT is an indirect Tax on consumption. It is a tax on the value at the retail point of sale which is collected at each stage of sale.

The essence of VAT is that it provides credit set off for input tax i.e. tax paid on purchases against the output tax i.e. tax payable on sales.

The following steps have to be taken by the auditors while auditing under VAT:

(i) ***Knowledge of Business****:* The Auditor should familiarize himself with the business of the Auditee.

(ii) ***Knowledge about VAT Law and Allied Laws****:* The Auditor should study the VAT Law particularly definitions, procedures to be adopted, provision regarding issues of invoices, claiming of input tax credit etc.

(iii) ***Major Accounting Policies****:* The Auditor should ascertainable major accounting policies with regard to sales purchases and valuation of inventory.

(iv) ***Accounting Records maintained by Auditee****:* The auditor should obtain a complete list of all the accounting records relating to sales/purchase of goods, stock, various registers ledgers etc, maintained in which, the transactions are recorded.

(v) ***Evaluation of Internal control****:* The Auditor should evaluate the internal controls prevalent in the entity with respect to sales, Purchases, Production and Accounting. He must examine the adequacy and effectiveness of the controls in order to plan the nature and timing of his audit procedures.

The following provisions of VAT need to be understood:

- Credit for inputs/supplies (and its accounting).
- Credit in case of capital goods.
- Utilising VAT credit for set off.
- Valuation of inventories/capital goods.
- Credit for goods lying in stock at inception of VAT scheme.
- VAT on sales.

(b) An illustrative Format of Audit Report: SA 700 "The Auditor's Report on Financial Statements", states that there may be circumstances when it is not practicable to quantify the effect of modification in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

The following illustration of a qualification where quantification was not possible will explain the point:

"(2) No provision has been made in respect of product warranties outstanding at the year end. The amount of provision required in this behalf could not be ascertained."

In the above situation, the overall paragraph would appear as follows:

"We further report that, without considering item mentioned in paragraph (2) above, the effect of which could not be determined, had the observations made by us in paragraph (1) (not reproduced) and (2) above been considered, the profit for the year would have been Rs.500.41 lacs (as against the reported figure of Rs.596.07 lacs), reserves and surplus would have been Rs.685.43 lacs (as against the reported figure of Rs.781.09 lacs) and total fixed assets would have been Rs.200.00 lacs (as against the reported figure of Rs.229.05 lacs)"

Subject to the above in our opinion………………..

(c) (i) Disposal of Fixed Assets: Under CARO, 2003, an auditor is required to state if substantial part of the fixed assets have been disposed off during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedures to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets.

Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets. The auditor is required to exercise his professional judgement to determine whether disposal off of one-third of total assets constitutes substantial part or not. Depending upon the judgement arrived at by the auditor, he shall report whether substantial part of fixed assets have been disposed off or not during the year and it has affected or not affected the going concern status of the company. Alternatively, in case the auditor is of the opinion that it constitutes substantial sale but the going concern assumption is appropriate because of mitigating factors then he has to ensure that the same are disclosed in the financial statements or else he shall have to modify the auditor report. The manner of reporting shall also be modified appropriately in case the going concern assumption is resolved or not.

(ii) **Utilisation of Term Loans:** Under CARO, 2003, an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, since term loan taken for the purpose of R&D equipment has been utilized for purchase of car which has no relation with R&D equipment. Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that the out of term loan of R&D lack, Rs.12 lakhs was not utilised for the purpose of acquiring the R & D equipment.

7. (a) Verification of Premium Income

(1) Review the internal control procedures and its compliance. This would ensure that in respect of all risks assumed, proper cover notes are issued and that no cover note/policy is omitted. Also find out whether all the cover notes are serially numbered and also the existence of adequate internal check on issue of stamps, stationery, etc. Depending on the assurance obtained from such initial evaluation, decide the extent of substantive checking to be carried out.

(2) Ensure that all premiums in respect of risks incepting during the relevant accounting year has been accounted as the premium income of that year.

(3) Verify the premium received and recorded during the year for fire, marine, motor and miscellaneous insurance business in the relevant books of account.

(4) Check that in respect of risks commencing after the year end, where the premium is received in advance, the same has been shown as "Premium Received in Advance" and see whether the similar advance of last year is accounted this year as income.

(5) Ensure that the company is not at risk in case policy documents have not been issued for any reason like dishonour of cheque and ensure that the risk has not commenced.

(6) Ensure that the company is not under risk in respect of amounts lying at credit and outstanding at the year end by verification and also obtaining a confirmation from the manager to that effect.

(7) Check whether the premium collected is recorded at gross figure without providing for unexpired risks and reinsurance.

(8) Verify that in case of co-insurance, the company's share of premium have been properly booked in the books of account in case the risk has commenced.

(b) Disclosures under 'Basis of Issue Price': Under this heading, the following information is to be disclosed:

(i) (a) Earnings per share, i.e., EPS pre-issue for the last three years (as adjusted for changes in capital);

(b) P/E pre-issue and comparison thereof with industry P/E where available (giving the source from which industry P/E has been taken);

(c) Average return on net worth in the last three years;

(d) Minimum return on the increased net worth required to maintain pre-issue EPS;

(e) Net Asset Value per share based on last balance sheet;

(f) Net Asset Value per share after issue and comparison thereof with the issue price.

Provided that projective earnings shall not be used as a justification for the issue price in the offer document.

(ii) The accounting ratios disclosed in the offer document in support of basis of the issue price shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

(c) Steps involved while conducting investigation on behalf of an incoming partner: The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service. Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of existing partners, socio-economic setting, etc. and whether he would be capable for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully. Broadly, the steps involved are as under :

(a) Ascertaining the history of the firm since inception and growth of the firm.

(b) Studies of the provisions of the Deed of Partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, etc.

(c) Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature and profitability of the business, qualification and expertise of the partners and such others as may be relevant.

(d) Examination of the asset and liability position to determine the tangible asset, partners, investment, appraisal of the value of intangibles like goodwill, know-how, patents, etc impending liabilities including contingent liabilities and those for pending tax assessment.

(e) Assess position of order at hand and the range and quality of clientele should be thoroughly examined under which the firm is presently operating.

(f) Scrutinise terms of loan finance to assess its usefulness and the implication for the overall financial position.

(g) Study important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full import of such standing agreements would be gauged before a final decision is reached.

(h) Study the composition and quality of key personnel employed by the firm and any likelihood of their leaning the organisation.

(i) Ascertain reasons for the offer of admission to a new partner and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable impact having on the firm's successes.

(j) Appraisal of the record of capital employed and the rate of returns. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure.

(k) Ascertain manner of computation of goodwill on admission as also on retirement, if any.

(l) Examine whether any special clause exist in the Deed of Partnership to allow admission in future a new partner.

8. **(a)** 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 eliminated 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 minimise 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 Rs. one lakh.

(ii) To check whether all freight outward bills are accounted for a report containing a month-wise co-relation between goods despatched 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 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 verified on a random basis to find out its reliability.

(b) Probable format of "Environmental Statement": The following are the main aspects which may be covered in the probable format of Environmental Statement :

a. Name and address of the owner/occupier of the industry, operation or process.

b. Date of last environmental audit report submitted.

c. Consumption of water and other raw materials during current and previous year.

d. Pollution generated in the air and water along with the output and the types of pollutants and the deviation from standards.

e. Generation of hazardous waste in current year and previous year from processes.

f. Quantity of solid waste generated during current year and previous year and from recycling or reutilisation of waste, etc.

g. Disposal practice for different type of waste.

h. Practice in operation for conservation of natural resources.

i. Additional investment proposal for environmental protection including abatement of pollution.

9. (a) **Financial Indications and Going Concern:** SA 570 on "Going Concern", aims to establish standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements. The following are the financial indications be considered:

- ♦ Negative net worth or negative working capital.
- ♦ Fixed-term borrowings approaching maturity without realistic prospects or renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets.
- ♦ Adverse key financial ratios.
- ♦ Substantial operating losses.
- ♦ Substantial negative cash flows from operations.
- ♦ Arrears or discontinuance of dividends.
- ♦ Inability to pay creditors on due dates.
- ♦ Difficulty in complying with the terms of loan agreements.
- ♦ Change from credit to cash-on-delivery transactions with suppliers.
- ♦ Inability to obtain financing for essential new product development or other essential investments.
- ♦ Entering into a scheme of arrangement with creditors for reduction of liability.

(b) **Auditor's responsibilities regarding comparatives:** SA 710, "Comparatives", establishes standards on the auditor's responsibilities regarding comparatives.

The auditor responsibilities laid down are as under:

(i) The auditor should determine whether the comparatives comply, in all material respects with the financial reporting framework relevant to the financial statements being audited. Further, the auditor should obtain sufficient appropriate audit evidence that the corresponding figures meet the requirements of the financial reporting framework.

(ii) When the comparatives are presented as corresponding figures, the auditor's report should not specifically identify comparatives because the auditors opinion is on the current period financial statements as a whole, including the corresponding figures.

(iii) When the auditor's report on the prior period, as previously issued, included a qualified opinion, disclaimer of opinion, or adverse opinion and the matter which gave rise to the modification in the audit report is:

(a) unresolved and results in a modification of the auditor's report regarding the current period figures, the auditor's report should also be modified regarding the corresponding figures; or

(b) unresolved, but does not result in a modification of the auditor's report regarding the current period figures, the auditor's report should be modified regarding the corresponding figures.

In such circumstances, the auditor should examine that appropriate disclosures have been made or if appropriate disclosures have not been made, the auditor should issue a modification report on the current period financial modified with respect to the corresponding figures included therein.

(iv) When the prior period financial statements are not audited, the incoming auditor should state in the auditors report that the corresponding figures are unaudited.

(c) Sampling Risk: Sampling Risk arises from the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure. The auditor is faced with sampling risk in both tests of control and substantive procedures as follows:

(a) Tests of Control:

(i) *Risk of Under Reliance*: The risk that, although the sample result does not support the auditor's assessment of control risk, the actual compliance rate would support such an assessment.

(ii) *Risk of Over Reliance*: The risk that, although the sample result supports the auditor's assessment to control risk, the actual compliance rate would not support such an assessment.

(b) Substantive Procedures:

(i) *Risk of Incorrect Rejection*: The risk that, although the sample result supports the conclusion that a recorded amount balance or class of transactions is materially mis-stated, in fact it is not material mis-stated.

(ii) Risk of Incorrect Acceptance: The risk that, although the sample result supports the conclusion that a recorded amount balance or class of transactions is no materially mis-stated, in fact it is materially mis-stated.

The risk of under reliance and the risk of incorrect rejection affect audit efficiency as they would ordinarily lead to additional work being performed by the auditor, or the entity, which would establish that the initial conclusions were incorrect. The risk of over reliance and the risk of incorrect acceptance affect audit effectiveness and are more likely to lead to an erroneous opinion on the financial statements then either the risk of under reliance or the risk of incorrect rejection.

Sample size is affected by the level of sampling risk the auditor is willing to accept from the results of the sample. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

(d) Reporting on a compilation engagements: The report on compilation engagements should ordinarily, be in the following layout:

(i) Title – The title of the report should be "Accountants Report on compilation of un-audited financial Statements."

(ii) Addressee: The report should ordinarily be addressed to the appointing authority.

(iii) Identification of the financial information also noting that it is based on the information provided by the management.

(iv) When relevant, a statement that the accountant is not independent of the entity;

(v) A statement that the Management is responsible for:

* Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant;
* Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
* Preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulation, if any;
* Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.
* Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance.

(vi) A statement that the engagement was performed in accordance with the Auditing and Assurance Standards.

(vii) A statement that the neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information.

(viii) A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework.

(ix) Date of the report

(x) Place of signature

(xi) Accountant's signature.

(e) Maintenance of Branch Offices by a Chartered Accountants in Practice: Section 27 of the Chartered Accountants Act, 1949 requires that if a chartered accountant in practice or a firm of chartered accountants has more than one office in India, i.e., a branch, each of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm, to have a member in charge of its branch office and a separate member in case of the branches, if more than one, would constitute professional misconduct. However, exemption from the above has been given to members practising in the hilly areas subject to the certain conditions. It is necessary to mention that the Chartered Accountant in charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him. The above rule applies in case additional office is situated at a place beyond 50 Kms. from the municipal limits in which the office is situated. The exemption may be granted under proviso to Section 27(1) of the Chartered Accountants Act, 1949 to a member or a firm of Chartered Accountants in practice to have a second office without such second office being under the separate charge of a member of the Institute, provided (a) the second office is located in the same premises, in which the first office is located or (b) the second office is located in the same city, in which the first office is located or (c) the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located. A member having two offices of the type referred to above, shall have to declare, which of the two offices is his main office, which would constitute his professional address.

(f) 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". Other Misconduct has not been defined in the Act. This provision empowers the Council to enquire into any misconduct of a member even if it does not raise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviations from these standards, even in his non-professional work, would expose him to disciplinary action. For example, a member who is found to have forged the will of a relative, would be liable to disciplinary action even though the forgery may not have been done in the course of his professional duty. Other misconduct would also relate to conviction by a competent court for an offence involving moral turpitude punishable with cause transportation on imprisonment to an offence not of a technical nature committed by the member in his professional capacity.

In the absence of a statutory definition of "other misconduct", the question whether a particular act or omission constitutes "other misconduct" has to be decided on the facts and circumstances of each case. In this context, the judgement of the Supreme Court in "Council of the Institute of Chartered Accountants of India and another vs B. Mukherjee" acquires special significance. After examining the nature, scope and extent of the disciplinary jurisdiction, which can be exercised under the provisions of the Act, the Supreme Court observed as under:

"We therefore, take the view that, if a member of the Institute is found, prima facie, guilty of conduct, which, in the opinion of the Council renders him unfit to be a member of the Institute, even though such conduct may not attract any of the provision of the Schedules, it would still be open to the Council to hold an inquiry against the member in respect of such conduct and a finding, against him, in such an inquiry, would justify appropriate action being, taken by the High Court."

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

(i) Where a chartered accountant retains the books of accounts and documents of the client and fails to return these to the client on request without a reasonable cause.

(ii) Where a chartered accountant makes a material misrepresentation.

(iii) Where a chartered accountant uses the services of his articled or audit clerk for purposes other than professional practice.

(iv) Conviction by a competent court of law for any offence under Section 8 (v) of the Chartered Accountants Act, 1949.

(v) Misappropriation by office-bearer of a Regional Council of the Institute, of a large amount and utilisation thereof for his personal use.

(vi) Non-replying within a reasonable time and without a good cause to the letter of the public authorities.

10. (a) Depositing Provident Fund Dues: The Companies Audit Report's Order, 2003 required the auditor to state whether the dues of provident fund have been regularly deposited with the appropriate authorities and, if not, the extent of arrears shall have to be indicated by the auditor. A company is required to deposit provident fund dues to appropriate authorities with in the period prescribed under the Rules governing it. In the case of fund constituted by the company, the company is required to follow provisions of section 418 of the Act. In this case there is a default in not depositing the provident fund contribution to the extent of Rs. 10 lakhs which is a lapse on the part of the company. The reason put forward by the Chief Accountant that the amount has not been deposited due to financial problems faced by the Company is no excuse for not remitting the provident fund. In fact, the company has not at all been regular in depositing the amount. Thus, the auditor shall include this in his report indicating the extent of arrears.

(Note: The Companies (Auditor's Report) Order, 2003 requires the auditor to comment upon the regularity aspects as also the extent of arrears in case the same has been outstanding for a period of more than six months. In the given case, it may be noted that M/s ABC Ltd. has failed to deposit the provident funds regularly and the major part of it has been outstanding for more than six months.)

(b) Auditor's Report on Revised Accounts: The Guidance Note on Auditor's Report on Revised Accounts of Companies before circulation to Shareholders deals with those situations wherein the statutory auditor is required to give report on the revised accounts. The auditors of National Tourism Ltd. have been asked to give revised report on the revised accounts as the original accounts have undergone changes consequent to audit of the C & AG. The Guidance Note requires that the statutory auditor must observe the following steps while issuing the revised report:

(i) All copies of the original accounts and reports thereon are returned to the auditor.

(ii) The adequate disclosure has to be made that the accounts which were earlier approved by the Board of Directors and reported by the auditors have been revised and re-approved by the Board of Directors as a specific note on the amended accounts.

(iii) In case the notes to accounts do not contain any note on revision or such a note is not considered adequate or comprehensive, the statutory auditor shall have to indicate that accounts have been revised based on the audit report of C&AG. The auditors at the time of issue of revised report has to bring these facts in his report if not included as a note in the revised accounts.

(iv) Finally, the auditor's report (revised) should clearly draw the attention to their earlier audit report.

(c) **Valuation by Actuary:** SA 620, "Using the Work of an Expert" states that the auditor has to evaluate the work of an expert, say, actuary, before adopting the same. This becomes more crucial since M/s XYZ's group gratuity scheme's valuation by actuary shows wide variation compared to previous year figures. There is no doubt that appropriateness, reasonableness of assumptions and methods used are the responsibility of the expert, but the auditor has to determine whether they are reasonable based on the auditor's knowledge of the client's business and result of his audit procedures. In the present case, the auditor must verify the reasonableness of assumptions made and methods adopted by the actuary in the evaluation particularly with reference to factors such as rate of return on investments, retirement age, number and salary of employees, etc. Accordingly, the auditor has to satisfy himself whether valuation done by the actuary can be adopted, otherwise he may report on his findings for wide variation.

(d) **Difference Between Control Accounts and Subsidiary Records:** The huge differences found between control accounts and subsidiary records in the books of M/s CDE Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date. Having regard to all these circumstances, it appears from the facts of the case that these difference indicate the possibility of some kind of material misstatements. As per SA 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements" when the auditor encounters circumstances that there is material misstatement, the auditor should perform procedures to determine whether the financial statements are materially misstated. If as a result of such examination the auditor comes across any material information involving fraud or gross irregularity the same shall be reported by him appropriately.

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

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

(b) **Advertisement of Professional Attainments:** Clause 7 of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner. Thus B is not guilty of any misconduct under the Chartered Accountants Act, 1949.

(c) **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 Meera & Associates can respond to tender as well as deposit Rs.70,000 as earnest deposit and shall not have committed any professional misconduct.

12. **(a)** Advantages of Cost Audit to Government: Cost auditor's approach is to ensure that the cost accounting plan is in consonance with the objectives set by the organisation and the system of accounting is geared towards the attainment of the objectives. A cost accounting system designed to exercise control over cost may be different from the one if the objective is to fix price. Accordingly, over a period of time particularly in view of administered pricing system the cost accounting becomes quite important. Some of the specific advantages which can be reaped by the Government are:

(i) It helps in the fixation of selling prices of essential commodities and thereby avoiding undue profiteering.

(ii) In the case of cost plus contracts of Government, it helps to fix the price at reasonable level.

(iii) It enables the Government to focus the attention on inefficient units.

(iv) It enables the Government to lay down policies in favour of protecting certain industries.

(v) It facilitates the settlement of disputes brought to the Government.

(vi) It creates healthy competition in the industry.

(b) Special Audit Report U/s 233A: Under Section 233A of the Act, the Central Government has a power to order a special audit of the accounts of a company for a specified period. An order to conduct special audit of the accounts of a company may be made where the Central Government is of the opinion that:

(a) the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices; or

(b) the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) the financial position of the company is such as to endanger its solvency.

The main objective of such an audit is to provide a critical review of the company's working and state of affairs to the government. Special audit should be distinguished from 'investigation' into the affairs of a company under Section 235 of the Act. The special auditor has the same powers and duties which a company auditor has under Section 227 of the Act, with the difference, however, the instead of making his report to the members of the company, the special auditor makes the report to the central government. The special audit report should, as far as possible, include all the information required to be included in an audit report under Section 227 of the Act. However, the central government may direct that the special audit report shall also include a statement on any other matter referred to the special auditor by the government.

13. (a) Since paid up capital and reserves of T Pvt. Ltd. is less than Rs. 50 lakhs and has no loan outstanding exceeding rupees 25 lakhs from any bank or financial institution, the only other condition is whether turnover exceeds rupees five crores. Turnover is not defined in the CARO. Part II of Schedule VI defines the term "turnover" as the aggregate amount for which sales are affected by the company. "Sales affected" would include sale of goods as well as services rendered by the company.

For ascertaining turnover though trade discount and sales returns should be deducted, the inclusion of services rendered would result in a turnover of Rs. 5.05 crores (i.e. 6 - 0.10 - 0.95 + 0.10 crore) Hence CARO will apply to T. Pvt. Ltd.

(b) The auditors are required to make a separate report to the Board of Directors and the RBI for every financial year as per the Non Banking Companies Auditors' Report (RBI) Direction 1998, in addition to the reporting obligations under section 227 of the Companies Act, 1956.

(1) *Reporting Requirements:* The auditor shall make –a statement on the following matters, together with reasons in case of any unfavourable or qualified statement:

(a) *Registration:* Whether the NBFC has obtained certificate of Registration or applied for registration.

(b) *Communication from RBI:* Whether the NBFC has received any communication from RBI refusing grant of Certificate of Registration.

(2) **NBFCs accepting/holding public deposits**

(i) ***Limit on Public Deposits***: Whether the public deposits and the following borrowings are within the permissible limits

(a) Borrowing from public by issue of unsecured non-convertible Debentures/Bonds.

(b) Borrowing from its share holders by a public limited company and

(c) Other deposits within the definition of "Public Deposit" in the NBFC (Reserve Bank) Direction, 1998.

(ii) ***Credit Rating***: Whether Credit rating for fixed Deposits, assigned by the credit rating agency is in force.

(iii) ***Limit on Fixed Deposits***: Whether aggregate amount of Deposit outstanding at any point during the year has exceeded the limit specified by the Credit Rating Agency.

(iv) ***Default:*** Whether the NBFC has defaulted in paying to its Depositors the interest and/or principal amount of the deposits after such interest and/or principal became due.

(v) ***Prudential Norms***: Whether the NBFC has complied with NBFC Prudential Norms (Reserve Bank) Direction, 1998 in relation to Income Recognition. According standards, classification, Provisioning for bad and doubtful debts and concentration of Credit/Investment.

(vi) ***Capital Adequacy***: Whether the capital Adequacy Ratio disclosed in the return submitted to the RBI is correctly determined and whether such ratio is in compliance with the minimum capital to Risk Asset Ratio prescribed by the RBI.

(vii) ***Liquidity***: Whether the NBFC has complied with the prescribed liquidity requirement and kept the approved securities with designated Bank.

(viii) ***Return of Deposits***: Whether the NBFC has furnished the return of deposits to the RBI within the stipulated period as required under First Schedule to NBFC Prudential Norms (Reserve Bank) Directions, 1998.

14. (a) Scope of concurrent audit of banks with reference to RBI guidelines

The following are the areas to be covered:

(i) Daily cash transactions with reference to abnormal receipts and payments. This will include currency chest transactions, major expenses met by cash, high value receipts and disbursements.

(ii) Purchase and sale of shares securities etc. Physical verification of investments and rates at which they are entered into.

(iii) Verification of procedure and documentation to open new current, savings, term deposit accounts, etc. Unusual operations noticed have to be thoroughly examined.

(iv) Verification of advances, overdrafts, temporary OD, Cash credit accounts, term loans, bills purchase, letters of credit etc. Procedure for sanction and documentation to be verified. Any deviation noticed to be examined in great detail.

(v) Foreign exchange transactions to be verified with reference to RBI guidelines.

(vi) Verification of balancing of all ledgers and registers, inter branch reconciliation calculation and verification of interest, discount, commission etc.

(vii) Revenue leakage to be detected.

(viii) Special efforts to be made in all fraud prone areas. The attempt should be to ensure that all effective measures are taken to prevent frauds.

(ix) Verification of high value transactions.

(x) Procedure for safe custody of security forms with the branch.

(xi) Whether all procedures for tax deduction at source are followed and the tax so deducted are deposited into Government Account within the time fixed.

(xii) Verification of returns, statements, calculation of capital adequacy ratio and compliance with requirements of government business.

(xiii) Study of RBI and Internal Inspection reports statutory auditors report and compliance thereto.

(xiv) Whether the customers' complaints are dealt with promptly.

(b) Areas of propriety audit under Section 227(1A)

Section 227(1A) of the Companies Act, 1956 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to:

(i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members;

(ii) whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;

(iii) where the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the securities have been sold at a price less than that at which they were purchased by the company;

(iv) whether personal expenses have been charged to revenue

15. (a) Verification of Re-insurance outward

1. Verify that re-insurance underwriting returns received from the operating units regarding premium, claims, paid, outstanding claims, tally with the audited figures of premium claims paid and outstanding claims.

2. Check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.
3. Check whether cessions have been made as per the stipulation applicable to various categories of risk.
4. Verify whether the cessions have been made as per the agreements entered into with the various companies.
5. See whether the outward remittances to foreign re-insurance have been done as per the foreign exchange regulations.
6. Ascertain whether the commission has been calculated as per the terms of the agreement with the re-insurance.
7. Verify the computation of profit commission by various treaty arrangements in the figure of the periodical accounts rendered and in relation to outstanding less pertaining to the treaty.
8. Examine whether the cash loss recoveries have been claimed and accounted on a regular basis.
9. Verify whether the claims paid items appearing outstanding claims list by ever. This can be verified at least in respect of major claims.
10. See whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support was insisted and verified.
11. Accounting aspects of the re-insurance cession premium commission recoverable, paid claims recovered and outstanding losses recoverable on cessions have to be checked.
12. Check percentage pattern of gross to net premium, claim paid and outstanding claim to ensure comparative justifications.

(b) Reporting on the Compilation Engagement: The objective of a compilation engagement is to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information, This ordinarily entails reducing detailed data to a manageable and understandable form without the requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the member to express any opinion on the financial information. Therefore, it is essential that the member clearly brings out the nature of association with the financial statement and the nature of the work performed by him. The following may be noted in this regard.

i. The title of the report should be "Accountant's Report on Unaudited Financial Statement and not An Auditor's Report".
ii. The report should be addressed to the appointing authority.
iii. The report should identify the financial information compiled, also stating that it is based on the information provided by the management.
iv. The report should clearly state that the financial statements are not audited.

v. In describing the engagement, ambiguous terms such as review, general review, check, etc. should not be based.

vi. Date of the report should be mentioned.

vii. Name and address of the firm of the member appointed for carrying out the compilation engagement should be mentioned.

viii. Signature and the designation (sole proprietor/ partner) and membership number should appear in the report.

(c) Areas to be covered in the investigation: The first and foremost important aspect in any business investigation is to have an overall picture of the position of the business which is being investigated before the details are gone into. Further, it is important to know whether the business is engaged in the manufacture of one or two important lines of products, is principally processing materials or is concerned only with the sale of a single product. Also, whether it is a business which depends for its success on imported raw materials or supply of parts and components from ancillary businesses or uses indigenous materials and parts which are manufactured locally. If the business is labour - intensive, its future profitability would be dependent on availability of skilled labour and relations of the management with the trade unions. Labour relations thus can affect the future profitability of the business. The method of distribution of products, either through wholesalers or retailers also must be examined. For studying the economic and financial position of the business, the following should be considered:

(i) The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?

(ii) What will be the trend of the sales and profits in the future? The success of a business in the future would depend on the position enjoyed by it in the past in relation to its competitors. A business may be successful because it enjoys a monopoly. In such a case, the possibility of emergence of competition must be examined. This may be ascertained on the basis of the trend in market share of the product and the licensing policy followed by the government. Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.

(iii) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?

From the accountant's view point, the following specific areas need to be looked into:

Profit and Loss Account: To study the Profit and Loss Account of a concern and consider each item, included therein, in relation to the corresponding items in the Profit and Loss Account of the previous years. It is therefore, necessary that a summary, in a columnar form, should be prepared of the balances included in the Profit and Loss Accounts of the business for a period, say of 5 to 7 years.

Fixed Assets: Fixed assets, usually, are shown in accounts at cost less depreciation but the accounts do not show the ages of different assets. It is desirable, therefore, to obtain age analysis of various items of fixed assets. Assets which are old or are obsolete would naturally have to be replaced. It should be seen that their values are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap.

Stock and work-in-progress: It should be seen that stocks have been valued consistently and that the basis of valuation was such that the value placed on stocks did not include any element of profit. Also, there should be due allowance for damaged, obsolete and slow moving stocks.

Other liquid assets: It should be ascertained that the assets so described are readily realisable. Money with a bank in liquidation should be taken only to the extent guaranteed by Deposit Insurance Scheme.

Idle assets: On a scrutiny, it may appear that certain assets are remaining idle and are not being properly applied in the business. For example, certain plant and machinery may have been put to use after a considerable period of time after acquisition. Some of the fixed assets may be awaiting installation even at the valuation time.

Liabilities: The important matter to investigate in this regard is whether those are stated fully or understated or overstated. In other words, whether the profits of the business have been inflated by suppression of liabilities or there are any free reserves included in the liabilities. In either case, an adjustment would be necessary. Secondly, it should be ascertained that liabilities are not unduly 'large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.

Taxation: Orders in respect of assessments completed should be studied and it should be verified that an adequate provision has been made in respect of liabilities for taxes which have not been assessed. Also, it should be seen that in the past there has been no reopening of assessments. If so, the company may be liable for an undisclosed sum of taxes plus penalties. Any temporary tax benefit should also be disregarded.

Apart from the above areas, the other factors relating to the management, skilled labour, etc. may also be covered in the investigation.

16. (a) Banks maintain stocks of foreign currencies in the form of Bank Accounts with their overseas branches/correspondents. Such foreign currency accounts maintained by Indian banks at other overseas centres is designated by it as "Nostro Account". For example, all banks in India would be maintaining a US Dollar Account". For example with their New York office/branch/correspondents, such account would be designated by the Indian Office as Nostro Account. "Vostro Account" is the opposite of Nostro accounts. Here a foreign bank in another country maintains stocks of Indian rupees with their Indian branch/correspondent/local bank. Such Indian Rupee Accounts are designated as a Vostro Account. For example, a German Bank might maintain a Vostro Account in rupees in terms with Indian Bank. While examining the transaction in foreign exchange, the auditor should also pay attention to reconciliation of Nostro Accounts with the respective minor account. The amount in the Nostro account is stock of foreign currency in the form of bank accounts with the overseas branches and correspondents. Unreconciled Nostro Accounts, on an examination, may reveal unauthorized payments from the foreign currency account, unauthorized withdrawals, and unauthorized minor account. The auditor should also evaluate the internal control with regard to inward/outward messages. The inward/outward messages should be properly authenticated and discrepancies noticed, should be properly dealt with, in the books of accounts. The auditor should also verify whether prescribed procedure in relation to inter bank confirmation in the Vostro account is followed or not, in case balance confirmation certificate have been received but the same have not been reconciled, or where confirmation has not been received the same should be reported, in respect of each Vostro Account.

(b) Compliance Procedures and Evaluation of Internal Controls: SA 200 on "Basic Principles Governing an Audit" states that, "the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. According to it, compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Obtaining audit evidence from compliance procedures is intended to reasonably assure the auditor in respect of the following assertions :

Existence	-	that the internal control exists.
Effectiveness	-	that the internal control is operating effectively.
Continuity	-	that the internal control has so operated throughout the period of intended reliance.

The auditor formulating his opinion on financial information needs reasonable assurance that transactions are properly authorised and recorded in the accounting records and that the transactions have not been omitted. Internal controls, even if fairly simple, may contribute to the reasonable assurance the auditor seeks. The auditors' objective in studying and evaluating internal controls is to establish the reliance he can place thereon in determining the nature, timing and extent of his substantive auditing procedures.

Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in place and are also effective. Compliance procedures enable the auditor to determine the existence, effectiveness and continuous operation of the internal control system. These procedures include tests requiring inspection of documents supporting transactions to gain evidence that controls have operated properly. For example, the auditor may see that the documents have been properly authorised. The auditor may also make enquiries about the observation of controls, for example, determining who actually performs each function not merely who is supposed to perform it. Compliance procedures are conducted by the auditor to gain evidence that those internal controls on which he intends to rely operates generally as identified by him and they function effectively throughout the period of intended reliance. The concept of effective operation recognises that some deviations from prescribed controls may have occurred.

Based on the results of his compliance procedures, the auditor evaluates whether the internal controls are adequate for his purpose. If based on the results of the compliance procedures, the auditor concludes that it is not appropriate to rely on a particular internal control to the degree previously contemplated, he should ascertain whether there is another control which would satisfy his purpose and on which he might rely (after applying appropriate compliance procedures). Alternatively, he may modify the nature, timing or the extent of his substantive audit procedures.

17. Rolling settlement: A rolling settlement is one in which trades outstanding at the end of the day have to be settled (payments made for purchases or deliveries in the case of sale of securities) within 'X' business days from the transaction date.

In the rolling settlement, trades on each single day are settled separately from the trades done earlier or subsequent trade days. The netting of trades is done only for the day and not for multiple days.

SEBI has gradually mandated most of the scrips to be settled exclusively on Rolling Settlement basis [T+2]. Thus, in a T+2 rolling settlement, a transaction entered into on Monday, for instance, will be settled on Wednesday when the pay-in or pay-out takes place. The transaction in the Compulsory Rolling Settlement (CRS) are settled on T+2 basis i.e. both pay in and pay out of monies and securities for transactions in scrips on transaction day (T-Day) would take place on the day after immediately following day.

However, transactions in 'Z' group securities are settled only on trade to trade basis on T+2, i.e. the facility of netting up of buy and sell transactions of the same day, as available in other securities, is not available with securities falling under 'Z' group. In other words, if the investor buys and sells X number of shares on the same day , then he shall first have to actually deliver and then receive the securities on the settlement day.

Value at Risk (VaR) based margining approach has been adopted for transactions done in CRS scrips w.e.f. July 2, 2001. In the VaR system of margining, historical volatilities of scrips and overall market volatility is considered to arrive at a VaR margin percentage for a scrip. Further the mark-to-market difference are collected on a daily basis and the broker members are required to maintain a capital level, as prescribed by the exchange, adequate to support their exposure at all times.

In case, a member fails to deliver the shares sold in rolling settlement, the exchange conducts an auction session on T+2, to meet the shortfall created by non-delivery of shares. In this auction session, offers are invited from the other members to deliver the shares sold by originally selling member, since delivery has to be made to the buying member. In case no shares are received in auction, the sale transaction is closed-out at a close-out price, determined by higher of the following:

- Highest price, recorded in the scrip from the settlement in which the transaction took place upto a day prior to the auction OR
- 20% above the closing price on a day prior to the auction.

In this case, the auction price/ close-out and difference between sale price, if positive is payable by the seller who failed to deliver the scrips. In case, auction/ close out price is less than sale price, the difference is not given to the seller, but is credited to investor protection fund.

18. Classification of Investments in the Financial Statements of a Bank

The entire investment portfolio of the banks (including SLR securities and non-SLR securities) should be classified under three categories viz., 'Held to Maturity', 'Available for Sale' and 'Held for Trading'.

However, in the balance sheet, the investments will continue to be disclosed as per the existing six classifications viz., (a) Government securities; (b) Other approves securities; (c) Shares; (d) Debentures & Bonds; (e) Subsidiaries/Joint Ventures and (f) Other (CP, Mutual Fund Units, etc)

Banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

Held to maturity

(i) The securities acquired by the banks with the intention to hold them up to maturity will be classified under **Held to Maturity**.

(ii) The investments included under 'Held to maturity' should not exceed 25 per cent of the bank's total investments.

(iii) The following investments are to be classified under 'Held to Maturity' but will not be counted for the purpose of ceiling of 25% specified for the category:

    (a) Re-capitalisation bonds received from the Government of India towards their re-capitalisation requirement and held in their investment portfolio.

    (b) Investment in subsidiaries and joint ventures. [A joint venture would be one in which the bank, along with its subsidiaries, holds more than 25% of the equity.]

    (c) The investments in debentures/bonds, which are deemed to be in the nature of an advance.

(iv) Profit on sale of investments in this category should be first taken to the Profit & Loss Account and thereafter be appropriated to the 'Capital Reserve Account', Loss on sale will be recognized in the Profit & Loss Account.

Held for Trading

The securities acquired by the banks with the intention to trade by taking advantage of the short-term price/interest rate movements will be classified under **Held for Trading**.

The investments classified under held for trading category would be those from which the bank expects to make a gain by the movement in the interest rates/market rates. These securities are to be sold within 90 days.

Available for Sale

The securities which do not fall within the above two categories will be classified under Available for Sale.

Profit or Loss on sale of investments in both the categories will be taken to the Profit & Loss Account.

19. Section 62 of the Companies Act, 1956 lays down the civil liability for misstatement in a prospectus issued to invite persons to subscribe for shares in or debentures of a company. The professional accountant will in such a case be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage sustained because of an untrue statement made by him as an expert.

However, professional accountants will not be liable if they can prove that**:**

(a) the prospectus was issued without his knowledge or consent and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(b) he withdrew his consent in writing before delivery of the prospectus for registration; or

(c) after the delivery of prospectus for registration but before allotment of shares, on becoming aware or the untrue statement , he withdrew his consent in writing and gave reasonable public notice of the withdrawal, and of the reasons therefore ; or

(d) he was competent to make the statement and that he had reasonable grounds to believe and did up to the time of allotment of the shares or debentures believe that the statement was true.

20. (a) Decision Tree: A decision tree is a graphic display of the relationship between the present position and future events; future events and their consequences. The sequence of events is mapped out over time in a format similar to the branches of a tree. The decision tree approach gets its name because of the resemblance with a tree having number of branches. A decision tree represents a decision problem as a series of decisions to be taken under conditions of uncertainty. A present decision depends upon the past decision and their outcomes. The decision trees are the diagrams that permit the various decision alternatives, their outcomes and probabilities of their occurrences to be mapped in a clear fashion.

In a typical decision tree, therefore, the project is broken down into clearly defined stages, and the possible outcomes at each stage are listed along with the probabilities and cash flows effect of each outcome. Important steps while constructing a decision tree in respect of an investment proposal are: definition of the investment proposal, identification of decision alternatives, identification of decision points, chance of events and other data, location on the decisions tree branches of the relevant data such as projected cash flow, expected present value, and selection of the best alternatives. This approach is extremely useful in handling sequential investments and working backwards, eliminating unprofitable branches and determination of optimum decision at various decision points.

The major advantage of a decision tree is that it brings out the implicit assumptions and calculations for all to see, raise questions and revise. It also allows a decision maker to visualise assumptions and alternatives in the graphic form which are easy to understand. The disadvantages, however, are that the diagram becomes complicated and cumbersome as more and more variables are added. The addition of interdependent alternatives and variables does not only present a queer picture but also makes calculation time consuming.

(b) **Utility Routines:** Utility Routines are generally supplied by the computer manufacturer and are available for call up by the operating system. These routines play a key role in an electronic data processing. These are generalised programmes that perform necessary but routine jobs in a computer installation. These routines are sufficiently flexible to handle needs of all users. They are controlled by parameters to indicate the particular characteristics of the data or the requirements. Generally, three types of utility routines are made available by computer vendors.

Data set utilities are used to manipulate files of stored data. One data set utility programme might merge or combine data from more than one file of stored data. Another might copy a file of data to another file. A third might instruct the computer to print selected portions of a set of data. A fourth might sort file records into a desired sequence.

System utilities are used to simplify the task of knowing where data are stored in a computer file. One utility routine might add data to a file, name the set of data, and catalogue the data set to distinguish it from other data sets. Another utility routine might list the catalogue of data sets, showing where particular data is stored in a file. A third might label magnetic tapes. A fourth might accumulate and report errors incurred during the processing of magnetic disk and tape.

Independent utilities perform such housekeeping functions as preparing a back up copy of the contents stored on a magnetic disk file or analysing a magnetic disk for defective tracks. This type of a utility routine performs the needed diagnostic tests.

(c) **Test Packs:** Test pack is a technique to determine the correctness of the computer programming used to record transactions through the computer. Preparation of test pack requires a great deal of expertise. It may be prepared by the auditor himself with the help of the entity's staff or by the Internal Control department of the entity. Normally test packs are used where:

(i) a significant part of the control system is embodied in the programme;

(ii) there are gaps in audit trail making it difficult to trace output from input and to verify intermediate calculation; and

(iii) the volume of records is large, so that it may be more economical and more effective to use test packs rather than to trace the transactions manually.

The operations of a test pack involve following steps:

(i) The auditor or the Internal Audit Department prepares a set of special data covering different types of transactions containing valid and invalid conditions.

(ii) Data will include both that falling outside the control parameters (and printed out as an error or conception) and that falling within the parameters (and hence should be processed normally).

(iii) The test data are seen on the clients' computer with the client's programme but under audit supervision.

(iv) The results of the test data are also prepared separately, independent of the computer/programme, and are compared with the results obtained by running the programme through the computer.

(v) If the results are identical, reliability of the computer programme is proved.

(d) Record of Audit assignments: In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India issued a notification which specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 224 and /or Section 228 of the Companies Act, 1956. As a part of this notification, to meet its requirements, a CA in practice as well as a firm in practice shall maintain a record of the audit assignments accepted as laid out in notification issued by the Council of the ICAI under Part II of Second Schedule to the Chartered Accountants Act, 1949 in respect of ceiling on audits containing following particulars:

(i) Name of Company Audit/ Assignment.

(ii) Regn. No.

(iii) Date of appointment with Registrar of Companies.

(iv) Date of acceptance.

(v) Date on which form 23B filed.

(e) Environmental Audit: Environmental reporting deals with the disclosure by an entity of environmentally related data, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities or environmental performance to those who have an interest in such information as an aid to enabling/enriching their relationship with the reporting entity via either the annual report; a stand-alone corporate environmental performance report; or some other medium (e.g. staff newsletter, video, CD ROM, internet site). The reports that are generated after such audits can be either compliance-based reporting or impact-based performance reporting.

Environmental audit deals with verification of information contained in such reports with a view to expressing an opinion thereon. Environmental audit can be performed by external agencies or internal experts (including internal auditors). In practice, environmental audit is not done by a single agency but by various agencies who are experts in the field. Since the subject matter of environmental audit involves multi-disciplinary knowledge and skill, it is preferable to form a team of persons drawn from different disciplines who may assist the chartered accountant in performing the task in an effective manner, generally environmental audits are not required by any statute but are sometimes done at the request of the management to address issues like compliance with environmental laws and regulations, etc.

(f) Audit of Indirect Taxes: The components of central indirect tax which form a part of the materials cost could be basic customs duty, additional duty of customs, special additional duty, excise duty (Cenvat), special excise duty, additional duties of excise, etc. The various components have a relationship with each other and also with central and local sales tax. The audits of in this area are redirected to the audit under sections 14A and 14AA of the Central Excise Act, 1944. All these audits are conducted by or on behalf of the Government. The steps involved in conducting indirect tax audit are as under:

1. Evaluate the internal control systems in general with specific weight given to the strength of the systems in aiming at the quantification and discharge of the indirect taxes. Internal control questionnaire may be designed specifically for the area of indirect taxation.
2. Obtains information about the company and the industry. Specific information on amount of imports, percentage of customs, amount of removals, quantum of cenvat-proportion of credit could also be calculated. The walk through of the process from the point of ordering of materials till the receipt of the payment from the customer is advisable.
3. Formulating an audit programme to assist in the actual conduct of the audit. The actual extent of verification would be dependent on the results of the evaluation of the internal controls.
4. Ensure that the audit staff is knowledgeable in the law and the procedures governing the indirect taxes. The examination of the documents, physical verification, reconciliation tracing techniques, comparison of ratios, observation of the activities and discussions of the weaknesses observed should be part of an effective audit.
5. Prepare a report on the indirect tax audit providing specific comments on the statutory information, material matters reported by way of an executive summary and the assertion/qualification that the acceptable accounting policies are in vogue.