



HOW TO PREPARE FOR AUDIT

Audit is a very vast and broad subject. The study material of the Institute runs into a number of pages. Any body can be frightened to see such a big book at first instance. So don't be afraid; all you have to do is to make a systematic study of it. The whole course of Audit should be studies in the following preference order. It should a kept in mind that the preference order should not be changed:

- 1. Code of Conduct - 16 marks.**
- 2. Company Audit - 20 marks**
- 3. Accounting Standard - 16 marks.**
- 4. Bank Audit - 9 marks.**
- 5. AAS/Guidance Notes - 9 marks**
- 6. EDP Audit - 9 marks**
- 7. Management Operation Audit - 9 marks**
- 8. Cost Audit - 8 marks**
- 9. Cooperative Society Audit - 8 marks**
- 10. Stock Exchange Audit - 8 marks**
- 11. Tax Audit - 9 marks**
- 12. Insurance Audit. - 9 marks**
- 13. Non corporate borrowers - 9 marks**
- 14. Public Enterprise Audit - 9 marks**
- 15. Proprietary Audit - 9 marks**

POINTS TO BE FOLLOWED ON THE DAY OF EXAM & ON THE PREVIOUS NIGHT

- 1.** Don't learn or read anything new on the day before the day of exam. All you should do is to revise what you have already done.
- 2.** On the day of examination do that question first, which you know the best. This will lead a good impression on the mind of the person who will check your copies. Always begin answer to any question with one or two summary sentences.
- 3.** Begin new paragraph for each point or idea.
- 4.** Try to attempt all questions.
- 5.** Underline key points.
- 6.** Write legibly & big so that it is clearly visible from distance.
- 7.** After the exam do not discuss the paper with any body. What has happened has happened it cannot be changed. Discussion will only spoil your other papers.
- 8.** Once all your exams are over, you should make a note of all the mistakes and drawbacks for future reference. Look them before the next exams.

Special Aspects

Non-Banking

Classification of NBFC :

- A. NBFC is one whose principal business is that of receiving deposits or that of financial institution.
 1. Equipment Leasing Company.
 2. Hire Purchase Finance Company.
 3. Investment Company.
 4. Loan Company.
 5. RNBC *i.e.* Residuary non-banking co. that receives deposits under any scheme.
- B. **MBFC (Mutual benefit Financial Co.)** : *i.e.* Nidhi Co. notified by Central Government u/s 620 A of Companies Act.
- C. **MBC (Mutual Benefit Company)** : *i.e.* potential Nidhi co. working on lines of Nidhi co. but not so notified by Sec. 620A of Companies Act and Central Government. Company having minimum net owned fund and preference share capital of 10 lacs.
- D. **MNBC (Miscellaneous Non-banking co.)** : *i.e.* Chit Fund Company. Where a company enters into an agreement with specified number of subscribers to subscribe a certain sum and everyone of them be entitled to a prize amount. (may be by lot).

AUDIT PROCEDURE

1. **Ascertaining the business of the Company.**
2. **Evaluation of I.C. System.**
3. **Registration with RBI** which is compulsory for companies having net owned funds of Rs.2 Crores. Also ascertain whether it has submitted quarterly return with RBI about liquid Assets within 15 days in specified form. Moreover, it must transfer at least 20% of its net profit to reserve fund before any dividend is declared.
4. **NBFC Public Deposit Directions**
 - (i) Public deposit **in accordance with** the credit rating assigned to it.
 - (ii) Interest calculations.
 - (iii) NBFC accepted public deposit or renewed it **only after written application** received by the depositor in a specified form.
 - (iv) Public deposits should be accepted **only after advertisement or statement in lieu of advertisement** has been filed with RBI.
 - (v) Check deposit **register** (payment on due date).
 - (vi) Investment in **approved liquid assets** and it should be kept in **safe custody**.
 - (vii) **Audited statement** submitted **within** 15 days of Holding AGM to RBI.
 - (viii) **Annual Return within** 6 months from close of year submitted to RBI.
 - (ix) If not accepting deposits, see Board resolution in this behalf.
 - (x) For Group holding Investment Company, see board resolution to identify the group.
5. **NBFC Prudential Norms Directions**
 - (i) **Compliance** with income recognition and Accounting Standards, *etc.*
 - (ii) **Classification** as Standard / Sub-standard / Doubtful / Loss Asset.
 - (iii) Income from NPA on **realization basis**.
 - (iv) Previous year's NPA A/c. **continue or not**.

CHECK-LIST FOR NBFC

1. Equipment Leasing Finance Company :

- (i) Check whether proposals for equipment Leasing are accepted only after proper credit appraisal.
- (ii) The auditor should verify the adequacy of system in place for ensuring installation of assets and their periodical physical verification.
- (iii) The auditor should check the system to monitor whether Asset is adequately insured and properly maintained should be in place.
- (iv) Verify the lease agreement.
- (v) The auditor should ensure that leasing transactions are classified and accounted as per AS-19 "Lease".
- (vi) Ensure that the provisions relating to asset classification, provisioning and income recognition laid down for lease financing by NBFCs are observed.

2. Hire Purchase Finance Company

- i. The auditor should ascertain whether there is an adequate appraisal system for extending hire-purchase finance.
- ii. The auditor should verify that payments for assets are made directly to the vendor and the assets are properly charged in the name of the NBFC.
- iii. The auditor should ascertain the adequacy of system in place to ensure installation of the asset and their periodic physical verification.
- iv. If the finance is against vehicles, the registration certificate should contain an endorsement in favour of the NBFC.
- v. Auditor should verify the system to ensure that hirer have not sold the assets or encumbered them.
- vi. Whether hire-purchase instalments are received regularly.
- vii. The auditor should verify that hire purchase assets are adequately insured.
- viii. Check the valuation of goods sold on hire purchase and goods repossessed.
- ix. Examine the method of accounting followed for appropriation of finance charges over the period of hire purchase contract.

3. Investment Company

- (i) The Auditor should physically verify the investment certificate. If these are lodged with another institute/bank obtain a certificate to that effect.
- (ii) Verify whether investments made by the NBFC are within limits.
 Lend $\left[\begin{array}{l} \leq 15\% \text{ of net owned funds to single borrower} \\ \leq 25\% \text{ of net owned fund to single group of borrowers} \end{array} \right.$
 Same is the case with investment.
 Lending + investments $\left[\begin{array}{l} \leq 25\% \text{ of net owned funds to single borrower} \\ \leq 40\% \text{ of net owned fund to single group of borrowers} \end{array} \right.$
- (iii) Verify that no loans have been advanced on the security of its own share.
- (iv) Verify whether income in the form of interest, dividend and capital gains is properly recognized.
- (v) Test Check the bills/contract notes received from brokers w.r.t. prices in the stock market on the respective dates.
- (vi) Verify the board minutes for authorization of purchase and sale of investments.
- (vii) Shares/Securities held through depository, obtain confirmation from D.P.
- (viii) Check whether investments have been valued as per NBFC Prudential Norms and AS 13 "Accounting for Investments".
- (ix) Obtain a list of subsidiary/group Company from NBFC.

- (x) Check the investments made in subsidiary / group companies for basis for price paid, quantum of investment made etc.
- (xi) Ascertain that investments in unquoted debentures and bonds have not been classified as investments but as term loans for the purpose of asst classification, provisioning and income recognition.
- (xii) Incase of securities lent / borrowed under securities lending scheme of SEBI, verify the terms and conditions of the agreement.

4. Loan Company

- i. Ascertain whether there is system in place for proper appraisal, and sanction of loans.
- ii. Verify the terms & conditions of loan agreement and security obtained.
- iii. Check whether adequate records are maintained as regards the bill discounting facilities.
- iv. Check whether the loans are within the limits specified for single and group borrowers.
- v. No loans should be given of the security of NBFCs own shares.
- vi. Check whether norms for asset classification, provisioning and income recognition as specified for credit facilities have been adhered to.
- vii. The auditor may also obtain balance confirmation from the borrowers.
- viii. Check whether there is adequate system to ascertain creditworthiness of client for co. engaged in business of providing short term fund in ICD market.

AUDIT OF BANK BORROWERS

- ⇒ For those Non-corporate Borrowers enjoying working Capital Limits of Rs.25 lacs and above from the Banking System.
- ⇒ Term Borrowing includes (for purpose of limit) :
 - (i) Packing Credit facility.
 - (ii) Cash Credit facility
 - (iii) Loans – Secured and Unsecured.
 - (iv) O/D.
 - (v) Deferred Payment facility.
 - (vi) Guarantee (a) Performance, (b) financial.
 - (vii) Bill Discounting facility.
 - (viii) Any other Credit facility.
- ⇒ To submit such audited statement and report to concerned bank, at earliest but not later than 6 months from the close of Accounting year.

⇒ AUDIT PROCEDURES

- (i) Auditor to use his professional skills and experience and apply such audit tests as required by circumstances. Report is special purpose report as it is to be given to lending bank.
- (ii) Consider materiality. Perform compliance procedures.
- (iii) Obtain all relevant information and explanation from the client being audited.
- (iv) Entity may choose any Chartered Accountant.
- (v) Auditor to obtain letter of engagement and list of books of A/c. / records maintained by the entity before undertaking audit assignment.
- (vi) Check compliance with terms of documents etc. (Partnership/Trust Deed) so far as they relate to A/c. and audit.
- (vii) Figures of immediately preceding year for comparisons (AAS-22 & 25).
- (viii) Any material departure of A/c. from accepted principles / Policy followed in preceding year should be reflected in notes to A/c. / Auditor's report.
- (ix) Overall consideration whether financial statement give a true and fair view. It should help the lending banker in evaluation of loan proposals and strict financial discipline.

Special Auditor Report:

⇒ Can be called by a lending bank, if circumstances want. Submitted on *quarterly basis*, it is in addition to normal audit report which is on annual basis).

Information regarding :

- (i) Actual Production.
- (ii) Actual production as % of rated capacity.
- (iii) Sales.
- (iv) Cash of goods sold / cost of production.
- (v) Gross margin.
- (vi) Interest on bank borrowing.
- (vii) Interest on others.
- (viii) Age-wise classification of raw material and finished goods.
- (ix) Basis of valuation of raw material and finished goods.
- (x) Age wise classification of B/R and other receivables due from domestic parties and for exports.
- (xi) Some ratio etc. also is given.
- (xii) Information w.r.t. following
 - (a) Balances at the end of each month of the quarter for major categories of stock, receivables and bills receivables;
 - (b) Tax assessments and payments made during the quarter.
 - (c) Actual disbursement of capital expenditure during the quarter;
 - (d) Outstanding contracts.
 - (e) The contingent liability;
 - (f) Investment made during the quarter and the income from such investments including profit on sale of investments.
 - (g) Loans given during the quarter;
 - (h) Loans raised during the quarter
 - (i) Overdue statutory liability at the end of the quarter;
 - (j) Amounts due but not paid at the end of the quarter in respect of (a) loans from banks, (b) public deposits and (c) other loans; and
 - (k) Figures of cash losses during the last 2 years to be stated on the basis of the annual accounts. If such accounts were not audited this fact should be stated.

AUDIT OF CO-OPERATIVE SOCIETIES

- ⇒ Auditor's objective to see how far the decisions are in line with co-operative principles. Interest of members, provision in respective law of state and provision of bye-laws of society.
- ⇒ Managing Committee of society does the following :
 - (i) Custody and maintenance of moveable/un-moveable property.
 - (ii) Maintenance of account for receipt/payment.
 - (iii) Summon and attend all meetings.
 - (iv) Keeping all registers and records required by Act.

Auditor:

- ⇒ C.A. or diploma holder or having served as auditor in co-operative department of Government.
- ⇒ Appointment by Registrar and report submitted to him and to society also.
- ⇒ Audit fee may be w.r.t., working capital at prescribed rates.
- ⇒ Books of accounts required for :
 - (i) Sum of money received and expanded.
 - (ii) All sales and purchases and accounts of st. in hand.
 - (iii) Assets and liabilities.

Further different books can also be maintained by the society.
- ⇒ For limited lia. Society, no member other than a registered society can hold share-holding exceeding 20% of shares or Rs. 1,000.
- ⇒ No loan to any person other than member. Special permission to grant loan to another society.
- ⇒ Accept loan/deposits from members/others subject to bye-laws.
- ⇒ Investment in :
 - (i) Central/State Co-operative Bank.
 - (ii) Approved securities.
 - (iii) Share security bond, etc. of any other society with limited liability.
 - (iv) Any co-operative bank if approved by Registrar.
 - (v) Other money permitted by Central/State Government.
- ⇒ 25% of pt. Transferred to Reserve Fund before distribution to members. Registrar may reduce it but at least 10% is even then required. It may use Reserve fund in Business of a society or may invest or for some public purpose.
- ⇒ Some State Act provide for compulsory contribution to education fund of state.
- ⇒ Over due debts for 6 m – 5 yr. and more than 5 years classified and reported upon.
- ⇒ Overdue interest excluded from interest outstanding in calculation of pt.
- ⇒ Some Act provide that Bad debts can be written off only if certified as Bad.
- ⇒ Auditor to see *existence, ownership and valuation* of asset.
- ⇒ Special report to registrar for e.g. :
 - (i) Personal profiteering by members.
 - (ii) Detection of fraud.
 - (iii) Mis-management.
 - (iv) Urban co-operative bank, disproportionate advances to vested interest groups.
 - (v) Reckless advancing

⇒ Then he provides a *class* to society. If society is unsatisfied, it may appeal to Registrar and he may direct to review the audit classification.

⇒ **Audit Report :**

- (i) All necessary information and explanation.
- (ii) A/c. give all information required by Act.
- (iii) P & L true and fair view.
- (iv) B/S true and fair view of state of affairs.
- (v) Proper Books of Accounts maintained.
- (vi) P&L and B/S in agreement with Books of Accounts.

Schedules to the report for :

- (i) Transaction contrary to Act, rules and Bye-laws
- (ii) Sums not brought into A/c.
- (iii) Material/property appearing as doubtful/bad.
- (iv) Material irregularity in expenses/realization of money.
- (v) Any other matter specified by registrar.

⇒ He may also have to answer two sets of questionnaire called audit memos.

- (i) General nature (Applicable to all)
- (ii) Practical nature (like for Housing agriculture, etc.)

Multi State Co-operative Societies Act, 2002

❖ **Books of A/c: w.r.t :**

- (i) All sum of money received & expended & matters of receipt / exps.
- (ii) All sale & Purchase of goods.
- (iii) All assets & liabilities.
- (iv) For MSCOS engaged in production, processing & manufacturing their, utilization of materials or labour or other items of cost as may be specified in by-laws of society.

❖ **Qualification of Auditors (Sec. 72):** A chartered accountant under CA Act, 1949. Disqualification:

- (i) Body corporate.
- (ii) Officer / Employee of MSCOS.
- (iii) Partner / Employee of Officer / Employee of MSCOS.
- (iv) Indebted / Guarantor for amount > 1000/-

❖ **Appointed of auditors (Sec. 70):**

- (i) First auditor by board within one month of registration date to hold office until conclusion of 1st AGM. If board fails then in general meeting.
- (ii) Subsequent auditor at each AGM to hold office from conclusion of that meeting until conclusion of next AGM.

❖ **Power & Duties of Auditors (Sec. 73):** Right to access at all times to books, A/C⁵ & Vouchers to require information & explanation from employee / officers etc.

Following inquiries shall be made [73 (2)]

- (i) Loans & advances made by MSCOS on basis of security, properly secured & whether terms aren't prejudicial to interest of MSCOS / members.
- (ii) Transaction of MSCOS represented merely by book entries are not prejudicial to interest.
- (iii) Whether personal Exps. have been charged to revenue.
- (iv) In case it is stated in Books of MSCOS that any shares have been allotted for cash whether cash actually been received & if no cash has been so received, whether positions stated in books & B/s are correct & not misleading.

❖ **Contents of Auditors report (Sec. 73):** To member of MSCOS:

Sec 73 (3):

- (i) B/s. True & fair view of state of affairs &
- (ii) P&L A/c. True & fair view of Profit or Loss:

Sec 73 (4):

- (i) Whether obtained all information & explanation
- (ii) Whether, proper books of A/c kept by MSCOS & proper returns received from branches
- (iii) Whether report on A/c of any branch office forwarded to him & how he dealt with the same
- (iv) Whether MSCOS's B/s & P&L A/c are in agreement with the books of account & return. Where any matters aforesaid are in negative → reasons.

❖ **Special Audit of MSCOS (Sec. 77)**

- In case Central Government or State Government either alone or both hold 51% or more of paid-up share cap. In such MSCOS.
- Central Government may direct either a C.A or MSCOS's auditor to conduct special audit & make a report to it.
- Cases for special audit:
 - (i) Central Government is of opinion that affairs of MSCOS aren't being managed in accordance with self help & Co-operative principles or sound business principles or:
 - (ii) MSCOS managed in manner likely to cause serious injury / damage to interest of trade / industry or business to which it pertains or
 - (iii) That the financial position of any MSCOS is such as to endanger its solvency.
- Auditor has same powers & duties as in Sec. 73.
- On receipt of report of special audit, Central Government may take such action as it considers necessary.

❖ **Inquiry by Central Registrar (Sec. 78)**

- Central Registrar may:
 - (i) On request from federal co-operation to which MSCOS is affiliated or
 - (ii) A creditor or
 - (iii) At least 1/3 of member of board or
 - (iv) At least 1/5 of total member of MSCOS holds an enquiry or direct some person to enquire into constitutions, working & financial condition of MSCOS. However before inquiry, 15 days notice to be given to MSCOS.
- Central Registrar or person authorised, shall have following powers:
 - (i) Free access to books / A/c / Cash / Properties in custody of MSCOS & summon any person to produce the same at any place specified by him.
 - (ii) Require the officer to call AGM by giving notice of at least 7 days or if officers fail / refuses, he may call it himself.
 - (iii) Summon any person having knowledge to appear before him & examine him on oath.
- Central Registrar with 3 months of receipt of report communicate the report of enquiry to society, FI & to person at whose instance it is needed.

❖ **Inspection of MSCOS (Sec. 79)**

- Central Registrar may (required by same as in case of inquiry)
- Powers:
 - (i) Access to books / sec In event of serious irregularity, take them into custody, verify the cash balance of society & subject to permission of Central Registrar call a meeting, if necessary.
 - (ii) Every officer / member shall furnish information w.r.t. working of society as required by Central Registrar.

- Copy of report within 3 months communicated to MSCOS.

AUDIT OF MUTUAL FUNDS

- ⇒ Auditor to be appointed by trustees. Report also forwarded to trustees.
- ⇒ Every asset, Management Company to keep proper books of accounts, records, etc. for each scheme.

⇒ **Audit Report :**

- (i) Obtained all information and explanation.
- (ii) Balance Sheet and Revenue Accounts – True and fair view.
- (iii) Accounts prepared in accordance with Ninth Schedule.

⇒ **Inspection and Audit :**

SEBI may appoint one or more persons as *inspecting officer* for following purposes :

- (i) Books of accounts maintained by Mutual Funds
- (ii) Provision of Act complied with.
- (iii) System procedure are adequate.
- (iv) Provision of Act or rules violated.
- (v) Investigate into complaints.
- (vi) Affairs are in interest of investors.

❖ **Requirement of Ninth schedule (Mutual funds)**

- (i) Mark all investments to market. Thus carry investments in B/s at MV.
- (ii) Dividend / Bonus to be recognized on the date when share is quoted on Ex-div / Ex-Bonus basis on S/E. & not on date of declaration.
- (iii) For interest bearing investments, interest income must be accrued on a day-to-day basis.
- (iv) For determining holding cost of investment, 'Average Cost' method is to be followed.
- (v) Transaction of purchase / sale of investment to be recognized as of trade date & not as of settlement date.
- (vi) Where interest on investment has been accrued & hasn't been received for 12 months beyond due date, provision, is to be made for income as accrued & no further accrual is made for such investment.
- (vii) For open ended scheme, difference between SP & FV of unit should be credited / debited to reserve. FV. Being credited to capital A/c. also treatment of equalization A/c is to be taken care of.
- (viii) For close-ended scheme, the par value of unit has to be adjusted to capital A/c & difference should be to reserves.
- (ix) Cost of I should include brokerage, stamp & any other direct charge.
- (x) Underwriting commission is recognized only if there is no development on the scheme. Where there is development, the full commission received should be reduced from the cost of investments.

❖ **General clarification**

Close Ended	Open Ended
1. Open only for specified period say 45 days in which public may subscribe.	1. Open every time. Any one can subscribe them any time
2. Traded in stock exchange.	2. Bought & sold by M.F itself
3. Weekly NAV	3. Daily NAV.
4. No such account	4. Equalisation A/c

AUDIT OF DEPOSITORIES

- ⇒ To maintain following records and documents :
 - (i) Record of sec. Dematerialized/re-materialised.
 - (ii) Transferor, transferee and date of transfer.

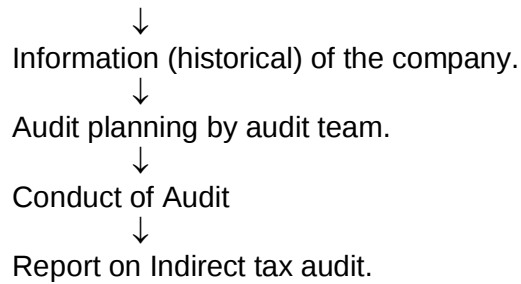
- (iii) Register of beneficial owner (B.O.).
 - (iv) Instruction received.
 - (v) Approval notice, cancellation or pledge.
 - (vi) Details of participants.
 - (vii) Details of securities eligible for DEMAT.
 - (viii) Other specified by board.
- ⇒ Intimate SEBI the place of maintaining records and documents.
- ⇒ Preserve for minimum 5 years.
- ⇒ If kept electronically, ensure integrity of system and precaution.
- ⇒ SEBI may appoint one/more inspecting officer for following purposes :
- (i) Ensure that books of accounts maintained by depository, participants, or agents.
 - (ii) Look into complaints.
 - (iii) Whether provision of Act, Bye-Laws, etc. being complied with.
 - (iv) Whether system, procedures followed.
 - (v) Affairs conducted in interest of investors or securities market.
- ⇒ Every issuer shall submit on a quarter basis, the details of changes in share capital during the quarter to the concerned stock exchange. It should be audited by a qualified Chartered Accountant or a practicing Company Secretary. It is submitted for the purpose of reconciliation of total issued capital, listed capital and capital held by the depositories in DEMAT form. It should also contain an updated status of register of members of issuer. Further, the issuer shall immediately bring to the notice of the depositories and the stock exchanges, any differences observed in its issued, listed and the capital held by depositories in dematerialized form.

AUDIT OF INDIRECT TAX

- ⇒ Conducted on behalf of Government.
- ⇒ For detecting and preventing tax evasion.
- ⇒ It is for use for -

Government	Industry & Service providers	Consumers
(i) Increased Revenue	(i) awareness of changes	(i) Better Tax compliance with reduced tax rates
(ii) Less cost of administration	(ii) Tax planning	(ii) Faith of general public
(iii) Complete self-assessment	(iii) Corporate governance	
(iv) Tax awareness	(iv) Good internal controls	
(v) Broader Tax Base		

Methodology : Evaluation of Internal Control.



SCOPE OF INDIRECT TAX AUDIT

- Non-availment of short/excess availment of Export Incentives.
- Goods imported duty with free or payment at concessional rates, subject to conditions classified incorrectly or without complying with the conditions.
- Transfer Pricing issues.
- Applicability of central excise and availability of exemption on the activity and the products.
- The valuation of goods not removed in normal course using valuation methods not in line with the central excise valuation rules.
- The utilization of goods procured on concessional duty for specific uses/for general uses.
- The availing of inadmissible cenvat credit and mis-utilisation of credit.
- The passing on of duty suffered on imported goods and of locally manufactured goods in excess of actuals.
- The structural rigidity built into the method of production or marketing and distribution.
- The authorization levels of the indirect tax function, not specifically set out in line with general authorization for the organization.
- Procedural non compliance which could lead to demands and losing of benefits.
- The liability under service tax on services provided being ignored.

EXCISE AUDIT 2000

- (i) All assesses → paying duty $\geq$ 1 cr. p.a.
- (ii) 10 lakhs $\leq$ duty < 1 crore. → once in two years.
- (iii) Duty < 10 lakhs → Maximum 20% of units on rotation basis.

PROCEDURE OF EXCISE AUDIT 2000

Selection of Assessee Risk factor. If bad track record then high priority.



Desk Review gather in formation about the assessee without interacting



Documenting Information questionnaire



Touring Visit the units of assessee to actual running.



Audit Plan list vulnerable areas, dynamic plan.



Verification conduct of actual audit on a scheduled date.



Audit objection and Audit Para if short/non payment. Discuss with assessee. Make objection but not of mere procedural lapse.



Audit Report He makes draft report. Discuss with superior officers. Then finalise.

- ⇒ Excise Audit 2000 good and participative audit. Auditor must be thorough about laws and having good accounts background.

ENERGY AUDIT

- ⇒ Activity that serves the purposes of assessing energy use pattern of a factory or energy consuming, equipment and identifying energy saving opportunities.
- ⇒ Energy Auditors to give recommendation.
- ⇒ Function of energy Auditor :
- (i) Quantify energy cost and quantity.
 - (ii) Correlate production to energy cost.
 - (iii) Energy database format.
 - (iv) Compliance of organization for policy aspect.
 - (v) Highlight areas needing attention.
 - (vi) Conduct preliminary and detailed energy audits.
 - (a) Data collection and analysis
 - (b) Measurements, mass and energy balances
 - (c) Reviewing energy procurement practices.
 - (d) Identification of energy efficiency projects and techno-economic evaluation.
 - (e) Establishing action plan including energy saving targets, staffing
 - (f) Recommendations on goal setting.
- ⇒ Audit team to have representation from various sections.
- ⇒ A standard of energy/p.u. to be derived then compared with actuals.

Methodology to Energy Auditing

a. Preliminary Energy Audit :

- (1) It typically involves two or three days of plan visit.
- (2) It is also referred to as walk-through audit.
- (3) One may rely on data supplied by the unit or personally read from meters installed in the industry.

- (4) In many instances, the meters installed in the industry do not show accurate reading.
- (5) Ideally, the energy auditor must carry proper portable instruments and make recommendations.

b. Detailed Energy audit :

- (1) It goes much beyond the quantitative estimates of cost and savings.
- (2) The scope of the audit assignment is discussed in detail with the plant personnel.
- (3) The study involves details examination of major energy consuming equipment.
- (4) The study proposes specific projects/feasibility study for replacement proposals, providing a cost-benefit analysis of the recommended measures.

ENVIRONMENTAL AUDITING

- ⇒ Disclosure of environmentally related data regarding environmental risks its impact, policy target, cost and performance, etc. to interested parties.
- ⇒ Multi-disciplinary thus conducted by a team of experts from various disciplines.
- ⇒ Mainly for Internal use.
- ⇒ Environmental Impact Assessment (EIA) is a pre-requisite to start an industry which forecast the expected damage to the environment and means required to mitigate the damage.
- ⇒ Its objective is to evaluate the efficiency of the utilization of resources and identifying the areas of risks and to control the generation of pollutants and waste, etc.
- ⇒ Following aspects should be considered :
 - 2. **Layout and design** : Adequate provision for pollution control measures, etc.
 - 3. **Management of resources** : It should be used in such a manner to produce best output and minimum waste.
 - 4. **Pollution Control System** : It should be in existence.
 - 5. **Environment Safety Measures** : like emergency plans, aware, etc. to meet the contingency.
 - 6. **Medical & Health care facilities** : Regarding workers.
 - 7. **Industrial Hygiene** :
 - 8. **Occupational health** : According to type of industry.
 - 9. **Information Assimilation and Reporting System** : Authorities and responsibilities should be clearly defined.
 - 10. **EIA Methodology** : Degradation of Environment and mitigatory measures should be suggested.
 - 11. **Compliance to Regulatory Mechanism** : To avoid penalty, etc.
 - 12. **Concern for the society** :

AUDIT REPORT FORMAT

- | | | |
|---|--|--|
| 1. Name, address, etc. | 5. Generation of hazardous waste in current and previous year. | 9. Additional proposal for environmental protection. |
| 2. Date of last EAR submitted | 6. Quantity of sold waste. | |
| 3. Consumption of input during current and previous year. | 7. Disposal practice for waste. | |
| 4. Pollution generated and types. | 8. Practice for conservation of natural resources | |

PEER REVIEW

- ⇒ In March 2002,
- ⇒ To assure that profession is conscious of its responsibilities and strive its best to ensure that highest standards are observed by all practicing members rendering audit and attestation services to the society.
- ⇒ In involve examination of the systems and procedures of the PU.
- ⇒ To ensure that in professional assignments, the member of ICAI.
 - (a) Comply with technical standard, and
 - (b) Have proper system to maintain quality of work.

PEER REVIEW

Stage-1 PLANNING	Stage-II EXECUTION	Stage-III REPORTING
1. <u>Empanelment of Reviewers:</u> The reviewer should be member of ICAI having at least 10 years audit experience (cumulative) & currently in practice. 2. <u>Intimation to practice unit:</u> In writing information of its selection for peer review alongwith a panel of 3 reviewers & a copy of the questionnaire. 3. <u>Initial communication by PU :</u> Choice of reviewer to board within 15 days from receipt of information . Within 1 month of receipt of intimation, send completed questionnaire along with complete list of client. 4. <u>Selection of sample Attestation service engagement:</u> Random basis for review. 5. <u>Confirmation of visit:</u> Reviewer in consultation with PU fix the dates for on site review to complete the peer review process in the four months of receipt of initial intimation to PU.	1. <u>Initial meeting:</u> between reviewer & PU to confirm the accuracy of responses to the questionnaire. 2. <u>Compliance Review:</u> that is independence, maintenance of professional skills and standard consultation, staff selection & supervision & office administration to understand working and control procedures of PU. 3. <u>Selection of Attestation services Engagements:</u> He may modify his initial sample selected for review in consultation with the PU at executions stage. 4. <u>Review of Records: Compliance & substantive approach:</u> Compliance procedure to know worthwhile ness of IC. Then he decided whether to rely on IC or not. In case of rely, his NTE of sub procedure will be less extensive & vice-versa. Compliance procedure not necessary if size of firm is small/ medium. He may adopt only sub procedure.	1. <u>Preliminary Report of Reviewer:</u> At end of review preliminary report to PU (before any report to Board) in case its system & procedure found to be deficient or where non-compliance has been noticed. No preliminary report otherwise. Report on latter head dated and reviewers signature, membership no. & reviewers code no. 2. <u>Reply to Preliminary Report:</u> In writing within 21 days from receipt of the preliminary report from reviewers. 3. <u>Interim Report of Reviewer:</u> If reviewer not satisfied with reply, interim report to Board. The Board recommend to PU & instruct the reviewer to carry out review again after 6 months to verify whether systems & d procedures have been modified appropriately. 4. <u>Final Report of Reviews:</u> If reviewer is satisfied with reply of PU. Final report should incorporate the findings.

Clause 49 of listing agreement (Corporate Governance)

It is the system by which companies are directed and controlled by the management in the best interest of the stakeholders and other ensuring greater transparency and better and timely reporting (financial).

Entity required to obtain a certificate from auditors for compliance of conditions of corporate governance. This certificate to be annexed to director's report and also sent to S.E. along with annual return.

1. **Board of Directors:** optimum combination of ED & non ED with at least 50% of BOD comprising non ED. If non ED chairman —→ At least 1/3 of Board comprise of independent directors else at least ½ of Board comprise of independent directors. Independent director is a non-ED, who fulfills all the following conditions -
 - (i) He shouldn't have (apart from receiving managerial remuneration any other material pecuniary relationship / transaction with the co., its promoters. Management / Subsidiary which (in judgment of Board) may affect independence of judgment of Board.
 - (ii) Not related to promoters or persons occupying management positions at Board level or at one level below the Board.
 - (iii) Not been executive of co. in proceeding 3 F.Y.
 - (iv) Not partner / executive (this year or Pr. 3 F.Y) of (i) Statutory /internal audit firm and (ii) legal / consulting firm having material association with co.
 - (v) Not a material supplier, service provider or customer or lesser / lessee of co.
 - (vi) He is not a substantial shareholder of the company owning 2% or more of block of voting shares.

Company agrees that all pecuniary relationship / Transaction of non ED vis-à-vis co. shall be disclosed in Annual Report.

2. **Audit Committee**

- Minimum 3 members (any director) with 2/3 independent.
- All members financially literate.
- Chairman independent director.
- Minimum no. of meetings in a year 4. One meeting before finalisation of A/c Maximum gap between 2 meetings is 4 months.
- Quorum—→2 members or 1/3 of members (higher) & out of which minimum of 2 independent director.
- Co. secretary shall act as secretary of A.C.
- A.C. to invite financial executive of co. in its meeting. However, they can meet without his presence too.
- A.C
 - (i) Will maintain liaison with Co. & auditor. Consider:
 - (a) Matter to be included in director's responsibility statement.
 - (b) Review functioning of whistle blower mechanism (if any).
 - (c) Review performance of statutory / internal auditors.
- AC Mandatorily review —→
 - (i) Management discussion & analysis of financial statements.
 - (ii) Statement of significant related party transaction.
 - (iii) Management letter / letters of IC weaknesses issued by statutory auditors.
 - (iv) Internal audit reports relating to internal control weaknesses.
- Appointment / Removal / Terms of remuneration of chief internal auditor.

3. **Remuneration of Directors:** Remuneration of non-ED decided by BOD, after obtaining prior approval of shareholders. If stock option to non-ED. Limit for maximum no. to be granted to non-

ED in one F.Y. & in aggregate to be disclosed alongwith disclosure of elements of remuneration package. Details of incentives, service contract in annual report.

4. **Board procedures:** Meeting 4 times a year with maximum gap 3 months between two meetings. Code of conduct for Board / Senior management laid by BOD. A director not to be a member in more than 10 committees or chairman in more than 5 committees across all companies in which he's is a director.

5. **Management:**

- (a) Management discussion & analysis report should form part of annual report.
- (b) Disclosure of all material transaction having personal interest, having potential conflict with interest of the company a large.

6. **Shareholder:** In case of Appointment / RE-appointment of a director, shareholders must be provided with its brief resume, nature of this expertise & names of companies in which he holds directorship.

- (a) Shareholders: Information like quarterly results to be put on companies web-site or on S.E's site.
- (b) Shareholders: Board committee under chairmanship of non-E.D to look into redressing of shareholders & investors complaints.
- (c) Shareholders: To expedite the process of share transfer this work to be delegated to an officer or share transfer agent.

7. **Subsidiary Company:**

- (i) At least one independent director of holding company shall be a director in material non-listed Indian subsidiary company.
- (ii) AC of holding shall review the financial statement (particularly investment) by unlisted subsidiary company.
- (iii) Minutes of Board meeting of unlisted subsidiary company to be placed at board meeting of holding co.

8. **Disclosures:**

- (i) Statement on transaction with related parties in ordinary course of business/not in ordinary course of business to be placed before A.C.
- (ii) Details of transaction with related parties or other not on arms length to be placed before A.C. with management justification.
- (iii) Financial Statement to disclose (with management explanation) A/C treatment difference from A/C standard.
- (iv) Procedure to inform Board risk assessment & its minimization procedures.
- (v) Company to disclose Audit Committee (quarterly) use of funds raised through issue.
- (vi) Criteria for making payment to non-ED.

9. **CEO / CFO Certification :** The CEO and the CFO or any other person heading the finance function discharging that function shall certify to the Board that :

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - i) These statements do not contain any materially untrue statement or omit any material fact.
 - ii) These statements together present a true and fair view of the company's affairs.
- (b) There are no transactions entered that are fraudulent, illegal and violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls.
- (d) They have indicated to the auditors and the Audit committee

- i. Significant changes in internal control during the year;
- ii. Significant changes in accounting policies during the year.
- iii. Instances of significant fraud.

10. Report on Corporate Governance :

There shall be separate section on Corporate Governance in the Annual Reports of company with a detailed compliance report on Corporate Governance.

11. Compliance : The Company shall obtain a certificate either from the auditors or practicing company secretaries regarding compliance of conditions of corporate governance.

Clause 49 of Listing Agreement	Section 292A of the Companies Act, 1956
1. (a) For entities seeking listing for the first time, at the time of seeking in principle approval for such listing.	Every public company having minimum paid up capital of rupees five crore, shall constitute an audit committee immediately on the enactment of Companies (Amendment) Act, 2000. i.e., with effect from December 13, 2000
(b) For existing listed entities which were required to comply with Clause 49 which is being revised, i.e., those having a paid up share capital of Rs.3 crores and above or net worth of Rs.25 crores or more at any time in the history of the company, by April 1, 2005.	
2. The audit committee having minimum three directors as member. Two thirds of the members of audit committee shall be independent directors.	The audit committee shall have minimum three directors of which two-third of the total number of such directors shall be directors other than managing or whole time directors
3. The Chairman of the Audit Committee shall be an independent director	The members of the Audit Committee shall elect a Chairman for amongst themselves.
4. A representative of the external auditor, when required shall be present as an invitee for the meetings of the Audit Committee	The auditors shall attend and participate at meetings of the audit committee.

AUDITING UNDER VAT

1. VAT is a tax on the value added to the commodity at each stage in production and distribution chain.
2. VAT is an indirect tax on consumption.
3. The total amount of tax, which is to be collected at the final, or retail point of sale, is collected in instalments.
4. Major states who have introduced VAT have generally incorporated audit provisions in their VAT legislation.
5. Section 61(1) of the Maharashtra Value Added Tax (Levy and Amendment) Act, 2005, requires the dealers, having sales or purchases exceeding Rs.40 lacs, to get their accounts audited by a Chartered Accountant.
6. The following steps required to be taken by the auditor while auditing under VAT.
 - (a) *Knowledge of Business* : The auditor should refer AAS – 20 'Knowledge of the Business' issued by ICAI. The auditor to obtain preliminary knowledge of the industry and of the nature of ownership, management and operation of the entity to be audited. The knowledge of business is important not only to the auditor but also to his staff engaged in the audit.
 - (b) *Knowledge about the VAT Law and Allied Laws* : The auditor and his staff should obtain a detailed knowledge of the State VAT law under which the audit is to be conducted. The auditor should study the VAT law starting from the definition of various terms, the procedure to be adopted.

- (c) *Ascertaining the Major Accounting Policies Adopted by the Auditor* : The auditor should know the major accounting policies based in which, books of accounts have been recorded.
- (d) *Evaluation of Internal Control* : Before determining the extent of audit checks to be applied, i.e. whether to go in-depth or to do only test check, the auditor should ascertain whether there is an internal check system in operation in the entity.
- (e) *Obtaining the list of all the Accounting Record Maintained by the Auditor* : The auditor should obtain a complete list of all the accounting records relating to sales/purchase of goods.

AUDIT PROGRAM

- i. The turnover of sales/purchases of goods has been properly determined. The sales turnover arrived at by applying the generally accepted accounting policies may not be the same as required under the VAT law.
- ii. The turnover of purchases should be tested to enable the auditor to get the purchases eligible for grant of input tax credit segregated from other purchases.
- iii. The auditor is expected to list out the due dates of filing of returns and find out the reasons for delay in filing the returns, if any.
- iv. The auditor should apply tests as will enable him to ascertain whether the auditee is eligible for composition.
- v. The auditor may also be expected to check the consolidation of the returns filed for all the periods covered in the year under audit.
- vi. The auditor should check whether all the transactions relating to sale and purchase are entered in the books of account and have been taken into consideration while filing the returns.

AUDIT REPORT UNDER THE VAT LAW

At the end of the audit the auditor has to arrive at his conclusion on the matters to be reported in the audit report. The format of the audit report is generally prescribed under the relevant VAT law and the auditor has to fill in all the columns of the audit report that are applicable. His opinion is on the adequacy of accounting records, correctness and completeness and arithmetical consistency of returns filed.

AUDIT OF MEMBERS OF STOCK EXCHANGE

- ☞ Every active member shall get his accounts audited by a chartered accountant.
- ☞ Company can also become a member of stock exchange.
- ☞ SEBI may levy monetary fine & penalties on any person in following cases:
 - (i) Failure to furnish document information etc. required by Board
 - (ii) Failure to maintain books of accounts/returns.
 - (iii) Failure by sponsor of any collective investment scheme including M.F. to obtain registration certificate. To comply with terms of such certificate, to dispatch unite certificate, to refund application money, to invest money in desired manner & in specified securities.
 - (iv) Failure to Issue contract notes in form required, to deliver security, make payment to client, charging excess brokerage.
 - (v) Failure to enter into agreement with client.
 - (vi) Person dealing/communicating on basis of price sensitive information.
 - (vii) Failure to disclose aggregate of shareholding in body corporate before acquiring furthers share & to make public announcement to acquire share at minimum price in case of takeovers.
- ☞ Business at S.E. can be transacted only by its members. They enter into transaction either on their own behalf or their clients or sub-brokers.

MARGIN

1. Due to wide fluctuations in prices of securities over a period of time, the exchange levies margin on its members.
 2. This certain deposit is to be kept with exchange by its members.
 3. This mechanism is adopted, in order to restrict excessive speculations and safeguard the interest of the investors.
 4. The members are required to collect margins from their clients and deposit it with the clearing house of exchange.
 5. The three types of margins are –
- 1. Volatility Margin :**
 - (a) The volatility margin is imposed to curb excessive volatility in the securities.
 - (b) It is also used to prevent building up of excessive outstanding positions.
 - (c) This margin is calculated at the discretion of stock exchange to charge margin on any particular security because of its volatile nature, on specific percentage.
 - 2. Gross Exposure Margin :**
 - (a) It is the percentage of net cumulative outstanding position in each security that the member should keep with the exchange at all times.
 - (b) This margin is calculated on continuous basis.
 - (c) This margin is to be kept with stock exchange in advance.
 - (d) Gross exposure is calculated on all securities unlike volatility margin which is on any specific security.
 - 3. Mark to Market Margin :**
 - (a) This margin is imposed to cover a loss that a member may incur in case the transaction is closed out at the closing price of the trading day, which is different from the price at which the transaction has been entered into.
 - (b) It is the notional loss if net cumulative outstanding position in all the securities were closed out at closing price of relevant transaction date, for a specific member.

TYPES OF MARKET

There are four types of market.

- I. **Normal Market** – All orders which are of the regular lot size or multiples thereof are traded in the Normal Market. For D-mat shares, lot size is 1 share.
- II. **Odd lot Market** – An order is called an odd lot order if the order size is less than the regular lot size, such orders are traded in the odd lot market. But for order matching both price & quantity should tally with each other.
- III. **Spot Market** – in all respects spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-à-vis normal orders. Pay in pay out takes place on the same day.
- IV. **Auction Market** – Stock exchange on behalf of their members initiate auctions to purchase from the market, the number of shares short deposited by the members. In this way, they complete the settlement process. Loss is recovered from members but profit is any deposited to investors education & protection fund.

TYPES OF ORDER BOOKS

As has been explained above, a member has various options regarding the type of order he wants to place. When an order is received it is given a unique number and a unique time stamp. In case, an order could not be matched, then they are stored in a different book in price – time priority in the following sequence.

- Best price
- Within price, by time priority.

Thus when two orders are entered at the same time the one with a better price gets priority. Similarly, in case two orders were entered at the same price; the one which was entered earlier gets priority.

The following types of books are maintained in the Capital Market

- i. **Regular Lot Book** – This book contains only regular lot orders and order do not have any of the following attributes attached to them.
 - All or Non (AON)
 - Minimum fill (MF)
 - Stop Loss (SL)
- ii. **Special Term Book** – All the orders, which have any of the following attributes, are recorded in this book. They are –
 - All or NON (AON)
 - Minimum Fill (MF)
- iii. **Stop-Loss Book** –
 - ☞ Stop loss orders are stored in this book till the trigger price is reached or surpassed.
 - ☞ When the trigger price is reached or surpassed, the order is released in the regular lot book.
 - ☞ The stop loss conditions are met under the following circumstances.
 - **Buy order** – a buy order in the stop loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.
 - **Sell order** – a sell order in a stop loss book gets triggered when the last traded prices in the regular market reaches or falls below the trigger price of the order.
- iv. **Odd Lot Book** – The odd lot book contains all orders with lot size lesser than the marketable lot.
- v. **Spot Book** – The spot book contains all orders having different settlement periods only. The system attempts to match an active spot order with a passive spot order in the book.
- vi. **Auction Book** – Auction Book contains orders that are entered for all auctions.

ORDER MATCHING RULES

- (i) The best buy-order is matched with the best sell order.
- (ii) It is obvious that a seller would like to sell at the highest available price.
- (iii) Thus, the best buy-order is the one with the highest price.
- (iv) At the same time, a buyer would like to buy at the lowest available price.
- (v) Thus the best sell-order is the one with the lowest price.
- (vi) Thus the trading system tries to find for the seller the best possible buying price and the best possible selling price for the buyer.

Order Matching Rule

Buy		Sell	
Qty	Price	Qty	Price
500	38.90	200	39
400	38	500	40
100	37	700	41
1000	36	200	41.50
300	35.50	1000	42
Best price (Buy) highest		Best sell (lowest price)	

- (vii) Orders that match with other orders are called 'active' orders while those, which do not match, are called 'passive' orders.
- (viii) The system always matches orders with passive orders in order to clear earlier orders on priority basis.

Order Conditions: The order matching conditions fall into three categories

- i. Time Related conditions
 - ii. Price related conditions
 - iii. Quantity related conditions
- i. **Time Related Conditions**
 - a. **Day order** – A day order is valid only for the day on which it is entered. It gets automatically cancelled if not matched by the end of the day.
 - b. **Good till cancelled order** – A GTC order remains in the system until it is cancelled by the trading member. The maximum number of days for which a GTC order is valid is notified by the concerned stock exchange.
 - c. **Good Till Days/Date order (GTD)** – In such orders the trading member specifies the days / date up to which the order shall remain valid. The stock exchanges specify the maximum permissible term of such orders.
 - d. **Immediate or Cancel orders (IOC)** – An IOC order allows a member to buy or sell a security as soon as the order is released into the system, failing which the order is cancelled. If it is partially matched remaining quantity is automatically cancelled.
- ii. **Price Related Conditions**
 - a. **Limit Price order** – An order where the trader specifies his offer price is called a limit price order.
 Buyer – Max price up to which he is willing to pay.
 Seller – Minimum price is which he ready to sell.
 - b. **Market price order** – An order to buy and sell securities at the best market price at the time of placing the order.
 - c. **Stop loss price order** – Stop loss price orders get activated when the market price reaches or crosses a threshold price specified in the order (*refer stop loss book*).
- iii. **Quantity Related conditions**
 - a. **Disclosed Quantity Order (DQ)** – A DQ order allows a trading member to disclose only part of the order quantity to be displayed. For example in a buy order for 500 units only 100 units will be disclosed, when these are purchased the buy order for the next 100 units are disclosed to the market.

- b. Minimum fill orders (MF)** – Minimum fill orders allow the members to specify the minimum quantity by which an order should be filled.
- c. All or None order (AON)** – All or none orders allow the members. Put the order into market with the condition that only whole quantity should be matched.
- d. Short Sell** – The seller sells the shares even if he doesn't own them. These are speculative order (for bear). In this case, the orderer anticipates a decline in the price of shares. However, it is risky as he has to square up the transaction within the day.

SETTLEMENT SYSTEM AT STOCK-EXCHANGES

- There are two types of settlement systems that can be adopted in stock exchanges – Accounting period system and rolling settlement system. Now-a-days, stock exchange in India adopts rolling settlement only.
- a. Accounting period settlement systems -**
 - There is a predetermined period of usually 7 – 12 days, over which total trades are aggregated.
 - Cumulative net obligations of each member are calculated on last day of cycle.
 - It is more speculative than the rolling settlements. It may lead to payment crisis in case of wide fluctuations in the market.
- b. Rolling Settlement**
 - ☞ Each day constitutes an accounting period and that days traders are settled after 2 – 3 days.
 - ☞ (T + 3) rolling settlement was in operation in India upto 31st March, 2003, which was switched on to “T+2” rolling settlement system from 1st April, 2003.
 - ☞ Trades o/s at end of day are to be settled with ‘X’ business day from transaction.
 - ☞ T+2, transaction on Monday pay in & pay out takes place on Wednesday.
 - ☞ Trades on each single day settled separately from trades done earlier or subsequent trade days.
 - ☞ Netting of trades is done only for the day & not for multiple days (as earlier in settlement period).
 - ☞ It adopts VAR (Value at Risk) based margining approach.
 - ☞ If member fails to deliver shares sold the exchange conducts an auction session on T+3 to meet short fall due to non-delivery.

Derivatives

- ☞ It has two mechanism futures & options.
- ☞ Contracts are available for trading with one months & three months expiry.
- ☞ TM (Trading member) & CM (Clearing member)
- ☞ CM – (i) TM – CM (Both)
(ii) PCM (professional CM)
- ☞ Premium is paid on entering each option.
- ☞ Trading in index options also available.

AUDIT OF ACCOUNT

All active members of stock exchanges are required to get their accounts audited by a Chartered Accountant. Active member is any member who has conducted business in securities even for a single day in the year.

Books of Accounts and other Documents Subjected to Audit

A member holding membership of many stock exchanges or different segments of same exchange (derivatives/capital market segment), he has to maintain separate records and documents with respect to each exchange or each segment.

A member of the exchange is required to maintain the following books of accounts –

- Register of transactions / Sauda Book
- Clients ledger
- General ledger
- Journal Register
- Cash Book
- Bank pass book
- Documents (received / delivered) register
- Members contract book showing details of all contracts entered into by him with other members of the same exchange.
- Counterfoils or duplicates of contract notes issued to clients.
- Written consent of clients to the contracts entered into as principals.
- Margin deposit book.
- Register of accounts of sub brokers.
- Copies of agreements with sub-brokers.
- Copies of margin statements down loaded from the exchange.
- Details of spot delivery transactions.
- Client's database and member client agreement.
- Copy of registration certificate of each sub-broker.
- Copy of the power of attorney / board resolution authorizing the directors / employees to sign the contract notes.
- Copies of pool account statements.

Audit Procedures

1. Daily Transactions List (Sauda Book)

This is the basis record maintained by the member containing details of all transactions entered by them on a daily basis. It contains information on

- Name of the client
- Securities traded on behalf of client
- Rate and quantity of securities bought and sold.

Daily transaction register contains a record of all the following categories of transactions

- i. Member's own business on the exchange
- ii. Member's business on behalf of his clients
- iii. Member's business with his clients on a principal to principal basis
- iv. Member's own business with member's of other stock exchanges
- v. Member's business on behalf of his clients with members of other stock exchanges
- vi. Spot transactions

2. Contract Notes

Every member of the stock exchange has to issue contract notes to its clients for all business executed on their behalf within 24 hours of the execution. In reference to contract notes, the auditor should ensure that

- i. Contract notes are serially numbered
- ii. These are in the format prescribed by relevant exchange.
- iii. Brokerage has been charged within specified limits and shown separately
- iv. Ordering time should be reflected on contract notes along with the time of execution of order.
- v. Member/authorized signatory should sign contract notes.
- vi. Brokerage, Service tax & security transactions tax shown separately.

3. Client bills

- (i) It contain summary of all trades executed on behalf of the client during a period.
- (ii) It shows the net amount receivable from or due to the client.
- (iii) The auditor should ensure their proper postings.

4. Clients ledger

It contains transactions with each client. The auditor should examine

- i. Transactions remaining unsettled for a long time.
- ii. Whether amounts received from clients is consistently different from the contract bills.
- iii. That amounts received or paid as loans or deposits have not been passed through client's ledger.
- iv. Confirmation of balances received from clients of the member.

5. Settlement / Vallan control account

(a) It shows the net amount receivable from or payable to the exchange or clearing house.

(b) The auditor should verify that balance in this account is nil after settlement.

(c) If not reconciliation should be obtained.

6. Margin Deposit Book

It records the margin deposited by the member with the Clearing house.

The auditor should check

- i. Whether margin has been in accordance with SEBI guidelines.
- ii. The margin statement downloaded from the stock exchange / clearing member should be verified.
- iii. Whether margins have been properly calculated, collected and paid
- iv. Any exemptions from deposit of margin for particular trades available to the members

7. Member's own Trading Account

(a) The auditor should verify the entries with the bills raised for trading on own account.

(b) He should also ensure that there is a proper system for revenue recognition and closing stock from such transactions.

(c) No brokerage is charged on this account.

8. Bank book

The member holds a fiduciary position in the security trading system and hence certain restrictions are imposed on the operation of the bank account in respect of his clients. According to these restrictions –

A. No money be paid into clients account other than

- i. Money held or received from clients
- ii. Money for replacement of withdrawal by accident from such account.

C. No money can be paid from clients account other than

- (i) Settlement with the client
- (ii) Payment to clearing house on behalf of client
- (iii) Money for replacement of deposit by accident into such account.

9. Documents Register / (Inward / Outward) Register

It contains particulars of securities including their distinctive numbers received from or delivered to the client in physical form. With regard to documents register, the auditor should check

- i. Balance of stock as shown in deposit register segregated into client stock and own stock.
- ii. The reasons for client's stock remaining with the member for a long time.
- iii. The auditor should also physically verify the stocks.

10. Dematerialized securities

(a) Now-a-days, most of the securities have been converted into dematerialized form because of benefits of electronic trading system.

(b) Under this system, each member has to maintain two demat accounts.

(c) One of these is used to hold its own securities and known as "Beneficiary Account".

(d) The other one, 'Pool Account', is meant for trades executed on behalf of clients.

(e) The securities meant for sale are transferred to the 'Pool Account' from where these are given to the clearing house on the relevant pay in day.

- (f) The audit procedures should include
- i. Whether securities received in pool account have been transferred to client's Demat Account within 48 hours.
 - ii. Reasons for holding a particular security in pool account for an unreasonable time.
 - iii. Ensuring that securities lying in pool account have not been used to settle member's own trade obligations.

Audit Report:

- (i) We have audited B/s & P&L a/c of
- (ii) Obtained all information & explanation
- (iii) Proper books of a/c & records specified by securities contracts (regulation) rules are kept.
- (iv) Broker complied with requirement of exchange. So far as they relate to maintenance of a/c & was regular in submitting req. information to S.E.
- (v) In our opinion & to best of our information ... (true).

Matters to be considered by SEBI while granting registration to a prospective stockbroker:

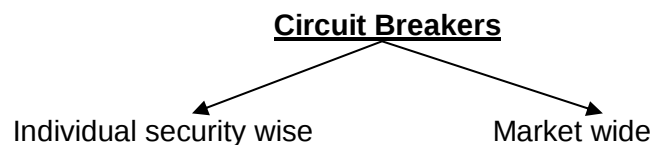
1. Is eligible to be admitted.
2. Has necessary infrastructure.
3. Has past experience in business of securities.
4. Is not subjected to in disciplinary proceedings by stock exchange.

Hit or take orders

- (i) These are a variations of market orders.
- (ii) Faster order execution.
- (iii) For the quantity specified, the system attaches the counter touchline price to it.
- (iv) The order will be matched while all unexecuted orders of this type are automatically killed.

Bought out deals

- (i) Companies may place its equity intended to be offered to be public with a sponsor member at a mutually agreed price through the Concept of Bought out deal.
- (ii) Thus after buying out the total equity. Sponsor member would sell the shares of the company to the public through "offer for sale".
- (iii) It ensures faster availability of funds to the company for timely completion of its projects and also a listed status on a later date.



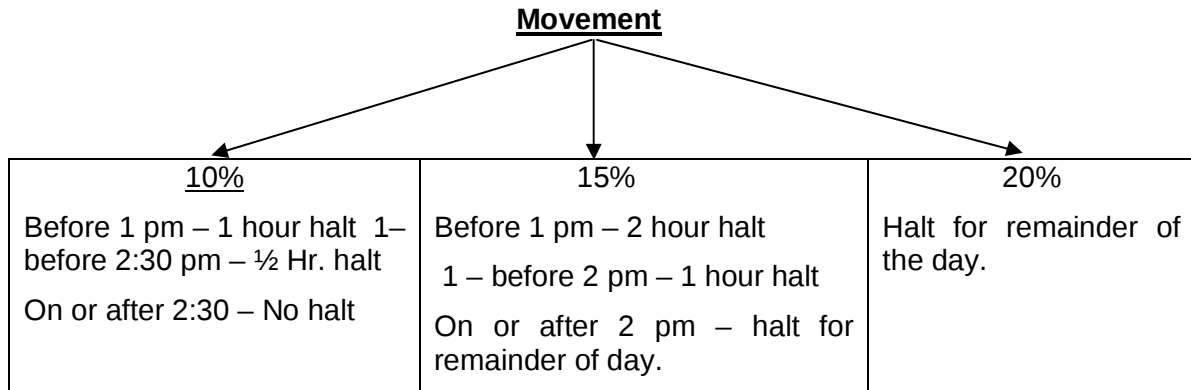
1. In securities:

- (a) To curb excessive volatility.
- (b) May be 2%, 5%, 10% or 20% based upon categories of shares.
- (c) It is calculated w.r.f closing price of previous trading day.
- (d) For example, if on 13-06-2005 the closing rate of AFTEC INFOSYS is Rs. 100 the price band in case of 20% circuit breaker is 80 (Lower freeze) and 120 (upper freeze).

2. Market wide C.B.

- (a) W.e.f 02-07-2001.
- (b) 3 stages of index movement 10%, 15% and 20%
- (c) It brings about trading halt in market nationwide (all markets)

- (d) The % are calculated into absolute points of index variations on quarterly basis, based upon closing index of last day of trading in a quarter.
- (e) So far only twice in Indian history
- (f) 17th May, 2004 **[Black Monday]**
22nd May, 2006



Depending upon time of index movement & its percentage trading may be halted for specified time period.

Depositories and Dematerialisation :

- (a) NSDL & CDSL keep record of ownership of securities electronically in book entry form.
- (b) Transfer of ownership of securities is done by simple account transfers.

Advantage :

- (I) Liquidity of scripts (immediate transfer and register)
- (II) Receive bonus and right as direct credit to A/c.
- (III) Much lower risk of bad deliveries.
- (IV) Saving of stamp duty.
- (V) Saving of courier charges.
- (VI) No physical certificates (no risk of getting them misplaced)
- (VII) Reduction in brokerage.
- (VIII) Easy settlement with clearing house.

Clearing and Settlement Mechanism

1. The securities pay-in obligations of members are downloaded by the clearing agency.
2. The members make available the required securities in their pool accounts with Depository Participants (DPs) by the prescribed pay-in time for securities.
3. The depository runs an electronic file to transfer the securities from the pool accounts of members with DPs to the DP account of the clearing agency.
4. The securities are transferred on the pay-out day by the depository from the DP account of the clearing agency to the DP accounts of members.
5. Select banks have been empanelled by clearing agency for electronic transfer of funds.
6. The members are informed electronically of their pay-in obligations of funds.
7. The members make available required funds in their accounts with clearing banks by prescribed pay-in day.
8. Same way, funds are transferred on the pay-out day by the clearing banks from the account of the clearing agency to the accounts of members.

MANAGEMENT & OPERATIONAL AUDIT

MANAGEMENT AUDIT :

“M.A. concern itself with whole field of activities of concern, from top to bottom, primarily concerned with whether the general management is functioning smoothly and satisfactorily.” *T.G. Rose*

- ⇒ It is *audit of management*.
(Management Audit = Op. audit + Review of adequacy and competence of top management).
- ⇒ Primary accent is on evaluating manager's ability to manage.

Scope of Management Audit

1. Purposes of organization.
2. Management Structure.
3. Reports required by the management.
4. Internal controls.
5. Nature of production of Business.
6. Production planning.
7. Factory layout, design and installed capacity.
8. Personnel policy.
9. Material management.
10. Sales management.
11. Decision making process.
12. Books and Records.
13. Financial Managements.

Thus, management audit includes all the elements of op. audit also.

Need / Desirability of Management Audit

1. **For detecting and overcoming current problems** – Managerial problems and related operational difficulties can be spotted before their adverse effects. This is thus forward looking approach.
2. **It is another tool to assist the organization in accomplishing desired objectives** – Management Audit questionnaire pinpoint the important problem areas. Thus corrective actions can be taken so that organizational objectives can be achieved with utmost efficiency.
3. **Helpful for ailing industries** – Management audit is helpful in detecting the problems of such industries and providing the suggestion to improve them. It becomes more important if such industries are to be taken over by government etc.
4. **Public sector undertakings** – In such PSUs mostly problems occur because of poor management which may be improved by conducting management audits.

Organising Management Audit

- (1) Devising statement of policy.
- (2) Location of audit function within organization or outside
- (3) Allocation of personnel.
- (4) Staff training program.
- (5) Time and other aspects.
- (6) Frequency.

Conducting Management Audit

- ⇒ Getting facts through interview.
- ⇒ Measuring performance through Management Audit questionnaire.
- ⇒ Concluding it.
- ⇒ Oral recommendation for improvement.

Management Audit Reports

- (1) **Oral Reports** : emergency wants. However not considered reliable. No permanent record but corrective steps can be taken immediately.
- (2) **Interim written report** : If it is advisable to inform management before regular report for their early consideration.
- (3) **Regular written reports** : formal report at end of work, may be short or long.
- (4) **Summary written report** : “Flash” reports summarizing various individual reports. For top management. Integrated approach. It facilitates management by exception because management (top) has not time to go through those lengthy individual reports.

Organisation of written report

(1) Format :

- (i) Title
- (ii) Objectives.
- (iii) Scope.
- (iv) Findings, conclusions and opinions.
- (v) Recommendations.
- (vi) Auditee’s view.
- (vii) Summary.

Behavioural Aspects in Management Audit

Financial auditor deal with figures, Management auditor with people.

- ⇒ Colleagues in own department.
- ⇒ Staff of auditee department
- ⇒ Top management.

Causes :

- 1) **Staff / line conflict** : Management Auditors are staff, thus line unhappy.

Reasons

- (i) Normally staff has superiority complex they don’t wanna understand line considering it to be inferior.
 - (ii) Staff may give irresponsible advice without judging its feasibility.
 - (iii) Line doesn’t co-operate with staff.
 - (iv) Line doesn’t provide sufficient information to staff.
 - (v) Line doesn’t use staff advice property.
 - (vi) Staff has fault finding advice.
 - (vii) Staff doesn’t consider line before advising.
- 2) **Control** : Auditee fear that his actions will have adverse effect on top management. They have → fear of criticism, → fear of changes and → punitive actions due to – (i) insensitive audit practices and (ii) Hostile audit style.
 - 3) **Changes** : Resistance to changes. Auditor’s recommendation for changes to which auditee resists.

Solution to such problem

1. For constructive benefit.
2. Maximum service.
3. Minimum interference with regular op.
4. Officers should be informed and review findings with them before submission of formal management audit report to top management.
5. Trust and friendly atmosphere.
6. Constructive criticism.
7. *Reporting Methods* : Participative. Suggest with those who have to implement them.
8. Right management culture, good auditee and right auditor.

Three cases

1. Auditor Objective
Auditee Offensive
Management indifferent.
2. Auditor cantankerous
Auditee progressive.
Management indifferent.
3. Auditor progressive
Auditee participative.
Management objective.

Management Audit / Operational Audit

“*Management audit* would concern itself with whole field of activities of concern from top to bottom primarily concerned with whether general management is functioning smoothly and satisfactorily.”

- T.G. Rose

“*Operational Audit* is undertaken at the instance of management for providing it with information and appraisal of operations and activities.”

<i>Management Audit</i>	<i>Operational Audit</i>
⇒ Audit of Management	⇒ Audit for management
⇒ Wider	⇒ Narrow
⇒ Quality of Managing	⇒ Quality of operational effectiveness

Types of operational Audit

1. **Functional Audits:** Functions are means of categorisation of activities of a business. It deals with functions of an organisation. Function audit requires specialisation by auditor. For e.g.:- production, payroll.
2. **Organisational Audits:** To emphasis how efficiently & effectively functions interact.
3. **Special Assignment:** At the request of Management For e.g.:- causes of ineffective IT system.

Differences between Financial / Operational Auditing

1. **Purpose:** opinion on financial information / effectiveness & efficiency of operations.
2. **Area:** only financial statements / all activities
3. **Reporting:** to all shareholders, bankers / to management.
4. **End Task:** reporting / suggestions.

Financial	Operational
1. Opinion on financial information.	1 Opinion on effectiveness & efficiency of operation
2. Only financial information	2 All activities
3. Report to shareholders	3 Report to management
4. It ends in report	4 It ends in report including suggestions
5. By C.A	5 By team of expert
6. By independent	6 May be by is house team
7. Compulsory	7 Optional
8. Yearly	8 It depends
9. Old concept	9 Comparatively new approach

Need for Operational Audit because –

- (1) Executives → no time to collect information and locate problems. Preoccupied with their own problems.
- (2) Managers generally relied upon.
- (3) Information transmitted by managers → biased.
- (4) Conventional nature of internal audit report and mechanical nature, as it does not provide recommendations.
- (5) Other reports (performance) → own limitation.
- (6) Operation of control → no idea of environmental condition. Whereas the operational auditor is always supposed to be open-minded.
- (7) Survey → costly, time consuming.

Objectives of Op. Audit

1. **Appraisal of control** – Internal controls provide the essential means to ensure proper performance in each functional or organizational area for accomplishing the desired organizational objective. Operational auditing deals with the administrative controls and its purpose is to determine whether the controls are adequate.
2. **Evaluation of performance** – During performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards.
3. **Appraisal of objectives and plans** – Though controversial, one school of thought holds that operational auditing can be stretched to evaluate management objectives and plans. If the management policy favours installation of controls, controls would have to stay within the policy frame. Therefore, the basic things that should be evaluated is management policies, plans and objectives.
4. **Appraisal of organization structure** – Organisational structure provides the line of relationship and delegation of authority and tasks. This is also another important area for appraisal by the operational auditor.

Internal Auditing & Operational Auditing

“Internal Auditing is an independent appraisal activity within an organization for review of operation as service to organization.”
Institute of Internal Auditors. N.Y.

- ⇒ Aforesaid definition equals Internal and Operational Audit.
- ⇒ Operational Audit is not different from internal Auditing, it is merely an *extension* of Internal auditing into operational area.”
Cadmus.

Difference between the two

A. Perception :

Traditionally, Internal auditors appraised financial and A/c. controls. But gradually started covering non-A/c. control as well. However, approach is to examine the same from monetary point of view only. For e.g. → To Internal auditor loss of Rs. 1,000 because of wrong totaling is important but for operational one, carrying of maintenance program of machine is more important. Thus, difference in approach. While the Internal auditor's approach (Traditional) is about monetary / Quantitative terms. Operational Auditor give more importance to the qualitative aspect (viz. attending to customers complaints, etc.).

B. Issues : According to few, area of operational audit is young while Internal audit is old concept. Extension of scope of operational audit to recommendation of specific changes. As per Lindberg & Cohn, operational auditors shouldn't involve in installing systems and controls of operational areas whose audit they're expected to perform. Same way, as per Institute of Internal Auditors. Internal auditor should also be completely objective in his approach. Thus, we can understand operational audit as an extension of internal auditing with definite work content stretching beyond traditional field of internal auditors (*financial A/c.*) Every aspect of operational audit, however, is towards management policies, management objects and goals only.

C. Objectives : Operational auditors try to verify fulfillment of plans and other requirements and focus on objectives and their achievement. Having good knowledge of business aspects. Open minded, well acquainted with performance yard-sticks, which he apply with suitable adjustments. Now, the modern definition of Internal auditing is broad enough to embrace the areas covered by operational auditing as well.

REVIEW OF SYSTEMS AND PROCEDURES

Systems – System is defined as a set interrelated components which work together to accomplish a common objectives.

Procedures – Procedures are the means by which policies are implemented. Procedures entail the use of documents in accordance with precise instructions or methods to be used. Standard procedures facilitate control of business operations.

Review of Systems and Procedures – The review of systems and procedures is undertaken to improve the methods, to get away from the old ways and traditional routines and to reduce the cost in completing the processing the paper work – eliminating waste, duplication and inefficiencies.

The important thing in the evaluation of systems and procedures is to make sure that they are designed to produce the desired results in the context of activities / operation of the organization. All deviations must be called to the attention of different levels of management depending upon the importance of seriousness of deviations.

The evaluation of a system or procedure actually includes three separate considerations. First, is the system of procedure meeting all of the current requirements? Second, is it operating effectively? and third, what is the degree of effectiveness? To determine whether a system or procedure is meeting current requirements, the following among other things, should be considered :

- i. Is the system or procedure designed to promote achievement of the company's objectives, and is it accomplished effectively?
- ii. Does the system or procedure operate within the framework of the organizational structure?
- iii. Does the system or procedure adequately provide methods of control in order to obtain maximum performance with the least expenditure of time and effort?
- iv. Do the routines designated in the system or procedure indicates performance in logical sequence?

- v. Does the system or procedure provide the means for effective coordination between one department and another?
- vi. Have all required functions been established?
- vii. Has the necessary authority been designated to carry out responsibilities?
- viii. Can any changes be made to improve effectiveness?

Management Audit Questionnaire

Manufacturing including Purchasing function	Marketing	Personnel
(i) Manufacturing overview	(i) Marketing overview	(i) Personnel overview
(ii) Production planning	(ii) Sales	(ii) Manpower planning
(iii) Production	(iii) Mark of research	(iii) Industrial Relations
(iv) Inventory	(iv) Advertising	
(v) Purchasing	(v) Physical Distribution	

For each of sub heads following points must be mentioned:

- (a)** Long-range plans
- (b)** Short or medium range plans
- (c)** Organizational structure
- (d)** Leadership
- (e)** Communication
- (f)** Control.

INVESTIGATIONS

INVESTIGATION AND AUDIT

Investigation implies systematic and critical examination of accounts and record of a business enterprise for a specific purpose. The specific purpose may be evaluation of state of affairs or establishing of a fact

AUDIT	INVESTIGATION
1. General	1. Specific
2. Opinion	2. Fact
3. No doubt	3. Doubt
4. 1 year	4. No fixed period
5. St. requirement	5. It depends
6. C.A	6. Any person

STEPS IN INVESTIGATION

1. Determine scope/objectives of Investigation
↓
2. Formulate Investigation programme.
↓
3. Examine/Study various records.
↓
4. Analysis, interpretation of finding
↓
5. Preparation of report.

Special Issues in Investigation :

1. Whether investigator to undertake *100% / Selective verification* :
It depends on circumstances. For cash defalcation (100%) / Profitability (selective basis).
2. Whether he can put *reliance on audited statements* :
It depends. If doubt in audited statement, then no reliance but for amount of g/w, he may rely for selective information.
3. For obtaining *opinions of experts* :
Get the written consent of client before referring.
4. Case arises out of *dispute / conflicting claims* :
He should be objective and professional.
5. *Refrain from issuing speculative opinion.*
6. *Refuse to be futuristic.*
7. *Retain all working papers.*

BUSINESS INVESTIGATIONS

C.A. may be requested to the study of financial statements and asked to report on them. Financial statements comprise of profit and loss account and balance sheet. He should take care to consider the following :

- ❖ **Profit and Loss Account** – Study of profit and loss account should cover profit statements over a period of 5 – 7 years in order to cover all possible phases of business cycle. This will also enable the accountant to establish a trend between various related elements of profit statement.

1. Depreciation:

- (i) Whether adequate depreciation has been provided on a consistent basis.
- (ii) In case of revaluation of assets, depreciation should be provided on revalued amount and over their estimated useful life.
- (iii) For leasehold property, it should be ascertained whether an adequate provision has been made for the deterioration charge that may be payable at the end of lease period.

2. Turnover :

- (i) Turnover of the company should be segregated between various products, types of customers, territory etc.
- (ii) Order books should be examined to identify and eliminate fictitious entries.
- (iii) Income and expenses should be broken proportionately between manufacturing and trading operations.

3. Wage Structure :

- (i) Method of computing wages and rate of wages should be checked.
- (ii) Any unusually high wage payment should be analysed.
- (iii) If the business has suffered labour disturbance in the past then it should be checked whether a long lasting settlement has been reached.

4. Managerial remuneration:

- (i) Check that remuneration payable is not excessive
- (ii) It should be in accordance with the provisions of Companies Act, 1956.
- (iii) Even if no or nominal remuneration has been paid, it should be adjusted to arrive at true profitability.

5. Exceptional and non-recurring items: These items disturb the trends of the profits. Therefore, the effect of these items along with their tax implications should be adjusted to arrive at maintainable profits.**6. Repairs and Maintenance:**

- (i) Major repairs and over hauling jobs are generally undertaken at any interval of 3 to 4 years. It should be ensured that these expenses have been systematically appropriated over a period of time. (However, take care of Accounting Standard – 26).
- (ii) It should be correctly broken into capital and revenue expenses.

7. Unusual year: Investigating accountant should eliminate results of one or more years which disturbs the trend due to exceptional factors, while arriving at maintainable profits.❖ **Balance Sheet:**

The elements of Balance sheet may be studied as under –

1. Fixed Assets – Fixed assets may be studied as regards with

- (i) Age of fixed assets in order to determine replacements that may be required in the future.
- (ii) In case proper repair and maintenance has not been ensured, a provision for heavy expenditure on repairs that may be required should be made in the value of the assets.
- (iii) In case of revaluation of fixed assets, depreciation should be provided on the revalued amount.

2. Investments –

- (i) Current investments should be valued at market price.
- (ii) Long term investments should be valued at cost. However, a permanent decline in value should be provided.
- (iii) Pre-acquisition profits should be reduced from cost of investment.

3. Debtors –

- (i) The bad debts should be adjusted in the year of sale unless the write off is on account of a slump or fall in international prices.
- (ii) A study of credit period allowed by a business which shows rise in credit period over the period of investigation is indicative of diminishing sales.
- (iii) Age – wise classification of debts helps in understanding the nature of customers and working capital requirement of business.

4. Stock and work in progress –

- (i) These assets should be consistently valued as per generally accepted accounting policies.
- (ii) Due allowance for damaged, obsolete and slow moving items should be made.

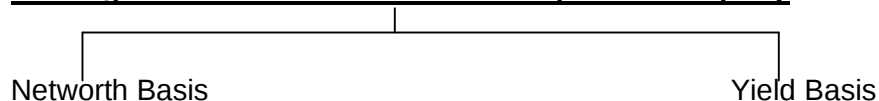
5. Other liquid assets – These assets include cash in hand and readily realizable bank balances. It is prudent to insure cash in hand.**6. Idle assets –** Idle assets may be in the form of unused plant, excessive cash holdings or obsolete stocks etc. The investigating accountant should ignore assets from the net worth of the business.**Liabilities:-****1. Taxation:**

- (i) It should be verified that adequate provision for tax has been made.
- (ii) In case there have been reopening of cases in the past, the final liability should be ascertained from the order passed by the authority.
- (iii) Any temporary tax benefit should be disregarded.

2. Capital

- (i) The investigator should ascertain a proper balance between owners and debt capital. A disproportionate ratio can handicap the business.
- (ii) It should be verified that the capital is reasonable as compared to fixed assets and working capital.

The underlying purpose of conducting such an investigation is to enable the accountant in predicting with reasonable accuracy the future positioning of the business. For example, he may be able to determine the allowance required for replacement of worn out fixed assets or the turnover as over the coming period or the working capital requirements etc.

❖ **Investigation under Companies Act, 1956 [Refer to Sec.235, 237, 239, 240, 247, etc. from Companies Act]**❖ **Investigation for valuation of shares in private company**❖ **Investigation on Behalf of Incoming Partner**

The purpose of this investigation is for the incoming auditor to know whether -

- (i) The terms offered to him are reasonable
- (ii) His capital contribution would be safe and applied usefully.

The investigator should take care of the following -

- (i) Ascertain the history of inception and growth of the firm.
- (ii) Study the provisions of the partnership deed.
- (iii) Scrutiny of the profitability and the rate of return of the firm's business over a period of time.
- (iv) Examinations of the assets and liability position of the firm. This helps in determining the tangible asset backing, impending liabilities etc.
- (v) Position of orders on hand the range and quality of customers should be thoroughly examined.
- (vi) Study the composition and quality of key personnel's employed.
- (vii) Study the important contractual and legal obligations.
- (viii) Ascertain the reasons for offer of admission to a new partner.
- (ix) Manner of computation of good will of admission and retirement of a partner should be ascertained.
- (x) The standing and reliability of other partners and their personal reputation should be properly judged.

❖ **Investigation on Behalf of Bank Proposing to Advance Loan to a Company.**

A bank is primarily interested in knowing –

- (i) the purpose for which a loan is required,
- (ii) the sources from which it would be repaid and
- (iii) the security that would be available to it.

The investigating accountant, should collect information on the following –

- (1) The purpose for which the loan is required and the manner to invest the amount of the loan.
- (2) The schedule of repayment of loan submitted by the borrower.
- (3) The financial standing and reputation enjoyed by directors and officers of the company.
- (4) Whether the company is authorized by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.
- (5) The history of growth and development of the company during the past 5 years.
- (6) Effect on economic position of the company due to economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business, the investigating accountant should take the under-mentioned steps –

- (d) Prepare a condensed income statement from the Profit and Loss Accounts for the previous five years, showing various items of income and expenses, gross and net profits earned and taxes paid annually during each of the five years.

- (e) Compute the under-mentioned ratios –

Compute the under-mentioned ratios –

- (i) Sales to Average Stocks held
- (ii) Sales to fixed assets.
- (iii) Equity to fixed assets.
- (iv) Current Assets to current liabilities.
- (v) Quick assets (the current assets that are readily realizable) to quick liabilities.
- (vi) Equity to long term loans.
- (vii) Sales to Book debts.

(viii) Return on Capital Employed.

(f) Break-up of annual sales product-wise.

Verification of assets and liabilities included in the financial statement submitted by the applicant:

The investigator should prepare schedule of assets and liabilities in them the particulars given below:

1. Fixed Assets:

- (i) Description of the item.
- (ii) Gross value
- (iii) Depreciation rate used
- (iv) Total depreciation written off
- (v) Nature of charge on assets created
- (vi) Revaluation of the assets if carried out recently
- (vii) Basis of revaluation.

2. Inventory:

- (i) The different types of raw material and finished goods held.
- (ii) Basis of valuation of the inventory.
- (iii) Slow moving and obsolete items.
- (iv) In case the stock has been pledged or hypothecated the fact should be stated.
- (v) Assessment of the redundancy of stock consequent to changes that occurred after balance sheet.

3. Sundry Debtors:

- (i) Composition of debtors.
- (ii) Age wise classification debtors.
- (iii) The adequacy of the provision if any created.
- (iv) Classification as follows –
 - a. Debts due in respect of which the credit has not expired.
 - b. Debts due in respect of which the credit has expired.
 - c. Debts due from directors and employees.
 - d. Debts due from subsidiary companies or affiliated companies.
 - e. The subsequent recovery of debts after the Balance Sheet date.

4. Investment: The schedule of investment should be prepared showing date of purchase, cost, nominal value, market value and in case it is pledged for a loan, the details of people.

5. Secured Loans: The loans should be classified between debtor and other showing there in the secured and unsecured classification. The particulars of the assets pledged for securing the debt should be clearly stated.

6. Provision for Taxation: The breakup of the year wise provisions and a note on the adequacy of a each provision shall be provided.

7. Other liabilities: A statement to the effect that all the liabilities have been properly disclosed showing the age wise analysis of trade creditors.

8. Insurance: A statement of insurance policies giving details of the risk covered and the particulars of the prepayment

9. Contingent liabilities: A list should be provided giving a break up of the contingent liabilities existing.

Finally, the investigator should ascertain whether any other application has been made by the applicant for loans to other institutions or agencies and if so the result of such applications on the date of review.

❖ **Procedure for investigation of frauds**

1. **Cash Receipts** – The probability of cash being diverted before being entered in the books is very high and hence
 - (i) Income received from different sources should be scrutinized.
 - (ii) Carbon copies of receipts marked 'duplicate' should be scrutinized.
 - (iii) The record of small or negligible sources of income such as sales of scrap or sale of waste paper.
 - (iv) Recoveries from customers and sundry parties along with deductions on account of cash discounts should be reviewed and checked thoroughly.
2. **Cash Payments** –
 - 1) Acknowledgement for payments has to be carefully scrutinized
 - 2) Care is required where a figure appears to have been erased or altered on such acknowledgement.
 - 3) Payment by bearer Cheques should be checked.
 - 4) Payment as regards wages should be examined for possible over totaling of wage sheets and entries regarding dummy workmen.
 - 5) Check whether payment has been made in respect of supplies which have not been received.
 - 6) Petty Cash Book itself should be vouched and totaled.
3. **Balances in customers' ledger** – The first steps is to find out
 - (1) Whether the customers are properly debited in respect of goods received.
 - (2) Test the entries in the order book with those in the sales daybook.
 - (3) Amounts adjusted on account of goods returned or difference in price as well as amounts written off as bad debts should be checked.
 - (4) Balance confirmations from customers.
4. **Balances in Suppliers ledger** –
 - (1) The Bought Journal should be vouched by reference of Goods Inward Book.
 - (2) Amounts have been correctly credited in respect of goods duly received or not.
 - (3) Request the supplier to furnish statements of their accounts to find out whether or not any balance is outstanding or due and
 - (4) Confirm that allowances and rebates given by them is correctly adjusted.
5. **Defalcation of stock** –
 - (1) The defalcation of trading stock, etc. is usually possible through a collusion among a number of persons.
 - (2) Check whether there is
 - (a) A system of stock control, and existence of detailed record of the movement of stock, or
 - (b) Availability of sufficient data from which such a record can be constructed.
 - (3) Physically check the quantities in stock and those shown by the stock book.
 - (4) Shortages observed on physical verification of stock should be reconciled with the discrepancies observed on checking the books.

❖ **Investigation for Review of Profit / Financial Forecasts [Guidance note on Profit Forecast]**

Chartered Accountants are required to investigate into the profit forecasts of a business for various purposes like purchase of a business or sanction of loan etc. As per guidance notes

issued by the ICAI a Chartered Accountant should consider the following aspects while conducting review of profit forecasts.

1. **Preliminary considerations**

- (i) Obtain in writing the scope of work
- (ii) Procure the following information in written form
 - (a) Period covered by forecast
 - (b) The assumptions used
 - (c) The purpose of forecast
 - (d) The ultimate user of the forecast.

2. **General considerations**

- (i) Obtain a clear understanding of client's business and its environment.
- (ii) Review the accounting policies.
- (iii) Check the reasonableness of various assumptions.
- (iv) Review the method of forecasting.

3. **Specific considerations**

- (i) Check whether correct accounting policies have been consistently applied over the period of forecast.
- (ii) Ensure proper disclosure of extra ordinary items.
- (iii) In case where purpose of forecast is to estimate fund requirements, ensure that proper bifurcation has been made between working capital and long term capital requirements.
- (iv) Proper investigation into the current status of the entity should be made.
- (v) Evaluate the opinion of other experts.
- (vi) Ensure the proper explanatory notes supplement the forecasts.
- (vii) The investigator should properly adjust inflationary factors and make reasonable inter firm comparisons.

The report of the investigator should cover the following aspects.

- (i) The assumptions used
- (ii) The forecasts made
- (iii) Conclusions of the review.

DUE DILIGENCE

- (1) This term is used in relation to corporate restructuring.
- (2) Corporate restructuring includes internal reconstruction, amalgamations, mergers, joint ventures etc.
- (3) Corporate restructuring involving **more than one party** should be **planned** properly.
- (4) Thus, due diligence **review** is performed to check whether it is **feasible and desirable** to acquire / merge the unit.
- (5) Discipline-wise it can be classified as follows:
 - (a) **Commercial /operation Due Diligence** : i.e. to check whether the target is commercially feasible.
 - (b) **Financial Due Diligence** : To check the financial feasibility of the target by examining the financial statement and devising their profit trends.
 - (c) **Tax Due Diligence (Direct and Indirect)** : Whether the target is paying appropriate taxes on a regular basis. Moreover, ascertain what are the tax benefits available to target.

- (d) **Information system Due Diligence** : Whether information system of target is providing right information to the right management at the right time in the right quantity.
- (e) **Legal Due Diligence** : Whether the target is complying with all the applicable laws and regulations.
- (f) **Environmental Due Diligence** : To check the compliance of target with environmentally related rules and regulations.
- (g) **Personnel Due Diligence** : To ascertain whether the employees of target company are efficient.

FINANCIAL DUE DILIGENCE

Sometimes it is interpreted as complete Due Diligence review as it ascertain the **financial implications** of all other Due diligence reviews, yet its scope is less than over all Due Diligence reviews.

A full-fledged financial Due Diligence review includes the following:-

- (1) **BRIEF HISTORY OF TARGET AND BACKGROUND OF ITS PROMOTERS:-**
How Company was set up, who were original promoters, its survival strategies in past, any regulatory requirement, history like nature of production, location, product/ service and markets, franchises, licenses, patents, R & D, legislation & regulation, information systems.
- (2) **ACCOUNTING POLICIES:-**
Appropriateness, effect of recent changes in A/c policies, effect on overall profitability and their correctness. Areas where A/c policies of target are different from that of acquiring enterprise and their effect.
- (3) **Review of Financial Statement:-**
In accordance with statute, relevant framework and A/c standards. Review the operating results, extraordinary items. Comparison of actual figures with budgeted figure. Trading results of last 4-5 years, valuation of intangible assets, special attention to over valued assets or hidden liabilities.
- (4) **Taxation:-**
Regularity of payment of various taxes to government, tax affects of mergers.
- (5) **Cash Flow:-**
Cash generating abilities and major trends.
- (6) **Financial Projections:-**
For next **5 yrs** with detailed **assumptions** and workings on optimistic, pessimistic and most likely basis. If projections are inappropriate highlight the areas.
- (7) **Management and Employees:-**
Status of work force, staff and their demands etc. excess work force and implications, pay package, employee benefit PF, gratuity, E.S.I. leave and superannuation etc. to be taken care of.
- (8) **Statutory compliance:-**
List of applicable laws, punitive charges etc.

Fine/Penalty-

Contents of Due Diligence Report

- (i) Summary
- (ii) History of Target
- (iii) History of Promoters
- (iv) Review of Operational D.D
- (v) Review of Financial D.D
- (vi) Review of Tax D.D
- (vii) Review of Information system D.D
- (viii) Review of Legal D.D
- (ix) Review of Environmental D.D

- (x) Review of Personnel D.D
- (xi) SWOT Analysis
- (xii) Suggestion

TAX AUDIT

Under I.T. Act, audit is to be conducted by an Accountant. It defines accountant as **a C.A.** within meaning of C.A. Act & any other person entitled to be appointed as an auditor of a company u/s 226 of Company Act. But as per C.A. Act, it will nevertheless a necessary requirement that the member concerned must hold a certificate of practice.

But for Co. op. societies, the auditor appointed under the relevant statute provision need not be a C.A. but he can conduct the tax audit.

Audit of Public trusts (Sec. 12A)

Exemption from I.T. u/s 11 & 12 provided :

1. The person in receipt of the income has made an application for registration of the trust/ Institute to C.I.T. Before expiry of one year from date of creation of trust.
2. Where total income > 50,000 in any previous year, the accounts of trust/ Institute have been audited.

⇒ As per guide published by ICAI, the audit programme in this case will be as follows :

(A) Preliminary

- (i) Obtain **resolution** from trust (Scope of audit)
- (ii) Letter of appointment from trust & communicate with previous auditor.
- (iii) Certificate as to op. balance of Assets & Liabilities & fund
- (iv) List of Books of A/c
- (v) Certificate from trust as to system of A/c & I.C.
- (vi) List of institutions/ activities run by trust
- (vii) Certified true copy of deed of trust.

(B) Routine checking

- (i) Check Book of A/c.
- (ii) Vouch transactions. Whether within power and authorised, Properly A/c for, recorded on the basis of system of Accounting etc & funds applicable towards objects of the trust.
- (iii) Obtain trial Balance on closing date certified by trust.
- (iv) Obtain B/s & P & L A/c authenticated by trustee.

(C) A/c Principles: Usually accepted A/c Principles. In Particular.

- (i) All assets verified properly valued & depreciated.
- (ii) All liabilities properly A/c for.
- (iii) Investment properly classified & market values shown.
- (iv) O/s due to trust properly A/c for. Its recoverability examined. Provided made for irrecoverable.

(D) Annexure to Audit Report:-

- (i) Certified list of persons u/s 13(3).
- (ii) Statement for items specified in annexure to form 10B.
- (iii) Verify information supplied by trustees in light of available mater.

Audit u/s 44AB

Any person get his A/c audited by an Accountant who:

- (i) Carrying on Business, total turnover or gross receipt > 40 lakh Rs.
- (ii) Carrying on Profession, if gross receipt > 10 lakh Rs.
- (iii) Carrying on Business if profits & gains from Business are deemed to be profits & gains of such person if he has claimed has income to be lower than deemed one.

⇒ Audit by specified date i.e. 31st October.

Applicability of A/c Standards

In case of charitable / religious organisations, AS will **not** apply if **all** activities are not of commercial, industrial or business nature. Even if a small portion of activities of an entity is commercial, industrial or Business in nature, AS would apply to all its activities including those which are not commercial, industrial or Business in nature.

Section 145:-

- (i) Income under head "**Business or profession**" or **from other sources** be computed in accordance with either cash or mercantile regularly employed by the assessee.
- (ii) C.G. may notify AS to be followed
- (iii) If A.O. not satisfied about correctness or completeness of A/c of Assessee or where method, of a/c followed have not been regularly followed by the assessee, he may make assessment AS per method provided u/s 144.

As (I.T.) Mandatory for those following **mercantile** system.

- (i) AS I relating to disclosure of A/c policies
- (ii) AS II relating to disclosure of prior period & extraordinary items & changes in A/c Policies.

The tax auditor is not computing the income but

- (i) reporting on A/c &
- (ii) reporting on relevant information furnished in form no. 3CD. Thus in case of non-compliance with AS, the C.A should make appropriate qualification/ disclosure in the audit report.

Audit Report:-

- (i) Form 3CA + 3CD for person carrying on Business or profession who is required under any other law to get his A/c audited &
- (ii) For 3CB + 3CD for others.

FORM NO. 3CD

[See rule 6G(2)]

**Statement of particulars required to be furnished under
Section 44AB of the Income-Tax Act, 1961**

PART A

- | | | | |
|----|--------------------------|---|------------------------|
| 1. | Name of the assessee | : | |
| 2. | Address | : | |
| 3. | Permanent Account Number | : | |
| 4. | Status | : | |
| 5. | Previous year ended | : | 31 st March |
| 6. | Assessment year | : | |

PART B

7. (a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.
(b) If there is any change in the partners/members of their profit sharing ratios, the particulars of such change.
8. (a) Nature of business or profession.
(b) If there is any change in the nature of business or profession, the particulars of such change.
9. (a) Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.

- (b) Books of account maintained. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system.)
- (c) List of books of account examined.
10. Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).
11. (a) Method of account employed in the previous year.
 (b) Whether there has been any change in the method of Accounting employed *vis-à-vis* the method employed in the immediately preceding previous year.
 (c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.
 (d) Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss.
12. (a) Method of valuation of closing stock employed in the previous year.
 (b) Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss.
13. Amounts not credited to the profit and loss account, being, –
 (a) The items falling within the scope of section 28;
 (b) The proforma credits, drawbacks, refunds of duty of customs or excise, or refunds of sales tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
 (c) Escalation claims accepted during the previous year;
 (d) Any other item of income;
 (e) Capital receipt, if any.
14. Particulars of depreciation allowable as per the Income-Tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form:–
 (a) Description of asset/block of assets.
 (b) Rate of depreciation.
 (c) Actual cost or written down value, as the case may be.
 (d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of –
 (i) Modified Value Added Tax credit claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
 (ii) Change in rate of exchange of currency, and
 (iii) Subsidy or grant or reimbursement, by whatever name called.
15. Amounts admissible under sections 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35E:–
 (a) Debited to the profit and loss account (showing the amount debited and deduction allowable under each section separately);
 (b) Not debited to the profit and loss account.
16. (a) Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36 (1) (ii)].
 (b) Any sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in section 2(24)(x); and due date for payment and the actual date of payment to the concerned authorities under section 36(1)(va).
17. Amounts debited to the profit and loss account, being:–

- (a) Expenditure of capital nature;
 - (b) Expenditure of personal nature;
 - (c) Expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party;
 - (d) Expenditure incurred at clubs:–
 - (i) As entrance fees and subscriptions;
 - (ii) As cost for club services and facilities used;
 - (e) (i) Expenditure by way of penalty or fine for violation of any law for the time being in force.
 - (ii) Any other penalty or fine.
 - (iii) Expenditure incurred for any purpose which is an offence or which is prohibited by law;
 - (f) Amounts inadmissible under section 40(a);
 - (g) Interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;
 - (h) Amount inadmissible under section 40A(3) read with rule 6DD and computation thereof;
 - (i) Provision for payment of gratuity not allowable under section 40A(7);
 - (j) Any sum paid by the assessee as an employer not allowable under section 40A(9);
 - (k) Particulars of any liability of a contingent nature.
- 18.** Particulars of payments made to persons specified under section 40A(2)(b).
- 19.** Amounts deemed to be profits and gains under section 33AB or 33ABA or 33AC.
- 20.** Any amount of profit chargeable to tax under section 41 and computation thereof.
- 21. *** (i) In respect of any sum referred to in clause (a), (c), (d), or (e) of section 43B, the liability for which:–
- A. Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was –
 - (a) paid during the previous year;
 - (b) not paid during the previous year;
 - B. Was incurred in the previous year and was –
 - (a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1);
 - (b) not paid on or before the aforesaid date.
- (ii) In respect of any sum referred to in clause (b) of section 43B, the liability for which –
- A. Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year –
 - (a) nature of liability;
 - (b) due date of payment under second proviso to section 43B;
 - (c) actual date of payment;
 - (d) if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due date:
 - B. Was incurred in the previous year:–
 - (a) nature of liability;
 - (b) due date of payment under second proviso to section 43B;
 - (c) actual date of payment;
 - (d) if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due date.

* State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account.

22. (a) Amount of Modified Value Added Tax credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.
- (b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.
23. Details of any amount borrowed on hundi or any amount due thereof (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D].
24. (a) * Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year:–
- (i) name, address and permanent account number (if available with the assessee) of the lender or depositor;
 - (ii) amount of loan or deposit taken or accepted;
 - (iii) whether the loan or deposit was squared up during the previous year;
 - (iv) maximum amount outstanding in the account at any time during the previous year;
 - (v) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.
- * (These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)
- (b) Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year:–
- (i) name, address and permanent account number (if available with the assessee) of the payee;
 - (ii) amount of the repayment;
 - (iii) maximum amount outstanding in the account at any time during the previous year;
 - (iv) whether the repayment was made otherwise than by account payee cheque or account payee bank draft
25. Details of brought forward loss or depreciation allowance, in the following manner, to the extent available:

<i>Serial Number</i>	<i>Assessment Year</i>	<i>Nature of loss/allowance (in rupees)</i>	<i>Amount as returned (in rupees)</i>	<i>Amount as assessed (give reference to relevant order)</i>	<i>Remarks</i>
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26. Section-wise details of deductions, if any, admissible under Chapter VIA.

27. (a) Whether the assessee has deducted tax at source and paid the amount so deducted to the credit of the Central Government in accordance with the provisions of Chapter XVII-B.
- (b) If the answer to (a) above is in negative, then given the following details:

<i>Serial Number</i>	<i>Particulars of head under which tax is deducted at source</i>	<i>Amount of tax deducted at source (in rupees)</i>	<i>Due date for remittance to Government</i>	<i>Details of payment: Date/Amount (in rupees)</i>	<i>Remarks</i>
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28. (a) In the case of trading concern, given quantitative details of principal items of goods traded:
 (i) opening stock;
 (ii) purchases during the previous year;
 (iii) sales during the previous year;
 (iv) closing stock;
 (v) shortage/excess, if any.
- (b) In the case of manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products:
- A. Raw materials
 (i) opening stock.
 (ii) purchases during the previous year;
 (iii) consumption during the previous year;
 (iv) sales during the previous year;
 (v) closing stock;
 (vi) * yield of finished products;
 (vii) * percentage of yield;
 (viii) * shortage/ excess, if any.
- B. Finished products/By products
 (i) opening stock;
 (ii) purchases during the previous year;
 (iii) quantity manufacturing during the previous year;
 (iv) sales during the previous year;
 (v) closing stock;
 (vi) shortage/ excess, if any.

* Information may be given to the extent available.

29. In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form:—
 (a) total amount of distributed profits;
 (b) total tax paid thereon;
 (c) dates of payment with amounts.
30. Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit [See section 139(9)].
31. Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.
32. Accounting ratios with calculations as follows:—
 (a) Gross profit/Turnover;
 (b) Net profit/Turnover;
 (c) Stock-in-trade/Turnover;
 (d) Material consumed/Finished goods produced.

Place _____

Date _____

Signed: _____

Name: _____

Address: _____

Notes:

1. The Annexure to this Form must be filled up falling which the Form will be considered as incomplete.
2. This Form and the Annexure have to be signed by the person competent to sign Form No. 3CA or Form No. 3CB, as the case may be.

Annexure**PART A**

1. Name of the Assessee : _____
2. Address : _____
3. Permanent Account Number : _____
4. Status : _____
5. Previous year ended : _____
6. Assessment year : 31st March _____

PART B

Name of Business	Code*				
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Sl. No.	Parameters	Current year	Preceding year
1.	Paid-up share capital		
2.	Share Application Money		
3.	Reserves and Surplus		
4.	Secured loans		
5.	Unsecured loans		
6.	Current liabilities and provisions		
7.	Total of Balance Sheet		
8.	Gross turnover		
9.	Gross profit		
10.	Commission received		
11.	Commission paid		
12.	Interest received		
13.	Interest paid		
14.	Depreciation as per books of account		
15.	Net Profit (or loss) before tax		
16.	Taxes on income paid/provided for in the books		

Signed: _____

Place _____

Date _____

Note:

- Please enter the relevant code pertaining to the main area of your business activity.

EDP – AUDIT

1. Current IT Trends :

- (i) End user computing
- (ii) Declining Hardware prices, increase in micro user
- (iii) RDBM extensive use
- (iv) System development and CASE tools adopted by many users..
- (v) Shift from DOS to UNIX & C language.
- (vi) Knowledge based and decision support systems.
- (vii) Increased data communication and networking
- (viii) Use of EDI (Electronic data interchange)
- (ix) Scanners and voice recognition system for input.

2. Impact on Auditing :

- (i) Unintentional Errors (inexperienced persons)
- (ii) Program modification can take place with a view to fraud.
- (iii) Improper use of DSS.
- (iv) Auditor's participation in SDLC is necessary.
- (v) Use of sophisticated audit software.
- (vi) Data communication and networking – new risk.
- (vii) Data security problems.
- (viii) Move towards EDI (Elimination of much of traditional audit trail).
- (ix) Change in nature of audit evidence.

TYPES OF EDP ACCOUNT SYSTEMS

Batch Processing	Processing systems	Time Sh. & Service Buseu
<i>Batch (group) of transaction, tr. File, master file, batch totals, simple rarely found</i>	<i>OLRT System Ready updaton inquiry processing complex, no audit trail.</i>	<i>TS – one computer and more than one use. S.B. – an entity processing for others.</i>

File Systems

Flat File Systems	Integrated data base systems
<i>User own their data, data redundancy. For same transaction, updaton to be made at many place.</i>	<i>Set of inter related master file, easy updaton, data warehousing, immense volume, cross indexing.</i>

EDP Organization Structure

1. EDP Manager.
2. System analyst.
3. Programmers
4. Computer Operators.
5. Input Preparation Group.
6. Librarian.
7. Data Control Group.

Prerequisites auditing in CIS Environment

1. **Skill & Competence** : To determine over all audit risk, understanding I.C. to perform tests and to evaluate results thereof.
2. **Knowledge of Business** : Entity's attitude towards I.T., usage compared with industry, recent and planned changes.
3. **Planning** : To plan understanding about organization structure, significance of comp. Processing, complexity, availability of data source documents, files, etc.
4. **Assessment of Risk** : Risk may be due to deficiencies in CIS environment and they may increase potential for errors of fraudulent activities.

He should consider the following for risk assessment

1. Own application / packages.
2. Industrial environment.
3. Pervasive CIS controls.
4. Access to sp. function / data.
5. Ability to change and develop the report.
6. Documentation.
7. Factors affecting quality of evidence (paperless).
8. Sp. risk (Electronic funds trf.).
9. End-user computing.
10. Lack of time, discipline or knowledge to monitor results of processing.

CIS & ITS IMPACT ON AUDIT TRAIL

CIS – CIS is any environment where computer of any size are involved in processing of financial information of entity. CIS may be mainly of two types –

1. Batch Processing
2. Online Real Time Systems.

Audit Trail – It means tracing a transaction from starting to end or vice-versa.

Whereas much of audit trail is available in batch processing systems (because of maintenance of transaction file and master file), online real-time systems are devoid of it.

First of all auditor has to make risk assessment in CIS environment. If he assess risk as high, he will have to adopt some procedures to compensate with the same.

Compensating for loss of audit trail :

1. Arranging for sp. print-outs of additional informal.
2. Programmed interrogation facility.
3. Clerical recreation.
4. Testing on total basis.
5. Relying on alternative tests.
6. Special Audit Technique.

INTERNAL CONTROLS IN COMPUTER BASED SYSTEM

These controls include both manual procedures and procedures designed into the computer system. The controls can be broadly classified into general controls and application controls.

IT General Controls

General controls relate to the environment within which computer based accounting systems are developed, maintained and operated. They apply to all individual applications. General IT controls include:

1. **Organization and management controls**
These controls provide organizational framework to IT activities.
2. **Application system development and maintenance controls**

Designed to provide reasonable assurance that systems are developed and maintained in an efficient and authorized manner.

3. Computer operation controls

These controls ensure that authorized persons only who perform authorized programs and that all errors are prevented and detected by the systems access the system.

4. System software controls

These controls are designed to ensure that acquisition and development of system software is properly authorized and documented.

5. Data Entry and programs controls

These controls provide reasonable assurance that all transactions are properly authorized and access to data and programs are to restricted persons.

IT application controls

Application controls are controls over the thoroughness, accuracy and validity of accounting information. These controls include:

1. Controls over inputs

These controls are designed to provide reasonable assurance that,

- (a) All transactions are authorized.
- (b) Transactions are not lost or improperly added or modified.
- (c) The system detects and reports incorrect transactions.

2. Controls over processing and computer data files

The objective of these controls is to provide assurance that,

- (a) All transactions are properly processed.
- (b) Processing errors are identified and corrected on a timely basis.

3. Controls over output

These controls are designed to provide the accurate outputs are timely provided to authorised persons.

Computer Assisted Audit Techniques (CAAT) (Used in Auditing through the computer)

1. **Audit Software:** It is a set of computer programs used by the Auditor, as part of his Auditing Procedures, to process data of audit significance from the entity's accounting system. The Auditor should use such programs only after he proves their validity for Audit purposes. Audit Software may consist of:

- (a) **Package Programs** – These are generalised Computer Programs, that perform data processing like reading computer files, selecting information, performing calculations, creating data files and printing reports in a format specified by the Auditor. May be used at many clients site.
- (b) **Purpose Written Programs** – These are Computer Programs, designed by the Auditor / entity / outside programmer, to perform Audit tasks in specific circumstances. The Auditor may sometimes use the programs of the entity in the same or in a modified form. But it may not be used at many clients site thus cost consideration should taken care of.
- (c) **Utility Programs** – These are programs of the entity, designed for non-audit purposes, but for performing common data processing functions like sorting, creating and printing files. These are not designed specifically for audit purpose.
- (d) **System management software** – These are enhanced productivity tool that require specialised knowledge on part of auditor. However these are not specifically meant for audit purposes. Thus used with much skill and care. For example flow chart review systems. It may be used for comparing source code with object code.

2. **Test Data:** The Auditor enters a set of test data into the entity's computer system and compares the results with predetermined results. Test data are used to test specific controls / specific processing characteristics in computer programs like online password and data access controls. The test data are chosen by the Auditor. They may be of the following types –
 - (a) Testing a set of data selected from **previously processed transactions**, in the entity's system, **separately** from the normal processing procedure.
 - (b) Establishing a **dummy unit** to which test transactions are posted **during** the normal processing cycle of the entity. (Called integrated Test Facility). However, the dummy entries should subsequently be eliminated from the entity's accounting records. These are used mainly on line real time systems.

USE OF CAAT

CAAT are used to perform various Audit Procedures like –

1. **Tests of Details** of transactions and balances e.g. use of Audit software to test all / few transactions in a computer file. As substantive procedures.
2. **Analytical Review Procedures** e.g. use of Audit software to identify unusual fluctuations or unusual items.
3. **Compliance Test of General IT Controls** e.g. use of test data to test access procedures to the program libraries.
4. **Compliance Test of IT Application Controls** e.g. use of test data to test the functioning of a programmed procedure.

Use of CAAT / Audit Software Systems in Fraud Detection:

1. Even while auditing in an EDP environment, the Auditor is required to plan his work by exercising reasonable care and skill in such a manner that there is reasonable expectation of detecting material misstatements in the financial information resulting from fraud or error.
2. Use of the above CAAT / audit software systems will help the Auditor to identify errors and frauds in the accounting and internal control system.
3. However, frauds are intentional and generally deep-laid. While auditing through the computer with adequate knowledge of computer systems may highlight some frauds, there is not empirical evidence to prove the assertion that the use of audit software systems has unearthed well-concealed frauds. Thus it cannot be conclusively said that use of audit software systems increases the probability of detection of fraud due to inherent limitation present in any audit.

Consideration in use of CAATs

1. Computer knowledge, expertise and experience of the auditor.
2. Availability of CAATs and suitable computer facilities.
3. Impracticability of manual tests.
4. Effectiveness and efficiency.
5. Timing.

Steps in application of CAATs

1. Setting objective of CAAT.
2. Content and accessibility of entity's files.
3. Tr. type to be tested.
4. Procedure to be performed on data.
5. Define output req.

6. Personnel.
7. Refine cost and benefit estimates.
8. Ensure documentation of CAAT use.
9. Arrange administrative activities.
10. Execute CAAT application.
11. Evaluate the results.

The Auditor should take the following measures to control CAAT applications

Control of Software Applications	Control of Test Data
• Participate in the design and testing of the computer programmes. • Check the coding of program to ensure conformity with detailed program specifications. • Review of operating system instructions to ensure proper running of software in the entity's computer application. • Run audit software first on test files before taking up the same on main data files. • Ensure use of correct files. • Obtain evidence as to implementation of audit software as planned. • Establishment security measures to safeguard manipulation of data files & his audit software. • He should arrange for proper vendor support.	• Control the sequence of submission of test data. • Perform test runs containing small amounts of test data before submitting main audit test data. • Predict the results of test data and compare with actual test data output, both for individual transactions and also in total. • Confirm that only current version are used to process test data. • Obtain reasonable assurance regarding the continued use of programs throughout the period of audit.

❖ **Documentation** : about planning, execution audit evidence, etc.

❖ **CAATs in small business comp. Environment :**

- (i) Less reliance on I.C. thus, greater emphases on tests of details and application of audit procedures.
- (ii) If small volume of data – manual methods.
- (iii) Impracticable use of CAAT due to absence of technical assistance.
- (iv) Few program may not run on small computers.
- (v) Thus it may not be practicable to use CAAT in small business environment in all cases.

❖ **Auditor's involvement in computerization.**

Planning Topic

- (1) Comp. First time – feasibility study.
- (2) Hardware / Software specification.
- (3) Physical planning and site preparation.
- (4) Organization structure.
- (5) Corporate computerization plan.
- (6) Project plan for every application.
- (7) DRP (Disaster recovery plan).

Execution

- (1) Understanding user requirements.
- (2) Limitation and scope of standard packages.
- (3) Proper training of staff at all levels.
- (4) Organization must be service oriented.
- (5) Flexibility.

Requirement for internal auditor

❖ **Requirements for comp. Audit program system :**

- | | | |
|-------------------------------|---------------------------------|--------------------|
| (i) Simplicity | (ii) Understandability | (iii) Adaptability |
| (iv) Vendor technical support | (v) Statisticals sampling tech. | (vi) Acceptability |
| (vii) Processing capabilities | (viii) Report writing | |

❖ **Applications**

- | | | |
|----------------|-----------------------|----------------|
| 1. Inventories | 2. Payrolls | 3. Maintenance |
| 4. Energy | 5. Travel & Telephone | 6. Sales |

SERVICE BUREAU

Consideration of following matters with client :

1. **Ownership and stability** : Share holders, cr. rating, other clients, commercial appropriate staff.
2. **Location** : Conditions (geographical and others) machine loading (high or low).
3. **Back up** : Stand by arrangements.
4. **Documentation education and programs, etc.** : Systems and program documentation manual, staff training, approved changes, authorized owner of copyrights of programs ownership of data files.
5. **Liability of bureau for** : Losses to lateness, fraud, confidentiality, corruption of magnetic media.
6. **Control** : Over data processed, reconciliation, amendments and error reports, file retention.
7. **Packages** : Standard software package, req. of input and format and output.

❖ **Audit consideration of comp. Bureau.**

Movement of data outside client's premises, data preparation. Following matters should be considered :

- (i) Liaison between user and bureau.
- (ii) Systems testing.
- (iii) Responsibility for file conversion.
- (iv) Responsibility for rejection.
- (v) Output procedures defined.
- (vi) Control over maintenance of master file.

Tagging and Tracing

1. It is used for compensating loss of audit trail.
2. It involves tagging the clients input data in such a way that relevant information is displayed at key points to be verified by the auditor.
3. The hard copy generated is made available only to the auditor. For e.g. sales order in excess of 10 lakh etc.
4. It uses actual data, thus question of elimination of special entries (as in integrated test data facility) does not arise at all.
5. However, all erroneous data may not necessarily be tagged.
6. Auditor uses his professional judgment to decide the key point.

Effect of P.C environment on Audit Procedure

- (i) Not practicable to implement sufficient Internal controls. This control risk is high.
- (ii) No need for compliance procedure. He may directly switch over to substantive procedure.
- (iii) He may use CAAT's (Audit Software)
- (iv) He may perform audit work on a preliminary date (surprise visits)
- (v) Specific internal control characteristics.

Effect of on line system on Audit Procedure

- (i) Less Audit trail
- (ii) Authorisation & accuracy of on line transaction must be checked.
- (iii) He should include technical persons in Audit team.
- (iv) He should perform compliance procedures if he preliminary assesses control risk as less than high.
- (v) Sub procedure should include CAAT (normally ITF).
- (vi) Auditor should carry out Pre-implementation review of OLRT system if possible.

Note:

On data base I.C w.r.t. access the Data Base must be properly securitised.

Audit of Public Sector Undertaking

OBJECTIVES OF AUDIT OF PSU

- In PSU, there is involvement of public fund.
- These funds should be utilized considering public interest.
- Normally, these funds are lavishly used by management.
- While auditing, auditor has to check whether these funds have been used in a manner so as to hurt the basic objectives behind creation of PSU. (Public Welfare)
- Thus the main objective of auditor in such case is to check the substance of transaction entered into by the PSU.
- Auditor has to check whether transactions mainly expenses confirmed to propriety norms.

PROPRIETY AUDIT

- “Propriety Audit stands for verification of transactions on the test of *public interest*, commonly accepted *customs & standards* of conduct”.
- Propriety is that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirement of law, Government regulations and professional codes” – E.L. Kohler.
- It shifts the emphasis to *substance of transaction*.
- It requires transactions (mainly expenses) to conform to certain general principles :
 - a) Expense is *not* *prima facie* *more* than the occasion demands and same degree of vigilance is exercised as should be exercised in respect of his own money.
 - b) *Authority* exercises its *power* of sanctioning expenses to pass an order which will not accrue to its own advantage.
 - c) Funds *not* utilized for *benefit* of a particular person/group.
 - d) Apart from *agreed remuneration*, no other avenue is kept open to benefit management personnel, employees and others.

PROPRIETY ELEMENT u/s. 227 (1A) :

- a) Whether *terms* on which secured *loans* and secured advances have been made are *not prejudicial* to the interests of the *company or its members*.
Conditions like security, interest, repayment period and other business considerations.
- b) Whether *transactions* of company which are represented merely by *book entries* are not prejudicial to the interest of company, *i.e.* effects of book-entries, unsupported by transactions, etc.
- c) Whether *investment* of company (other than Banking/Investment company) in form of share, debenture and other securities have been *sold* at a *price lower than* its cost, *i.e.* to see reasonableness of decision to sell at loss.
- d) Whether *personal expenses* have been charged to revenue.

PROPRIETY ELEMENT UNDER COST AUDIT REPORT :

- b) Matters appearing clearly wrong in principle or apparently wrong.
- c) Cases where company's funds have been used in negligent/inefficient manner.
- d) Factors which could have been controlled but haven't been, thus, resulting in increase in cost of production.

PROPERTY ELEMENTS IN CARO, 2003

- a) If the company has given or taken loans, secured or unsecured, to/from companies, firms or other parties listed in the register maintained under section 301 of the Companies Act, whether the rate of interest and other terms and conditions of such loans are *prima-facie* prejudicial to the interest of the company. In this case, the auditor will have to look into the reasonableness of the rate of

interest and the terms and conditions of such loans. In other words, he will have to see whether the terms and conditions, including the rate of interest are apparently adverse to the interests of the company, having regard to the circumstances of the company at the time of taking the loans and the terms normally available. He is to exercise his judgment based on commercial considerations like urgency, security offered etc.

- b) If the overdue amount of the loan given to or taken from companies, firms or other parties listed in the register maintained under section 301 of the Companies Act is more than rupees one lakh, what reasonable steps have been taken by the company for recovery/payment of the principal and interest. In making this examination, the auditor would have to consider the facts and circumstances of each case, including the amounts involved. It is not necessary that steps to be taken must necessarily be legal steps. Depending upon the circumstances, period of delay and other similar factors, issue of reminders or sending of advocate's or solicitor's notice may amount to reasonable steps. The auditor should ask the management to give in writing the steps which have been taken. The auditor should arrive at his opinion only after consideration of the management's representations.
- c) Whether the transactions needed to be entered in a register in pursuance of section 301 of Companies Act have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. Section 301 requires that every company shall keep one or more registers in which shall be entered separately the particulars of all contracts or arrangements to which sections 297 and 299 of the Companies Act apply. As regards the reasonability of prices, the auditor is not expected to make a roving market inquiry but to examine price lists, quotations, prices for other parties etc. he should also taken into account the factors such as delivery period, quality, quantity involved, credit terms etc.
- d) Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employee State Insurance, Income-Tax, Sales Tax, Wealth Tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.
- e) Whether the company has made any preferential allotment of shares to parties and companies covered in the register maintained under section 301 of the Companies Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company.

PROPRIETY AUDIT- PROBLEMS

- It is a moral term.
- Auditing requires verifiable propositions establishment of which is very difficult for propriety audit.
- It has itinerant element of subjectivity.
- However, C and AG has developed norms of propriety for expenses of public funds but it may not apply to transactions of private sector.
- If management formulates norms of propriety for the entity, the element of subjectivity will get reduced.
- For e.g. – Travel by air (*feasible if saves time*).
- The judgement of auditor shouldn't be subjective.

COMMITTEES ON PUBIC UNDERTAKINGS

- It examine the Audit report.
- It can select some enterprises each year to examine whether affairs of same are managed in accordance with sound business principles, etc.
- It *doesn't* however examine mattes of major Government policy or day-to-day administration.
- It gives its findings and recommendations in its report which are presented to Parliament / State Legislatures.

Types of Audits

(1) Professional

Supplement Audit

- C & AG may comment upon or supplement the report submitted by the professional auditor.
- C & AG may issue directives to the auditors in regard to the performance of their function.
- Person so authorised may well be the auditor of the company.
- The form & content of supplementary audit report may be specified by C&AG.
- Supp Auditor may concentrate more on efficiency aspects.
- The person so authorised is having same powers as auditors.

(2) Supplementary Audit u/s. 619(4)

COMPREHENSIVE AUDIT

Scope is regarding checking of investment decisions, Project formulation, MIS, Capacity utilisation, Management, Use of material, Labour, Idle capacity, Capital cost, Cost control measure, R & D programs, Repair & maintenance etc.

Directions of C & AG :

(a) System of Account :

1. Examine the following systems and give deficiencies along with suggestions (Receipts/Expenses/Trial Balance/Inventories, etc.)
2. Allocation of expenses during construction.
3. Bank Reconciliation Statement.
4. Control and subsidiaries account are updated and reconciled regularly.
5. Examine accounting policies.

(b) System of Financial Control :

1. Delegation of financial power whether legally made.
2. Whether credit from bank are monitored regularly.

BANK AUDIT

There are mainly 4 types of Banks :

- | | |
|------------------------|-------------------------|
| (1) Commercial Bank | (2) Regional Rural Bank |
| (3) Co-operative Banks | (4) Development Bank. |

Special Features of Banks :

1. Custody of Large Volume of Monetary Item.
2. Large Volume and Variety of Transactions.
3. Wide Network of Branches and Departments.
4. Off-Balance Sheet items (no entry like guarantees etc.)
5. Regulated by Government authorities.

FORM & CONTENT OF FINANCIAL STATEMENT [Vertical form]

→ **Capital and Liabilities** (5 heads)

- Capital
- Reserve and Surplus
- Deposits
- Borrowings
- Other liabilities and provision

→ **Assets** (6 heads)

- Cash and Balance with RBI
- Balance with Banks and money at call and short notice.
- Investment
- Advances
- Fixed Assets
- Other assets

→ Contingent Liabilities and Bills for collection (aggregate amount to be shown on face of Balance sheet and details by way of a note.

→ **ON FACE OF PROFIT AND LOSS ACCOUNT**

- | | |
|--------------------------|--|
| 1. Income | - Interest Earned |
| | - Other Income |
| 2. Expenditure | - Interest expended |
| | - Operating expenses |
| | - Provision and Contingencies |
| 3. Profit / Loss | - Net profit (loss) for the year |
| | - Profit / Loss brought forward |
| 4. Appropriations | - Transfer to Statutory Reserve |
| | - Transfer to other Reserves |
| | - Transfer to Government / Proposed Dividend |
| | - Balance carried over to Balance Sheet. |

→ **Signature** : Financial statements of a banking company incorporated in India to be signed by manager / principal officer and by at least 3 directors. That of foreign Banking Company to be signed by Manager / Agent of the Principal Office in India.

→ **Appointment of Auditor** : Appointment of Auditor of Banking Company to be appointed at AGM of shareholders wherein fee is also determined. (Approval of RBI regarding appointment). Appointment of Auditor of Nationalised Bank by Bank concerned acting through its BOD (approval of RBI) their fee determined by RBI in consultation with Central Government.

Auditor of subsidiaries of SBI as well as their remuneration is decided by SBI.

Auditor of SBI and their remuneration by RBI in consultation with Government Bank.

RRB's auditors and their fee determined by Bank concerned with approval of Central Government.

Auditor's Report

For *Nationalised Bank*, Report to Central Government stating :

- (i) Balance Sheet is full and properly drawn up and True and Fair View.
- (ii) Transactions of Banks within their powers.
- (iii) Returns received from offices and branches of Banks are adequate.
- (iv) P & L A/c. shows true balance of profit or loss.

For *Banking Companies*, in addition to reporting u/s 227, also to state whether –

- (i) Information and Explanations are satisfactory.
- (ii) Transactions of company within power of company.
- (iii) Returns received from branches are adequate.
- (iv) P&L shows true balance of profit or loss.
- (v) Any other matter to be brought to notice of the share holders of the company.

Audit of Compliance with SLR Requirement

- Statutory Central Auditor to verify compliance with SLR requirements on 12 odd dates in different months of a financial year not being Fridays.
- Report of Management and RBI.
- **Examination of 2 Aspects**
 - (i) Correctness of figures of DTL (Demand & Time Liabilities) on reporting Friday (last Friday of second preceding fortnight), and
 - (ii) Maintenance of liquid asset on selected date.

Steps :

- i. See circulars of RBI regarding composition of DTL;
- ii. Branch auditor to verify correctness of cash on 12 odd dates (Br. Not maintain assets / securities);
- iii. Review Return from un-audited branches.
- iv. It is examination on test basis consolidation regarding DTL position prepared by the Bank.
- v. Examine exclusions and inclusions from / in the liabilities.
- vi. Verify computation of liquid Assets and following are treated as cash :
 - (a) Deposits with RBI by Banking Company incorporated outside India.
 - (b) Cash/Balance by Banking Companies with itself or with RBI.
 - (c) Balance maintained by Scheduled Bank with RBI in excess of balance required to be maintained.
 - (d) Net Balance in current A/c. in India by Scheduled Bank.
 - (e) Balance by RRB with Sponsor Bank.
- vii. Price of gold shouldn't exceed current market price.
- viii. Verify amount of unencumbered approved security.
- ix. Provision for Expenses and Liabilities not to be included in DTL.
- x. Number of unaudited branch and reliance on returns, etc. to be disclosed by central statutory auditor in his report.

CAPITAL ADEQUACY

“Adequacy of capital resources of a Bank in relation to risks associated with its operation” All Indian scheduled commercial Banks (excluding RRB) & foreign Banks operating in India to maintain CA Ratio at a minimum of 10%. Banking operations are risky thus it is more appropriate for a bank to maintain adequate capital funds corresponding to risk associated with its operations.

From 1st November 04 public sector bank require to maintain it at 9% and private sector bank at 10%.

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital funds}}{\text{Risk wto assets \& off B/S Items}} \times 100$$

⇒ Capital Funds

(1) Tier I Capital = (Paid up capital + St. reserve + disclosed free Reserves)

(Equity investments in subsidiary + Intangible Assets + current & B/f loss)

(2) Tier II Capital = It includes following i.e. undisclosed Reserve, general Provision & Loss reserves, Hybrid debt capital instruments & subordinated debt.

⇒ Tier II Capital can be maximum 100% of Tier I capital

⇒ Various assets after exposing to varying degrees of risk as specified.

CONCURRENT AUDIT

“Audit or verification of transactions or activities of an organisation concurrently as the transaction or activity takes place.”

⇒ It is done on regular Basis.

⇒ Mandatory for Banks to cover at least :

(i) 50% of total deposits &

(ii) 50% of total advances

⇒ Following should be considered :

(i) Large / very Large branches

(ii) Special branches

(iii) Large problem branches

(iv) H.O. department dealing with treasury/funds management & handling Investment Portfolio.

(v) Any other branch/deptt. at discretion of bank

⇒ It can be undertaken by internal inspection staff or outside C.A.

⇒ **Scope of Concurrent Audit :**

Daily Cash Transactions, purchase & sale of share & securities physical verification, procedure for opening new A/c Verification of Advances, foreign Exchange Transaction, House keeping (Reconciliation. Balancing of ledger etc.) , Determination of revenue Leakage, fraud prone areas, High Value transactions, Safe custody of security form, T.D.S., statement, H.O. return etc., study of RBI Report & Inspection Report dealing with customers complaints.

⇒ Its objective is to see whether transactions or decisions are within the policy parameters valid down by H.O., they don't violate instructions of RBI & they are within authority.

⇒ Remuneration of auditor is fixed by bank.

⇒ Minor irregularities to be rectified on the spot. Serious irregularities reported to H.O. /Z.O.

- ⇒ Proper reporting & at proper interval. Reported on 10th of next month/quarter but flash report can be submitted immediately,

AUDIT COMMITTEE

- ⇒ **Member** : Executive director, nominee of Central Govt. & RBI, CA director & one of non-official directors
- ⇒ Review Internal inspection/ appointment & Remuneration of Concurrent Auditor/ Conducting training Programmes etc.

NORMS FOR INVESTMENT

- ⇒ Banks to frame suitable Investment policy.
- ⇒ Classification of Investment
- Held to maturity
 - Available for Sale
 - Held for Trading
- ⇒ Disclosure in A/c same as present 6 categories.

HELD TO MATURITY

- ⇒ Intention Basis.
- ⇒ $HTM \leq 25\%$ of Banks total Investment.
- ⇒ Following not to be Covered /Counted for 25%
- (i) Re-capitalisation Bonds from govt. of India.
 - (ii) Investment in subsidiary & Joint Venture.
 - (iii) Investment in Debenture/Bonds if deemed to be in nature of advance
 - If issued for project finance (3 Yrs. or more)
Or
If issued for working capital finance (less than 1 yr.)
and
 - Banks state is $\geq 10\%$ is issue.
and
 - Issue is part of private placement.
- ⇒ Profit on sale of such I to P&L A/c & thereafter Capital Reserve A/c. Loss to P&L A/c.
- ⇒ Carried at acquisition cost. If acquisition Cost is more than face value there amortise the premium. Recognise permanent diminution.

HELD FOR TRADING

- (i) Intention to trade for short term price/Interest rate gain
- (ii) to be sold within 90 Days
- (iii) Profit or loss on sale to P&L A/c
- (iv) Marked to Market at Monthly/Frequent intervals.

AVAILABLE FOR SALE

- (i) If not is above 2 categories.
- (ii) Profit or Loss on sale to P/L A/c.
- (iii) Valuation ➔ Individually script-wise Marked to Market at quarterly/frequent interval.

- (iv) Dept. to be Provided (appreciation ignored) Debit to P&L A/c & equivalent amt. To be transferred from I Fluctuation Reserve A/c to P&L A/c.

INVESTMENT FLUCTUATION RESERVE

- (i) minimum 5% of investment within 5 years (only w.r. to held for trading and available for sale)
- (ii) Maximum upto 10% of Portfolio
- (iii) Transfer maximum amount of gains realised on sale of Investment in Securities to Investment Fluctuation Reserve (IFR)
- (iv) IFR eligible for inclusion in Tier-2 Capital.
- (v) Transfer to IFR as appropriation to net Profit "below line" after statutory Reserve.

Shifting among categories of I

- (i) To / from HTM → Approval of BOD. Shifting can take place once a year at beginning of year.
- (ii) From AFS to HFT → with approval of BOD / ALCO/ Investment Committee.
- (iii) From HFT to AFS → Generally not allowed only in exceptional situation with permission of BOD / ACCO / I Committee.
- (iv) Transfer at acquisition Cost / Book value / Market value on date of Transfer (least) depreciation provided for.

Income Recognition on I :

- (i) Accrual Basis on securities if guaranteed by Central govt.
- (ii) Otherwise if owners right is established.
- (iii) From mutual funds on cash Basis.

Broken period Interest

Banks not to capitalize BPI paid to seller as part of cost but treat as exps. in P&L A/c.

CDR (Corporate Debt Restructuring)

- (i) For corporate debt of entities facing problems which are outside purview of BIFR etc.
- (ii) Apply to multiple Banking A/c etc. with O/S exposure of 10 crore or more.
- (iii) Provision for sacrifice of Interest at H.O. Books.

SOME IMPORTANT MATTERS TO BE CONSIDERED BY AUDITOR

Bills for Collection

1. All documents accompanying the bill should be received and entered in the register by a proper officer.
2. The accounts of the principals should be credited only after realisation of the bill.
3. It should be ensured that bills sent by one branch to another branch for collection are not included twice in the amalgamated balance sheet.

Bills Purchased

1. At the time of purchase of the bills, an officer should verify that all documents of title are properly assigned to the bank.
2. Sufficient margin should be kept while purchasing or discounting of a bill.
3. All irregular outstanding accounts should be periodically reported to the head office.
4. In case of purchase or discounting of a bill, proportionate income should be recognized between the periods.

Credit Card Operations

1. There should be effective screening of applications with reasonably good credit assessment.

2. There should be strict control over storage and issue of credit cards.
3. The system whereby the merchant confirms the unutilized balance of the customer With the bank before accepting payment should be properly installed.
4. There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
5. All the reimbursements should be immediately charged to the customer's account.
6. Items overdue beyond a reasonable period should be identified and attended to carefully.
7. There should be a system of periodic review of credit card holder's accounts.

LOANS :

1. Loan documents to be check.
2. Check the securities hypothecated against loan.
3. Check the internal control, procedures for loans applied by the bank.
4. Whether loan agreements (sanction limits) within authority of bank.
5. Whether bank is properly following up the loan.
6. Check NPA and their provisions.
7. Interest calculations.
8. Whether there is healthy turnover in account.
9. Whether repayment schedule is made considering repayment capacity of borrower.
10. If borrower is a company, whether there is proper resolution to borrow amount from bank.
11. Audit of bank borrower.

⇒ *Loan to Dot Com Company (+)*

- (i) Revenue model
- (ii) Capital base

⇒ *Against life insurance policies (+)*

- (i) Security value is surrender value of policy
- (ii) Premium deposited on time
- (iii) Maturity of policy – ?
- (iv) Policy documents to be checked

⇒ *Against Statement exchange securities (+)*

- (i) Physically check/ confirmation from D.P.
- (ii) Market values of securities to be checked.
- (iii) Advance would be against fully paid shares.
- (iv) Advance against shares which are on lending list of bank.

⇒ *Against pledge/ hypothecation of goods (+)*

- (i) Margin should be maintained/ security value based.
- (ii) Goods in original packing/ periodic surprise visits.
- (iii) Physically check/ stock statements.
- (iv) Godowns & stock adequately insured.
- (v) Basis of valuation of goods.
- (vi) Slow moving or fast moving goods check banks policy for advances against the same.

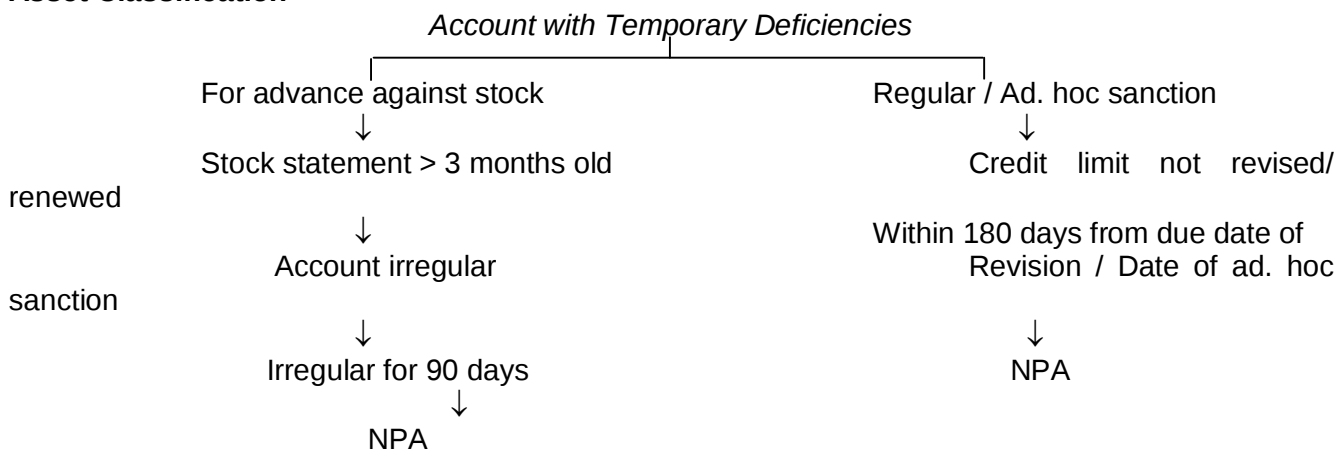
NPA

Agricultural Advances		O/D & e/c	Others
Short Duration crops (Crop season $\leq$ 1 year)	Long Duration crops (Crop season $>$ 1 year)	Out of order for 90 days $\rightarrow$ (1/1/05 – 31/3/05) (i) Balance $>$ D.P. Or $\rightarrow$ (ii) Credits $<$ Debits Or No Credits	Overdue for more than 90 days i.e. payable on/ before 30.12.04 (Term loan or Bills purchased or other credit facility)
$\downarrow$ Overdue for (2) Crop season	$\downarrow$ Overdue for (1) Crop season		

Income Recognition

1. NPA – Income on cash basis.
2. Advance against NSC, KVP, LIP, IVP, and Term Deposit – on accrual provided adequate margin is available.
3. If Govt. guaranteed advances becomes NPA – Cash Basis.
4. 1st time advance become NPA – interest accrued which had been recognised earlier should be reversed or provided for.
5. Past recoveries – adopt some account policy (i.e. 1st apply towards intt. & then towards principal)

Asset Classification



Std. Asset – Not NPA

Sub Std. – NPA $\leq$ 12 months

Doubtful – Sub std. for 12 months

Loss – if certified by Bank/Auditor/RBI as bad.

1. If amount are paid regularly in respect of NPA – upgraded as standard asset.
2. A few credit entries near the Balance date may not mean that account can't be treated as NPA.
3. Normal Rule NPA is (Borrower wise & not facility wise) but exception is loans as per on lending arrangement to PACS/FSS where it is treated as (facility wise).

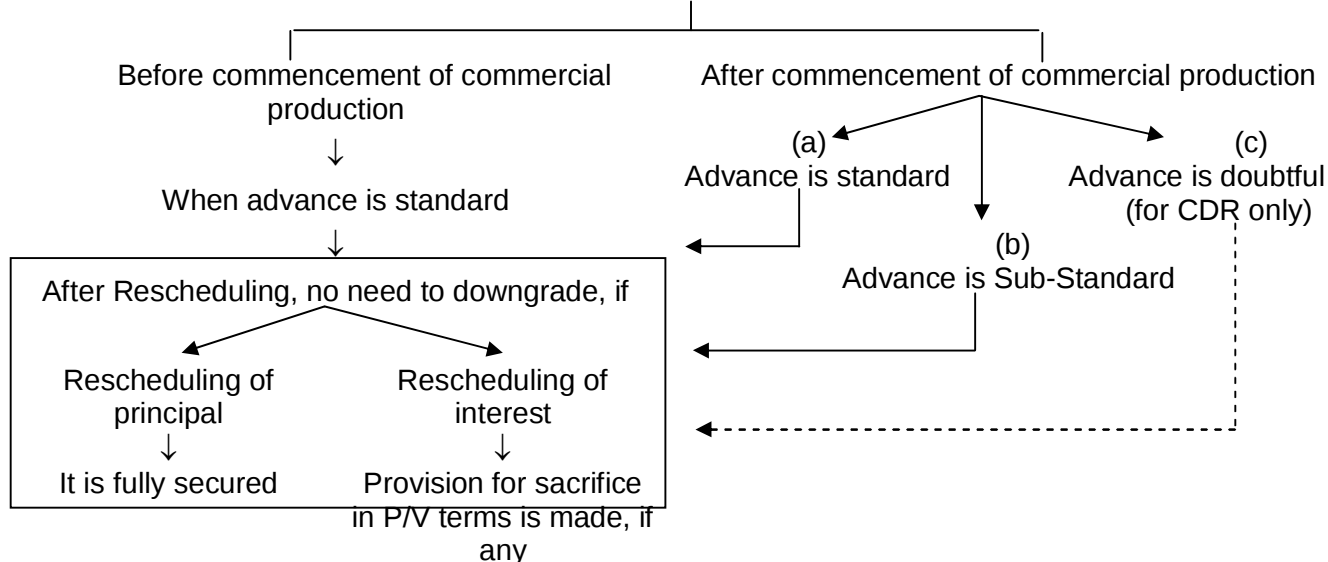
4. Asset classification of advances under consortium arrangements is based on records of recovery of individual number banks.
5. If realisable value of security < 50% of value assessed then it is treated straight forward as doubtful. If realisable value of security < 10% of O/s Balance then straight forward as loss asset.
6. Advances against TD, NSC, KVP, LIP, and IVP need not be treated as NPA.
7. If moratorium for payment of intt. is given, NPA only if defaults in payment (after moratorium is over) and not from date of debit of intt.
8. In case of natural calamities, term loans of agricultural borrowers may be rescheduled. Then fresh as well as term loans need not be treated as NPA.

9.

Government guaranteed advances



Restructuring / Rescheduling



- Upgradation of restructured account after one year from due date of 1st payment subject to satisfactory payment during that period.
- Project under implementation need not be treated as NPA for 2 years from deemed date of completion project but for time overrun > 2 years NPA irrespective of recovery record.
- Net-worth of borrower/ guarantor → need not be taken to be treated as NPA.
- Take out Finance – Lending Bank → recognise income only if paid by borrower / taking over institute.
- Taking over institute – Treat as NPA from actual date although account wasn't in its book.

Provisions	Provisions
Std → 25%	• Government guaranteed advance _____ Normal
Sub Std. → 10% on total o/s	becomes NPA Provisions
+	
10% on unsecured	• Advance against TD, NSC, _____ Normal
portion	KVP, LIP, IVP. If Provisions

<i>Doubtful</i> – Unsecured portion – 100% Secured portion ≤ 1 year – 20% 1–3 year – 30% > 3 year – 60% <i>Loss</i> – 100%	becomes NPA. • Advances covered by balance ECGC/ DICGC amount — in excess of guaranteed by them
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GENERAL INSURANCE COMPANY

Applicability of AS to G.I.C. :

1. AS – 3 → As per Direct Method only.
2. AS – 4 → Not applicable w.r.t. liabilities arising out of I. Policies.
3. AS – 9 → Not applicable w.r.t. incomes of insurance business.
4. AS – 13 → As per regulation. Apply AS – 13 where regulation is silent.
5. AS – 17 → Applicable in each case irrespective of its applicability clause.

Auditors' Report :

1. (a) obtained all information
(b) proper books of Ac/. Maintained.
(c) Proper returns received from branches.
(d) Balance sheet, revenue A/c., P&L A/c., R&P A/c. in agreement with books.
(e) Actuarial valuation of liability certified.
2. (i) **Opinion on :**
(a) Balance sheet – true and fair view of affairs.
(b) Revenue – true and fair view of surplus / deficit.
(c) P & L – true and fair view of profit / loss.
(d) R & P – true and fair view of receipt / payment.
(ii) Financial Statement prepared in accordance with regulation.
(iii) Investment as per reg.
(iv) A/c policies appropriate.
3. **Certify that**
(i) Reviewed management report and no mistake therein.
(ii) Insurer complied with terms of registration.
4. **Certificate that**
(i) Verified cash balance and securities.
(ii) Extent of verification of investment etc., relating to any trust undertaken by insurer as trustee.
(iii) No asset in contravention of Act.

Requirement of schedule B to IRD A Regulation 2002

Part 1 A/c principles for prep. of financial information

- (i) Applicability of A/c std.
- (ii) Premium
- (iii) Premium Deficiency
- (iv) Acquisition cost (Expand in the period in which incurred)
- (v) Claims
- (vi) Valuation of Investment
- (vii) Loan
- (viii) Catastrophe Disaster Reserve

Part 2: Disclosure

Part 3: General Instruction

(Last year figures, notional income, Provision/Reserve)

Part 4: Management Report

- Confirmation for validity of registration
- Confirmation that all statutory dues have been paid.
- Confirmation that shareholding pattern is in accordance with law.
- Confirmation that solvency margin is maintained
- Confirmation that valuation of I
- Confirmation that management has not invested any money outside India.
- Confirmation that overall risk exposure
- Confirmation that operation in other countries
- Confirmation that aging of claims
- Confirmation that quality of asset & portfolio
- Confirmation that payment to parties in which director are interested
- Responsibility statement.

INVESTMENTS

1. Investment in other than approved investment if :
 - (i) Such investment $\leq$ 25% of total investment; and
 - (ii) Consent of all Directors.
2. Insurer not to invest in one insurance / investment company exceeding –
 - (i) 10% of total asset of insurer; or
 - (ii) 2% of share capital/debenture of company concerned.

For other companies (other than insurance / investment company) 2% is replaced by 10%.
3. Funds of policy holders not to be invested outside India.
4. Every insurer to keep at all times

(i) at least 20% of Assets (ii) at least 30% (including (i)) (iii) at least 5% of total assets (iv) at least 10% of total assets (v) upto 55%	Central Govt. Securities. State Govt. and other guaranteed securities Housing & loan to State Government in approved securities under infrastructure / social sector. Other securities.
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Guidelines

- (i) Proper Balance between infrastructure and social sector.
- (ii) Based on rating of assets.
- (iii) Rating by independent agency
- (iv) Should be at least "A A" grade.
- (v) In shares in actively traded / liquid investment.

Valuation of Investment

- (i) **Real Estate** – Investment property : Historical cost less acc. Dep. Less impairment loss. Residual value as zero.
- (ii) **Debt Securities** – as 'held to maturity' – Historical cost.
- (iii) **Equity / Derivative Active Market** – F.V. at B/S date. Impairment as exps. Changes in F.V. in "Fair Value change A/c."
- (iv) **Unlisted and other** – at H.C. provision made for diminution in value such provision may be reversed but increased carrying amount not to exceed its historical cost.

VERIFICATION

Premium

⇒ Credited to separate Bank A/c.

- ⇒ No Risk Assumption without receipt of premium.
Three types of premium – for direct business for re-insurance business and share of co-insurance premium.
- ⇒ Recognised over policy period. As per risk pattern. Some portion of premium allocable to succeeding period thus called unearned premium.
- ⇒ Reserve for unexpired risk.
- ⇒ Premium deficiency = expected cost – related unearned premium. Provision to be made.
- ⇒ Internal controls and procedures.
- ⇒ Cover notes serially numbered.
- ⇒ Premium recognition on aforesaid criteria.
- ⇒ Company not at risk for uncollected premium, short premium, not collected in time, etc.
- ⇒ Reinsurance → look for all its details.
- ⇒ Collection after B/S date whether relating to year under audit.
- ⇒ Co-insurance, company's share of premium.
- ⇒ Premium register chronologically → in order of time of premium.
- ⇒ Due date and date of collection.
- ⇒ Year end transactions.
- ⇒ Service tax → applied on premium
- ⇒ Refund of premium.

Verification of claims

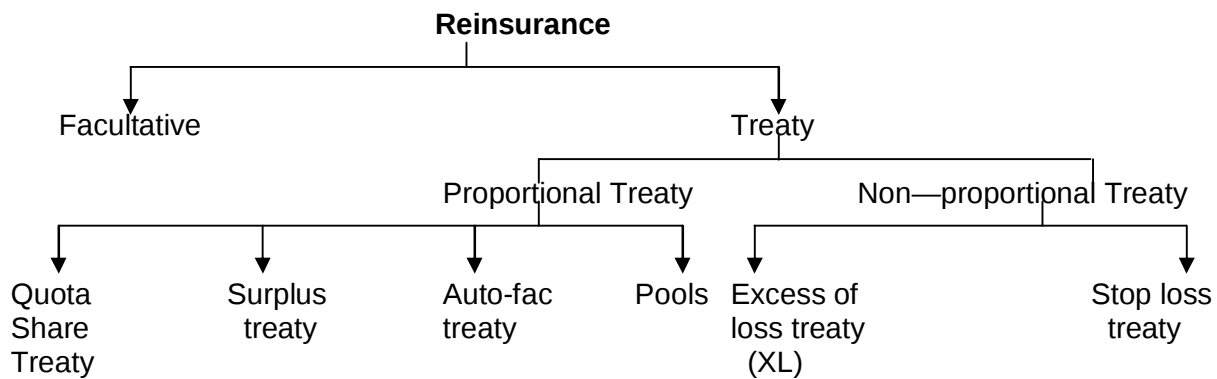
1. Provision for all unsettled claims.
2. Only for those co. is legally liable.
3. Not exceed insured amount.
4. Event after B/S date.
5. Average clause.
6. Co insurance, provision only for its share.
7. Reasons for long delays after claim lodged.
8. Under litigation, legal advice.
9. Provision net of salvage value.
10. No contingent lia. W.r.t. claim intimated.
11. Intimation within reasonable time.
12. Claim paid duly sanctioned.
13. Claim paid for its share in co-insurance.
14. Claim paid after salvage accounted for.
15. Claim paid discharge note from claimant.

Unexpired Risk Reserve

Not all risk expire as on B/S date. Risk will be there in succeeding year w.r.t. premium received in this year, thus provide for –

- (i) 50% of all other types and
- (ii) 100% for marine Hull.

____ % is to be taken of net premium income i.e. premium received, net of reinsurance premium paid.



- ⇒ **Facultative Particular** risk thus consideration of each risk separately.
- ⇒ **Treaty** : within limits of treaty covering all kinds of risk within treaty..
- ⇒ **Proportional Treaty** → %.
- ⇒ **Quota Share** → fix % of all policies issued under defined slope of business.
- ⇒ **Surplus** : cedes amount which it doesn't want to retain with it.
- ⇒ **Auto-fac** : After cession of its surplus treaties.
- ⇒ **Pools** : Members cedes to pool a portion of business directly written by them.
- ⇒ **Non-proportional** : on basis of loss.
- ⇒ **XL treaty** : XL on prevent : If more than one risk are affected, limit/loss is arrived at separately.
- ⇒ **XL on non-prevent** : Losses considered on together basis. (Aggregate).
- ⇒ **Stop Loss** : Protect the company from losing more than specified amount for given class of business.

Solvency Margin :

To maintain excess of assets over amount of its liabilities at all times, highest of following :

- i. 50 crores (100 cr. For reinsurer)
- ii. 20% of net premium income.
- iii. 30% of net incurred claims.

If non-maintenance of S.M., insurer to submit a financial plan to authority indicting plan of action, else it shall deemed to be insolvent and wound up by court.

for valuation of Assets :

- Zero value to following :
 - (i) Agent Bal. & outstanding premium in India not realized within 30 days.
 - (ii) Agent Bal. & outstanding premium outside India not realizable.
 - (iii) Debts not realizable.
 - (iv) Advances.
 - (v) Furniture, fixtures, stationery.
 - (vi) Deferred expenses.
 - (vii) P & L App. A/c.
 - (viii) Reinsurer A/c. outstanding for more than 3 months.
 - (ix) Preliminary Expenses.
- Computer Equipment / Hardware / Software.
- ⇒ Investments as per norms.

➤ Commission

Commission is the consideration payable for getting the insurance business. The internal control in this area are aimed to ensure that commission is paid in accordance with rules and regulations of the company, terms of the agreement and legal requirements. The internal controls with regard to commission may include:

- Established guidelines for determining appropriate terms for agency contracts.
- Appropriate guidelines for calculation of commission.
- Appropriate system is put in place to ensure timely processing of commission and regular reconciliation of general ledger and premium register.
- Commission payments are made in accordance with established guidelines.
- Correlate with this years business.

➤ **Management Expenses**

The following internal control measures may be adopted for management expenses

- Clear management guidelines are issued to cover authorization level of employees / managers for ordering products and services.
- Authorized personnel receive products and services only.
- Purchases should be made only from approved vendors who should be selected on the basis of tenders received from them.
- The management who should also enquire into unusual costs should regularly review work processes and operating expenses.
- Authorized personnel should release payments only.
- The company's policy on travel and entertainment expenses should be clearly laid out and communicated.
- A proper system should be established for compilation of employee records, computation of wage bills and disbursement of the same.

➤ **Operating Expenses Related to Insurance Business**

All administrative expenses relating to insurance business should be mentioned in schedule 4 to the financial statement. The Insurance Act requires that.

- Expenses in excess of Rs.5 lacs or 1% of net premium, whichever is higher, should be shown separately; and
- Expenses not directly relating to insurance business should be shown separately for example, expenses relating to investment department, bank charges etc.

➤ **Agents' Balance**

The audit procedures, which may be followed with regard to agent's balance, are as follows –

- Verify whether agent's balances and outstanding balances in outstanding premium account have been listed, analysed and reconciled for the purposes of audit.
- Verify whether recoveries of large outstanding have been made in post audit period.
- Verify whether there is any old outstanding debit or credit balances as at the year end which require adjustment. A written explanation may be obtained from the management as to their nature.
- Verify that agents' balances do not include employees' balances and balances of other insurance companies.
- Verify that no credit of commission is given to agents for businesses directly procured by it.
- Vouch adjustments / payments against old outstanding balances in agents' account.
- Ensure that the relevant control account in the General Ledger is reconciled with the subsidiary records.

➤ **Taxation**

The procedures to be adopted by the auditor while auditing provision for taxation are given below –

- The auditor should check whether provision for taxation has been made after taking into account the specific provisions relating to general insurance companies.

- The auditor should in addition to financial statements examine other accounts furnished by the company to C & AG.
- The auditor should examine the income of foreign branches and foreign countries and the impact of double taxation avoidance treaties.
- The auditor should see that all TDS certificates have been kept and deduction on the same is claimed.
- The auditor should assess the implications of wealth Tax Act, 1957 on the company.
- The auditor should see the system of service tax collection and the payments to statutory authorities and filling of returns.
- The auditor should examine sale tax implications on sale of salvage.

➤ **CO-INSURANCE**

- (i) Large business risks are shared between more than one insurer.
- (ii) The leading insurer issues the documents, collects premiums and settles claims and renders statements of Accountants to the co-insurers.
- (iii) The auditor should check that the premium account is credited on the basis of statements revived from the leading insurer.
- (iv) Auditor should check the communication in the post audit period and obtain a written confirmation to the effect that all incoming advice have been accounted for.
- (v) The claims provisions and claims paid should also be verified.
- (vi) For outgoing co-insurance the auditor should scrutinize the transactions relating to outgoing business; i.e. where the company is the leader.

➤ **Verification of Reinsurance Inwards**

- The Reinsurance inward underwriting should be as per the norms and guidelines prescribed in the Insurance Act, 1938 IRDA Regulations as well as the company's approved programme.
- The auditor should verify the reinsurance inward transactions are as per the arrangements with re-insurers.
- The auditor should examine the accounting policy of the company in regard to reinsurance business received, premium received and payment of commission and claim costs.
- The auditor should satisfy himself about the system of control over the reinsurance inward programme.
- The auditor should examine the foreign currency transactions and ensure that they comply with Accounting Standards (AS) 11, Accounting for Effects of Changes in Foreign Exchange Rates.
- The auditor should examine whether the outstanding claim figures have been properly obtained well in time, under proper arrangements and adequate provision has been made for outstanding claims.
- The auditor should check whether provision has also been made for claims incurred but not reported.
- Closing balance of the re-insurer's accounts should be reconciled and confirmation should be obtained from them.

➤ **Verification of Reinsurance Outward**

The auditor should apply the following verification measures for reinsurance outward transactions

- The auditor should verify that reinsurance outward transactions are as per the norms and guidelines prescribed in the Insurance Act, 1938, IRDA Regulations and company's approved reinsurance programme.
- The auditor should verify that insurances have been ceded as per agreements entered into with various companies.

- The auditor should verify the confirmations received from re-insurers regarding claims for losses submitted to them.
- The auditor should examine the aspects of reinsurance cession premium, commission receivable, paid claims- recovered, outstanding losses- recoverable from re-insurers.
- The auditor should examine the foreign currency transactions and ensure that they comply with Accounting Standard (AS) – 11.
- The auditor should set whether the sub-ledger balance tallies with general ledger control account. He should also scrutinize selected accounts of re-insurers.
- He should verify any old outstanding claims paid or outstanding at the end of the year.
- The auditor should look into events after balance sheet date which might have significant impact on recovery of claims – paid or outstanding.

COST AUDIT

Cost Audit comprise ;

- (i) Verification of Cost Account records, and
- (ii) Examination of these records to ensure that they adhere to Cost Accounting principles, plans, procedures and objectives.

Types of Cost Audit

(1) On behalf of management :

- (i) Establishing accuracy of cost data
- (ii) Whether objectives of Cost Account being achieved.
- (iii) Abnormal losses and gains with causes.
- (iv) Determine unit cost of production
- (v) Proper overhead rates.
- (vi) Fixation of contract price.
- (vii) Improving quality of Cost Accounting System.

(2) On Behalf of a Customer : For Cost plus contracts

(3) On Behalf of Government : For subsidies etc., may be to determine fair price.

(4) By Trade Association : Maintenance of a price.

(5) Statutory Cost Audit : U/s. 233 B of the Companies Act

Under-noted circumstances may also warrant the introduction of Cost Audit :

- (i) Price fixation, (ii) Cost variation within the industry, (iii) Inefficient management
- (iv) Tax assessment (v) Trade dispute.

Advantage of Cost Audit

To Management	To Society	To Shareholder	To Government
1. reliable data 2. check on wastage 3. inefficiency & corrective action 4. MBE 5. Budgetary control & Standard Costing 6. Valuation of closing stock 7. detection of error and fraud	1. Fixation of Price 2. Justification of price increase by increase in cost of production	Proper records are kept for material, wages, etc.	1. Cost plus contract 2. Ceiling price 3. Inefficient unit. 4. Protection to certain industries 5. Settlement of Trade dispute. 6. Healthy competition among units in industry.

General features of Cost Records

- (ii) **Materials** → Raw material, processed material, consumable stores, etc.
 → Purchased, issued and balance.
 → Cost to include all direct charges upto works.
 → Separate records for wastage, spoilage losses, etc.
 → Method to adjust the loss.
 → Method of valuation actual or standard costing.

(iii) Manufactured components & Intermediaries :

- Separate records
- Quantity and value
- Wastage

(iv) **Stores and Spare Parts :**

- Receipt, issues and balances.
- Quantity and value.
- All direct charges upto works
- Used should be charged to relevant head.
- Wastage separately shown.

(v) **Wages and Salaries :**

- Proper Records to show attendance and earnings.
- Records to show overtime wages, piece rate wage earned, incentive wages and earnings of casual labourer.
- Idle time.
- Extent of wages and salaries capitalised.

(vi) **Overheads :**

- Proper maintenance of records.
- Classified under works, Administration and selling and distribution overheads.
- Allocation of or. to depts., etc.
- If allocation on method other than actuals the variation and its treatment.

(vii) **Service depts. Expenses including Expenses on utilities :**

- Expenses on power, fuel, water and steam (purchased or generated)
- Expenses on subsidized canteen.
- Maintenance depts. Expenses.
- Allocation on reasonable basis.

(viii) **Depreciation :**

- Cost, date of installation, rate of depreciation, and amount of depreciation provided.
- Old assets.
- Minimum rate of depreciation in Company Act.
- AS-6.

(ix) **Packing :**

- Quantity and cost of packing material.
- Wages and other expenses on packing.
- Income received by sale/disposal of spoiled, rejected waste materials.

(x) **By-products :**

- Proper records.
- Receipt, issues and Balances (quantity and value).
- Basis of Valuation.
- Sales realization.
- Expenses on further process of by-product.

(xi) **Production and Sales :**

- Records (quantity and value)
- Separate records of packed and unpacked finished goods.
- Records of Sales and inventory.

(xii) **Inventories :**

- Classified as raw materials, stores and spare parts WIP and finished goods.
- Separate records (quantity and value).
- Physically verified.
- Reasons for shortage and excess.
- Method to determine cost of WIP and finished goods.
- Methods to be followed consistently.

- (xiii) **Variances :** → If Standard Costing i.e. other than actuals then procedure followed to work out cost of the products.
→ Reasons for variances.
- (xiv) **Cost Statements :**
 - As part of cost records.
 - w.r.t. each product.
 - Form of cost sheet (prescribed).
- (xv) **Reconciliation of Cost and Financial Account :**
 - To ensure accuracy.
 - Variations clearly indicated and explained.
 - Period of reconciliation $\leq$ financial year of company.
 - Difference between sales realization and total cost and then it is reconciled with financial P&L A/c. for the period.
 - Specific information in Both A/c. not to be different.
- (xvi) **Royalty :**
 - Records of Royalty paid.
 - With terms of agreement.
 - Basis of computation.
 - Allocation to different cost centers, etc.
 - If it is a direct charge or overhead.
- (xvii) **Statistical Records :**
 - Plant utilization, idle machine time, capital employed, capital W.I.P.
 - Percentage of different raw materials.
 - To have control over various operations and costs.
- (xviii) **Inter – Company transfer :**
 - Normally, no inter co. transfer below cost.
 - Ensure against shifting of profits between corporate investors.
 - Proper valuation of inter-company transfer to generate revenue (duty and tax).

Programme of Cost Audit

- (c) Review of Cost Accounting Records : This will include :
 - i) Method of costing in use – batch, process or unit.
 - ii) Method of accounting for raw materials; stores and spares, wastages, spoilage defectives, etc.
 - iii) System of recording wages, salaries, overtime and spares, wastages, etc.
 - iv) Basis of allocation of overheads to cost centers and of absorption by products and apportionment of service department's expenses.
 - v) Treatment of interest, recording of royalties, research and development expenses, etc.
 - vi) Method of accounting of depreciation.
 - vii) Method of stock-taking and its valuation including inventory policies.
 - viii) System of budgetary control.
 - ix) System of internal auditing.
- (d) Verification of cost statements and other data. This will include the verification of :
 - i) Licensed, installed and utilized capacities.
 - ii) Financial ratios.
 - iii) Production data.
 - iv) Cost of raw material consumed, wages and salaries, stores, power and fuel, overheads provision for depreciation etc.
 - v) Sales realization.
 - vi) Abnormal non-recurring and special costs.
 - vii) Cost statements.
 - viii) Reconciliation with financial books.

Exemption from Cost Audit

The exemption from Cost Audit on year-to-year basis in the following situation :

- (i) Temporary Closure of the company/products.
- (ii) Negligible production activity.

Fees :

	Company having an authorized Capital	Amount of fees to be paid
A	Less than Rs.25 lakh	Rs. 500
B	Rs.25 lakh or more but less than Rs.5 crore	Rs.1,000
C	Rs.5 crore or more	Rs.2,000

Appropriate documents are required to be furnished along with application for exemption :

- (i) True copy of complete Annual Report containing balance sheet and profit and loss account for the year for which exemption is being sought along with copies of the same pertaining to preceding two years.
- (ii) An affidavit containing full facts of capacity utilization turnover and financial status of the company, duly signed by two Directors of the company and authenticated by a Notary Public.
- (iii) A brief note/status report on steps taken by the management for revival of the said unit.

Steps in Cost Audit

Review → verification of cost data → Refer to financial statement → Reporting.

Cost Audit Report

Within 180 days of end of F.Y. to Central Government. A copy to company whether –

- (iii) All information
- (iv) Proper Cost Account records as required.
- (v) Proper returns from Branches.
- (vi) Books give information in manner so required.
- (vii) Cost statement as specified in annexure are kept by company.
- (viii) In his opinion, true and fair view of cost.

Auditor's observation and suggestions ;

- (i) Adequacy or otherwise of Cost Accounting System and suggestions for improvement thereof.
- (ii) Adequacy or otherwise of Budgetary control system, if any.
- (iii) Matters clearly wrong in principle.
- (iv) If price charged for related party transactions is different from normal price and its impact.
- (v) Areas of decline profitability or loss with reasons, including default on payment to Government, F.I. and Banks, etc.
- (vi) Steps required under competitive environment.
- (vii) Export commitments vis-à-vis actual exports.
- (viii) Scope of internal audit of records and its adequacy, etc.

True and fair cost of production :

- (iv) Accepted Cost Accounting principles.
- (v) Costing system appropriate to product.
- (vi) Materiality.
- (vii) Consistency.
- (viii) Prescribed form.
- (ix) Elimination of prior period adjustments.
- (x) Abnormal losses ignored in determination of cost.

Composite Audit

It is not feasible due to :

- (i) Different information system (accounting data / costing data).
- (ii) Objective of Audit. (True and Fair financial statement Vs. Cost).
- (iii) Classification of accounting data (A/c head vs. Cost centres).
- (iv) Confidentiality. (Cost Audit Report is more confidential).
- (v) Applicability (for all Co. vs. Some Industries).
- (vi) Tool of Management (overall results vs. weaknesses in cost the system)
- (vii) Extensive Nature: (cost auditor also on propriety & efficient aspects).

Annexure to Cost Audit Report

- (1) General.
- (2) Cost Accounting System
- (3) Process of manufacture.
- (4) Quantitative Details (*).
- (5) (A) Major Input Materials / Components Consumed (*).
- (B) Standard / Actual consumption of input material per unit.
- (6) Break-up of cost of input materials imported during the year (*).
- (7) (A) Power, fuel and utilities (*).
- (B) Standard / Actual consumption of power, fuel and utilities in terms of quantity per unit of production.
- (8) Salaries and wages (*).
- (9) Repairs and Maintenance.
- (10) Fixed Assets Register and Depreciation.
- (11) Gross Block, Depreciation and Lease Rent.
- (12) Overheads (**)
- (13) Research and Development Expenses (**)
- (14) Royalty and technical know how charges (**)
- (15) Quality Control Expenses (**).
- (16) Pollution Control Expenses (**).
- (17) Abnormal non-recurring costs (**)
- (18) (A) Non-moving stock at end of the year (**)
- (B) Written off stock during the year (**)
- (19) (A) Inventory valuation at end of the year.
- (B) Physical verification of stock.
- (20) Sales of product under reference (quantity, rate amount for current and previous year).
- (21) Margin per unit of output (*)
- (22) Competitive margin against imports (**)
- (23) Value Addition and Distribution of earnings (**).
- (24) Financial position and Ratio Analysis (**).
- (25) Capitalisation of Revenue Expenditure (**).
- (26) Related party transactions.
- (27) Central Excise Reconciliation for product under reference.
- (28) Profit Reconciliation.

* Data for current year 1st previous year and 2nd previous year.

** Data for current and 2 previous year for product under reference and for factory as a whole.

AUDIT REPORT

TRUE AND FAIR : Financial statements are reported to be as true and fair when all of the following hold good –

- Reasonable evidence is obtained in support of the transactions recorded in the books of account;
- Accounting entries passed in the books of account are in conformity with the applicable accounting principles and standards followed consistently;
- The financial statements prepared represent a true summary of transactions that took place during the year;
- The process of classification and aggregation followed in preparation of the financial statements is fair and does not hide a material fact nor does it highlight something which may distort the real state of affairs. The form of accounting statement is in the required form, if any;
- The accounting statements do not contain any misstatement;
- The material transactions recorded in the books are neither illegal nor beyond the legal powers of the client; and
- All statutory and relevant disclosures have been made.

➤ **AUDIT REPORTS UNDER COMPANIES ACT, 1956**

• **Report under section 227 (1A)**

Section 227 (1 A) requires the auditor to make **specific enquiries** during the conduct of his audit. He is, however, not required to report on these matters unless he has any special comments to make. It should be understood that the auditor should only enquire on the specified matters and is not to investigate into them. The matters required to be enquired into are

- 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.
- Whether transactions of the company, which are represented merely by book entries, are not prejudicial to the interests of the company.
- Whether the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the assets of the company as consists of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.
- Whether loans and advances made by the company have been shown as deposits.
- Whether personal expenses have been charged to revenue account.
- Where it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been so received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in account books and balance sheet is correct, regular and not misleading.

• **Report under Section 227(2)**

The auditor has to state whether, in his opinion the said accounts give the information required by this act in the specified manner and give a true and fair view.

- in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
- in the case of the profit and loss account, of the profit or loss for its financial year.

- **Report under section 227(3)**

The auditor's report should state

- Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;
- Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books, and proper returns for the purposes of his audit have been received from branches not visited by him;
- Whether the report on the accounts of any branch office audited under section 228 by a person- other than the company's auditor has been forwarded to him as required by clause (C) and how he has dealt with the same in preparing his report;
- Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns;
- Whether, in his opinion, the Profit and Loss Account and balance sheet complied with the accounting standards referred to in section 211 (3c);
- Whether any director is disqualified from being appointed as a director under section 274(1).
- Whether any cess payable by the company has been so paid and if not the amount not so paid.

The companies (Second Amendment) Act, 2002 provides for section 441A which states as follows:

- (i) A cess on companies will be levied for purpose of rehabilitation or revival of sick industrial Co.
- (ii) These provisions are made in sections 441A to 441F.
- (iii) The amount to be collected must be in a range of .005% to .1% on value of annual turnover annual gross receipts more as the Central Government may notify from time to time in official gazette.
- (iv) The company shall pay the amount to Central Government within 3 months from close of every financial year.

- **Report under section 227 (4A)**

COMPANIES (AUDITOR'S REPORT) ORDER, 2005

➤ **Short title, application and commencement**

- This order may be called the Companies (Auditor's Report) Order; 2005.
- It shall apply to every company including a foreign company as defined in section 591 of the Act, except the following –
 - a Banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
 - an insurance company as defined in clause (21) of section 2 of the Act;
 - a company licensed to operate under section 25 of the Act; and
 - a private limited company with a paid up capital and reserves not more than fifty lakh rupees and does not have loan outstanding twenty five lakh rupees or more from any bank or financial institution and does not have a turnover exceeding five crore rupees.

➤ **Definitions -** In this Order, unless the context otherwise requires

- "Act" means the Companies Act, 1956 (1 of 1956);
- "chit fund company", "nidhi company" or "mutual benefit company" means a company engaged in the business of managing, conducting or supervising as a foreman or agent of any transaction or arrangement by which it in into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of instalments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to

a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to, members;

- “finance company” means a company engaged in the business of financing, whether by making loans or advances or otherwise, of any industry, commerce or agriculture and includes any company engaged in the business of hire-purchase, lease financing and financing of housing;
- “Investment Company” means a company engaged in the business of acquisition and holding of, or dealing in, shares, stocks, bonds, debentures, debenture stocks, including securities issued by the Central Government or by any local authority, or in other marketable securities of a like nature.
- “Manufacturing company” means a company engaged in any manufacturing process as defined in the Factories Act, 1948 (63 of 1948);
- “Mining company” means a company owning a machine, and includes a company which carries a the business of a mine either as a lessee or occupier thereof;
- “Processing company” means a company engaged in the business of processing materials with view to their use, a sale, delivery or disposal;
- “Service company” means a company engaged in the business of supplying, providing, maintaining and operating any services, facilities, conveniences, bureaux and the like for the benefit of others;
- “Trading company” means a company engaged in the business of buying and selling goods.

➤ **Auditor’s report to contain matters specified in paragraphs 4 and 5** - Every report made by the auditor under section 227 of Act, on the accountants of every company examined by him to which this Order applies for every financial year ending on any day on or after the commencement of this Order, shall contain the matters specified in paragraphs 4 and 5.

➤ **Matters to be included in the auditor’s report** - The auditor’s report on the account of a company to which this Order applies shall include a statement on the following matters, namely–

- (i) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
 - Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
 - If a substantial part of fixed assets have been disposed off during the year; whether it has affected the going concern;
- (ii) Whether physical verification of inventory has been conducted at reasonable intervals by the management;
 - Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
 - Whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of accounts;
- (iii) •has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions.
 - Whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company;
 - Whether receipt of the principal amount and interest are also regular;

- If overdue amount is more than one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;
 - Has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained u/s. 301 of the Act. If so, give the number of parties and the amount involved in the transactions.
 - Whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company.
 - Whether payment of the principal amount and interest are also regular.
- (iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a counting failure to correct major weaknesses in internal control system.
- (v) ▪ Whether the particulars of contract or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under the section.
- Whether the transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;
- (This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in anyone financial year).
- (vi) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 58 A and 58AA or any other relevant provision of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or RBI or any Court or any other Tribunal whether the same has been complied with or not?
- (vii) in the case of listed companies and / or other companies having' a paid-up capital and reserves exceeding Rs.50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business;
- (viii) where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of section 209 of the Act, whether such accounts and records his been made and maintained;
- (ix) ▪ is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom' Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall De indicated by the auditor.
- In case dues of sales tax 1 income tax 1 custom tax 1 wealth tax 1 excise duty 1 cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may please be mentioned.
- (A mere representation to the Department shall not constitute the dispute).
- (ix) Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty percent of its net worth and whether it ha incurred cash losses in such financial year and in the immediately preceding financial year.

- (xi) Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;
- (xii) Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out.
- (xiii) Whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/ mutual benefit fund / societies;
 - Whether the net-owned funds to deposit liability ratio is more than 1 : 20 as on the date of balance sheet;
 - Whether the company has complied with the prudential norms on income recognition and provisioning against substandard 1 doubtful / loss assets;
 - Whether the company has adequate procedures for appraisal of credit proposals 1 requests, assessment of credit needs and repayment capacity of the borrowers;
 - Whether the repayment schedule of various loans granted by the night is based on the repayment capacity of the borrower.
- (xiv) If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other securities have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act;
- (xv) Whether the company' has given any guarantee for loans taken by others from bank or financial institutions; the terms and conditions whereof are prejudicial to the interest of the company;
- (xvi) Whether term loans were applied for the purpose for which the loans were obtained;
- (xvii) Whether the funds raised on short-term basis have been used for long term investment; if yes, the nature and amount is to be indicated;
- (xviii) Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company;
- (xix) Whether securities or charge have been created in respect of debentures Issued?
- (xx) Whether the management has disclosed on the end use of money raised by public issues and the same has been verified;
- (xxi) Whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

A Quick Revision of CARO

Not applicable to:- (i) Banking Company. (ii) Insurance Company (iii) Company U/s 25 (iv) Private Limited Company (at only point of time) whose

- Paid up Capital + Reserves $\leq$ 50 lakh &
- Loan o/s < 25 lakh &
- Turnover $\leq$ 5 crore Rs.

Turnover

- (i) Trade discount deducted
- (ii) Sales Tax / Excise duty deducted if credited separately to A/c
- (iii) Commission to IIIrd parties not deducted
- (iv) Sales returns deducted (even if of prior years).

Reserve

{(Capital Reserves + Revenue Reserves + Revaluation Reserves) – (Debit Balance of P/L Account + Misc. Expenses not w/o)}

Loan o/s

In aggregate from Banks or F.I. is to be taken.

Matters to be Considered

1. Fixed Assets

- Proper records
- Physical verification & discrepancies
- If disposed off → going concern

2. Inventories

- Physical verification
- Procedure reasonable (inadequacy)
- Proper records & discrepancy.

3. Loan to parties covered under register U/s 301

Given

1. If yes, no of parties and amount
2. Interested terms/conditions prejudicial
3. Receipt regular
4. If overdue amount > 1 lakh reasonable steps.

Taken

1. If taken no. of parties and amount
2. Interested term/conditions prejudicial
3. Payment regular.

4. Internal Control

- Purchase of inventory and F.A.
- Sale of goods and services
- Is failure to correct weaknesses?

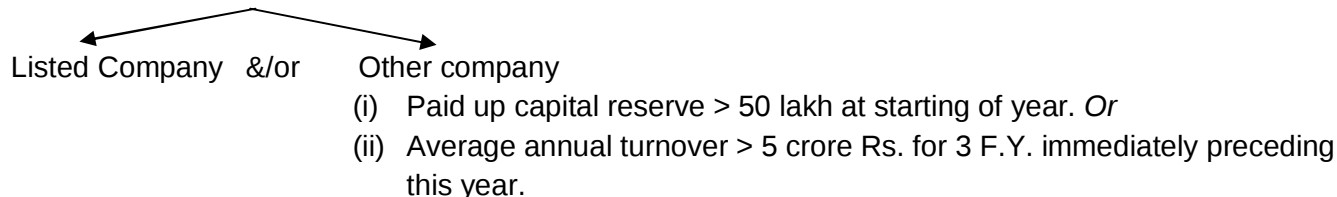
5. Transaction with parties covered under register U/s 301

- Particulars of contract/arrangements entered in register
- Transaction at reasonable prices (for transaction > 5 lakh for each party for each F.Y.)

6. Companies accepting public deposit

- RBI/Companies Act/ any other act complied.
- Order by CLB/RBI/Court/NCLT complied.

7. **Internal Audit**



8. **Cost record** – Whether maintained if prescribed.

9. **Statutory Dues**

- Regular in depositing undisputed statutory dues if not extent of arrears as at balance date exceeding 6 months to be reported.
- If dispute amount and forum.

10. **Company registered $\geq$ 5 years**

- Account losses at end $\geq$ 50% of net worth and
- Cash loss in this / immediately preceding F.Y.

11. **Defaulted** –Payment of dues to Financial Institutions or Debenture holders – Yes paid and amount.

12. **Loan/Advance (secured)** – Proper records/Documents (deficiency)

13. **Special Statutes to chit fund**

- Net owned fund/deposit liability > 1/20 as at B/s.
- Companies complied with prudential norms
- Adequate procedure for cr. appraisal
- Repayment schedule based on repayment capacity.

14. **Company trading / dealing in Sh/Securities etc.**

- Proper records of transfer and contracts
- Timely entries
- Investment in own name (except U/s 49)

15. **Guarantee to Bank/ F.I** – Terms & condition prejudicial

16. **Term loans** – Applied for purpose for which obtained.

17. **Short term funds** – Used for long term (amount & nature)

18. **Preferential allotment to parties covered under register maintained U/s 301**

- Whether made
- Price (whether prejudicial)

19. **Security/charge** – Created for debentures issued.

20. Whether management disclosed **end use of money** raised by public issue and same verified.

21. **Fraud** on / by company reported if yes – nature and amount.

Auditor should consider following while rendering modified report

- The auditor should identify the statements of facts and opinions, which require qualification.
- Where the auditor is in active disagreement with something, which the management had done he would either give an adverse report or disclaim his opinion.
- Where the disagreement with the management is only in respect of a particular item, he may qualify his report.

- iv. Where the item is material enough to distort the true and fair view of *state of affairs* of the company, he may give an adverse opinion in respect of such item.
- v. Where the item concerned is not material, he may even ignore the aspect and issue a clean report.



➤ **AUDITOR'S SEPARATE REPORT TO DIRECTORS**

1. The management of the company may require from the auditor a separate report in addition to his report under section 227 of the Act.
2. The objective of such reports is to provide the management with detailed information regarding procedures, systems, weaknesses in internal controls etc.
3. Such reports should be detailed enough to highlight the weakness and suggestions to improve.
4. However, the auditor should take care that matters, which are material enough to be reported to the shareholders are not contained in his report to the directors.
5. Thus, auditor's separate report to director can not be substituted for an otherwise modified report.



AUDIT CERTIFICATES AND AUDIT REPORT

1. A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
2. The auditors certificate represents that he has verified certain figures and is satisfied about their accuracy.
3. However, a report, is a formal statement made after an enquiry or examination of the specified matters under the report and the auditors opinion thereon.
4. Thus the opinion may differ from one auditor to another as it involves personal judgement.



AUDIT OF COMPANY PROSPECTUSES

According to section 2 (36) of the Companies Act, 1956 'Prospectus' means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.

In order to protect the investors from deceiving offers, the Companies Act has specified certain information to be furnished in detail in the prospectuses.

Reports to supplement the prospectus

Two reports on financial aspects to be included in a prospectus are

- Reports of the statutory auditor or joint auditors of the company; and
- Report of the accountant.

A person who is eligible to be appointed, as an auditor shall be qualified to act as an accountant.



Aspects Concerning the Auditor

- **Signing of the Report** - The requirements of signing of these reports are same as in case of signing of audit report under the Companies Act, 1956.
- **Fees for issue of reports** - The fees for making a report to be attached to the prospectus would be determined on the basis of agreement between the auditor and the directors of the company.
- **Consent Letters** - According to section 60 (3) of the Act, the auditor should give in writing his consent to act in such capacity. The letter should accompany the prospectus when submitted for registration.

- **Liability for misstatements in prospectus** - According to section 62 of the Companies Act, 1956 every person who _as authorized the issue of prospectus will be liable to compensate every person who has incurred any loss or damage due to untrue statement in the prospectus. Section 60 (3) provides that Chartered! Accountants will be liable only for untrue statements made by them in the capacity of expert. Where the auditor is made to compensate for any loss, he may claim contribution from other persons.

However, a professional accountant will not be so liable if he can prove that

- 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 consent; or
 - he withdrew his consent in writing before delivery of the prospectus for registration; or
 - after the delivery of prospectus for registration but before allotment of shares, on becoming aware of the untrue statement, he withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reasons therefore; or
 - he was competent to make the statement and that he had reasonable ground to believe and did upto the time of allotment of shares or debentures believe that the statement was true.
- **Rights of the auditors** - The auditors have right to access the books of account, other records and call for any necessary information from the company.
 - **Communication of the report** – The reports of auditors are addressed to the Board of Directors of the company.

➤ **Aspects Concerning the Accountant**

The reporting accountant is required to report on the profits and losses for the preceding five years and on the position of assets and liabilities. He should separately disclose items of extra ordinary nature in the profit statement. He may also have to adjust the figures in income statement on the following grounds –

- All prior items should be adjusted in the year to which they relate and not in the year in which they came to be known;
- All items of material nature which are not likely to recur should be adjusted in the preparation of profit trend statement, such items may be
 - Heavy repairs and renovation; or
 - Discontinued operations / business; or
 - Abnormal losses
- Where accounting policies have not been consistently followed, the accountant should compute the figures for all periods under report based on the policies applied in the latest period.
- Where the statement of trend of profits contains an interim period or broken period, the accountant may adopt either of the two approaches.
 - He may treat the interim period as part of the whole year. In this case, the items of the income and expenditure should be based on the yearly trend for the period covered by the report; or
 - He may view the interim period as a separate accounting period and items of income and expenditure will be reported at actual for the period. Similar will be the treatment for estimated provisions in the accounts.

With preparing the report to be included in the prospectus, the accountant takes up great responsibility. Thus he should take a note of

- The manner in which the directors, in their estimate of current and future profits, have dealt with the figures shown in the accountant's report and with the matters to which the directors' attention was drawn in that report;
- Material facts known to him, in relation to directors' estimates;
- The manner in which the directors have dealt with any special circumstance.
- Various certificates and representations submitted to him by the management.

In case there is a misstatement in his report and a liability to compensate a person for loss incurred as a result of the misstatement arises, the accountant can protect himself from such liabilities in the manner as discussed for the statutory auditors.

➤ **AUDIT REPORTS / CERTIFICATES ON FINANCIAL INFORMATION IN OFFER DOCUMENTS**

SEBI has been issuing several guidelines for disclosure and investor protection, which include certain financial information to be disclosed. This is in addition to information required as per schedule II to the Companies Act, 1956. This information is required to be audited by a Chartered Accountant.

Requirement regarding audit of financial information in offer documents:

Para 4 of Part A-1 of clarification XIV requires that all financial information forming part of offer documents shall be audited. The following are the various financial information which form parts of offer documents.

1. Auditor's Report

The offer document should include Auditor's Report on the profit and loss statement for the five years immediately preceding the issue of prospectus and on the assets and liabilities as on the date of issue of prospectus.

Adjustments in statement of profit or loss and assets and liabilities:

Clause 20 at Part II of Schedule II to the Companies Act, 1956 requires that "any report required under Part II of this schedule shall either (i) indicate by way of note any adjustments as regards the figures of any profits or losses or assets and liabilities dealt with by the report which appear to the persons making the report necessary or (ii) make those adjustments and indicate the fact that the adjustments have been made.

Where there is a qualification by the auditor with regard to statement of profit or loss, assets and liabilities, all adjustments shall be made in the respective statements itself.

Extraordinary Items

Profit or loss arrived at before and after considering the extraordinary items should be disclosed. The disclosure of such item should be on "net of tax basis".

2. Material Changes in Activities

The offer documents shall also disclose the changes in the activities of the issuer, which may have had a material effect on the financial statements. For example,

- Discontinuance of lines of business.
- Loss of agencies or market and other similar factors.
- Addition of new lines of business.

It is not intended to identify the impact of each change which is part of normal business activities e.g. updating the technology, normal change in product mix, change in ordinary agency relationship. The intention is to identify the changes, which pertain to separate major lines of business.

The management shall prepare the statement disclosing the above. The auditor should check the correctness of the information based on his knowledge of the company's operations. In the case of discontinued operation the following information shall be disclosed.

- Nature of the discontinued operation
- Effective date of discontinuance for the accounting purposes.
- Manner of discontinuance (sale / abandonment etc.)
- Turnover of the discontinued operation.

3. Significant Accounting Policies

All significant accounting policies followed in the preparation of offer document should be disclosed.

4. Transactions with Companies in “Promoter Group”

Disclosure in offer document is called for in respect of

- Sales or purchases between companies in the promoter group when sales or purchases exceed in value, in aggregate, 10% of the sales or purchases of the issuer.
- Material items of income or expenditure arising out of transactions within the promoter group.

5. Disclosure under the heading “Other Income”

Where such income exceeds 20% of net profit before tax the various details of “other income” shall be disclosed, viz.,

- Sources and other particulars of such income
- Indication whether it is recurring or non-recurring and has arisen out of business activities / other than the normal business activities.

The computation of 20% has to be made in relation to net profit or net loss before tax and extraordinary item. The concerned income should be after netting off of expenses, and such netting off is only for computing the relevant “other income”. For the purpose of disclosure in the relevant statement of profit or loss the incomes / expenses should be disclosed at gross amounts in the usual manner.

The disclosure should be

- Source;
- Nature;
- Amount;
- Recurring or non recurring; and
- Whether on account of normal business activity or not.

6. Disclosure of Bifurcated Turnover

- Turnover of products manufactured by the company
- Turnover of products traded by the company and
- Details of products not normally dealt in by the company but included in above should be mentioned separately.

Financial Information in Respect of which the Auditor should give Separate Report to the Management

There are some other financial information that should be provided by the management and the same should be audited by the auditor of the issuer company. The report should also be contained in the offer documents.

(a) Tax shelters

For proper understanding of future maintainable profits the incidence of tax should be properly explained by way of appropriate disclosure. The auditor should examine the detailed computations made by the management to arrive at the figure of provisions for taxation, which has been disclosed in the annual accounts.

(b) Accounting Ratios.

The following accounting ratios for each of the accounting periods for which financial information is given

- Earnings Per Share
- Return on Net Worth and
- Net Asset Value Per Share
- The auditor should satisfy himself that for making various computations for the above accounting ratios, the various items of profit / loss assets and liabilities have been properly adjusted.

- **Earnings per share**

It may be (i) basic earnings per share or (ii) diluted earnings per share.

$$\text{Basic Earnings per Share} = \frac{\text{Net Profit/ loss for the period attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}}$$

$$\text{Diluted Earnings Per Share} = \frac{\text{Net profit attributable to equity shareholders (after adjustment for diluted earnings)}}{\text{Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity shares)}}$$

Return on Net Worth

The formula used is -

$$\frac{\text{Net profit before extraordinary items but after adjusted tax}}{\text{Net worth excluding revaluation reserve at the end of the year}}$$

The term adjusted tax refers to tax provided for the period after adjusting tax attributable to extraordinary items. While calculating net worth, the effect of, revaluation should be ignored. In other words, the assets would be valued on historical cost basis.

- **Net Assets Value Per Share**

- ❖ NAV shall be calculated on the basis of the latest audited balance sheet.
- ❖ It can be computed either by net assets method or net equity method.
- ❖ In the case of net asset method the total liabilities and preference capital are deducted from the total assets.
- ❖ In the case of net equity method, equity share capital is added to reserves and surplus, deducting therefrom miscellaneous expenditure and debit balance of profit and loss account.
- ❖ The auditor should consider
 - ✓ Intangible assets are not taken into account (unless they have been paid for)
 - ✓ Revaluation of assets have not been taken into account
 - ✓ 'Arrears of preference dividend should be provided for
- ❖ The formula for NAV per share is

$$\frac{\text{Net Asset Value}}{\text{Equity shares at the end of the accounting period}}$$

(c) Capitalization Statement

The capitalization statement shows total debt and net worth and the debt / equity ratio before and after the issue is made. Where there is a change in the share capital since the date as of which the financial information has been disclosed in the offer document, a note shall be included explaining the nature of the change.

(d) Disclosure of Project Expenditure

The following information should be annexed to the Offer Document

- actual expenditure incurred on the project upto a date not earlier than 2 months of filling the prospectus with SEBI or Register of Companies whichever is later
- means and sources of financing such expenditure
- year wise break up of the 'expenditure proposed to be incurred on the said project.

The auditor should obtain a management representation regarding details of project expenditure and the means and sources of financing such expenditure and year-wise break-up of expenditure proposed to be incurred on the project. There is no need to audit the information as it is based on estimates arrived at by management.

(e) Bridge Loans

Details of bridge loans or other financial arrangement if any, for incurring expenditure on the project and which would be repaid from the proceeds of, the issue.

(f) Loans

The principal terms of loans and assets charged as security should be disclosed.

(g) Disclosure under “Basic of Issue Price”

The following information shall be disclosed

- EPS i.e. EPS pre-issue for the last three years (adjusted for changes in capital)
- P/E pre-issue - comparison with P/E of industry (giving source of information) Average return on net worth in the last three years
- Minimum return on increased net worth required to maintain pre-issue EPS.
- NAV per share after issue and comparison thereof with the issue price.

(h) Auditor's Certificate on Profit Forecast

The offer documents should also include a forecast of estimated profits for the financial year ending immediately before the date of offer document (if such information is not already given in the offer document) and for the financial year ending immediately after the date of the offer documents. This should be supported by an auditor's certificate, which lists the major assumptions on which the forecast is based and gives assurance on the arithmetical calculations derived, from such assumptions.

COMPANY AUDIT & COMPANY AUDITOR

- (i) Regulation 191 of the chartered Accountants Regulations 1988 allows the Chartered Accountant to act as a liquidator but the Institute of Chartered Accountants of India in order to establish a healthy competition, recommended that where the chartered accountant act as a liquidator, the statement of accounts to be filled u/s 551(1) of the companies act 1956 should be audited by a qualified chartered accountant other than the chartered accountant who is the liquidator of the company.
- (ii) U/s 228(4) of the company's act 1956, the central govt. has formulated Companies (Branch Audit Exemption) Rule. 1961. These Rules require that, if during the said financial year, the average quantum of activity of the branch does not exceed Rs. 200000/- or 2% of the average of total turnover and the earning from the other sources of the company as the whole, which ever is higher, the said branch is exempted.
- (iii) Section 226(3) of the company's act 1956 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for the amount exceeding Rs. 1000/- no matter what the case in the advance was taken.
- (iv) Section 231 of the Companies Act 1956 empowers the auditors of the company to attend any general meeting of the company; to receive all the notices and other communications relating to the general meeting, which member are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concern them as auditors. The discovery of a fact after the issuance of the financial statement that existed at the date of the audit report which would have cost the revision of the audit report requires that the auditor brings this to the notice of shareholders.
- (v) The provisions of the Companies Act 1956 applicable to the appointment of an auditor I place of a retiring auditor due to disqualification, death, resignation etc would be instant cases are given below:-
 - a. Section 225(1): Special notice shall be required for a resolution at an annual general meeting appointing as auditor other than retiring auditor.
 - b. Section 190(2): Special notice id to be given to all the members of the company at least 7 days before the date of AGM
 - c. Section 225(2): On the receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
 - d. Section 225(3): Representation if any, received from the retiring auditor should be sent to the members of the company.
 - e. Section 224A: Special resolution as required under this section should be duly passed
 - f. Section 224(1B): Before any appointment or reappointment of auditor is made at an AGM, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in section 224(1B).
 - g. The incoming auditor should also satisfy himself that the notice provided for under Section 224 and 225 has been effectively served on the outgoing auditor
- (vi) Section (3) (c) of the Companies Act 1956 prescribes that any person who is a partner or in employment of an officer or employee of the co will be disqualified to act as an auditor of a company. Sub-section (5) of section 226 provides that an auditor who becomes the subject, after his appointment, to any of the disqualifications specified in sub-section (3) and (4)
- (vii) Section 224 (7) of the Companies Act 1956 provides that an auditor may be removed from the office before the expiry of his term, by the company only in a general meeting after obtaining the prior approval of the Central Government in that behalf. An exception to this rule this that no such approval is required for the removal of the FIRST AUDITOR appointed by the board of directors u/s 224(5) of the Companies Act 1956.
- (viii) There is no concept of full or part audit u/s 227 of the Companies Act 1956. And the remuneration is a matter of agreement between the auditor and the shareholders. Section 224(8) specifies the remuneration of an auditor, shall be fixed by the company in general meeting or in such a as the company in general meeting may determine.

- (ix) Section 227 of the Companies Act 1956 grants power to the auditor that every auditor has a right to access, at the time to the books of accounts including all statutory records such as minute books, fixed assets register, etc of the company for conducting the audit.
- (x) Section 224(3) of the Companies Act 1956, empowers the Central Government to fill up a vacancy in case no auditors are appointed or re-appointed at an AGM (it is also opined that that the appointment of an auditor has been made by shareholders, sub- section (3) cannot be invoked. Thus the auditor can only be appointed at general meeting by shareholders). Thus the Board of Director is not authorized to fill up the vacancy in case the existing auditor (s) appointed at the AGM refuse to accept the appointment.
- (xi) As per section 224(6) of the Companies Act 1956, casual vacancy can be filled by the Board of Directors, provided that such vacancy has been caused by the resignation of the auditor.
- (xii) Section 226(3) (e), a person holding any security of the company after a period of 1 year from the date of commencement of the Companies (Amendment) Act 2000 w.e.f. 13 December 2001 is not qualified for appointment as the auditor if the company. For the purpose of this section, "Security "means an instrument which carries voting rights. A firm would also be disqualified to be appointed as an auditor even when 1 partner is disqualified u/s 226(3) (e).
- (xiii) Section 229 of the Companies Act 1956 requires a person that only a person appointed as the auditor of the company or where a firm is so appointed, a partner in the firm practicing in India, may sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.
- (xiv) Section 224 (5) of the Companies Act 1956 lays down that " the first auditor of a company shall be appointed by the Board of Directors within one month of the date of registration of the company. But in case of a Government company the appointment or reappointment of the auditor is governed by provision of section 619 of the Companies Act 1956 and shall be appointed by the Comptroller and Auditor General of India.
- (xv) Section 224(1A) of the act deals with the duties of an auditors requiring auditor to make an enquiry in respect of specified matters. Since the law requires the auditor to make an enquiry, the institute opined that the auditor is not required to report on the matter specified in sub-section (1A) unless he has any special comments to make on any of the terms referred to therein.
- (xvi) Section 227 of the Companies Act 1956 lays down that the power and duties of the auditor. As per the provision of the law, it is no part of the auditor's duty to send the copy of his report to member of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of the company to send the report to every member of the company.
- (xvii) Section 227(1) (g) of the Companies Act 1956, the auditor has to ensure that the written representation has been obtained by the board from the each director that one is not hit by section 274 (1) (g).
- (xviii) Under the Chartered Accountants Act 1949 only a chartered accountant holding the certificate of practice can engage in public practice. Chartered accountant of any other country can't be appointed as the auditor of a public company of India. Under Chartered Accountant Act 1949 an auditor of public limited company of India must hold the certificated of Practice from the Institute of Chartered Accountant of India.
- (xix) Companies (Audit Report) Order 2003 applies to all the Companies including a foreign company as defined u/s 591 of the Companies Act 1956.the Order specially exempt banking Companies, insurance companies and the companies which has been licensed to operate u/s 25 of the Act. The order also exempts from its application a private company which fulfils certain conditions.
- (xx) Section 209 of the Companies Act 1956 states that every company shall keep at its registered office proper books of accounts with respect to all sums of money received and spent, all purchase and sell of goods all assets and liabilities of the company and the required cost records. However if the company requires to keep the books of accounts at any place in India as the Board pf Directors may decide, then within seven days of the decision it should be file with the registrar a notice in Form 23 AA in writing giving the full address of the place.

- (xxi) Section 231 of the Companies Act 1956 confers the right on the auditor to attend the general meeting. The section does not cast any duty on the auditor to attend the annual general meeting. The law only confers right on the auditor to receive notices and also attend the general meeting if he so desires.
- (xxii) Section 233A of the Companies Act 1956, under the circumstances as specified in the section, empowers the Central Government that it may issue direction to the effect that a special audit of the company's account for the specified period shall be conducted. No matter whether the member of ICA has the certificate of practice.
- (xxiii) Section 274(1)(g), if the director is already holding a directorship of a "public company" which has not filled the annual account and annual returns for the continuous three financial years shall not be eligible to be appointed as the director of any other public company.
- (xxiv) As per para 4(vii) of CARO 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business. The clause has a mandatory application in respect of listed companies. For other company it is applicable if either of the following conditions is satisfied.
 - i. The company has a paid up capital and reserve exceeding Rs. 50lac at the commencement of the financial year.
 - ii. The company has an average annual turnover of Rs. 5cr or more for a period of 3 years proceeding the current financial year.

DIVIDENDS

Out of Current Profits		Out of Post Profits which had been transferred to Reserve
<u>Div. Reserves</u>	<u>% of Profits to</u>	1. Rate of Div. $\leq$ Average Div. rate in immediate preceding 5 yrs. Or 10% (Less) &
$\leq 10\%$		2. Amount withdrawn $\leq 10\%$ of (Paid up Capital + free Reserve) and this amount first be utilised to set off losses incurred in this year. &
$> 10\%$ but $\leq 12.5\%$	$\geq 2.5\%$	3. Balance of Reserve $\geq 15\%$ of paid up capital.
> 12.5 but $\leq 15\%$	$\geq 5\%$	
$> 15\%$ but $\leq 20\%$	$\geq 7.5\%$	
$> 20\%$	$\geq 10\%$	

Transfer to Reserve Exceeding 10%

Company declaring dividend also		Company not declaring dividend
No Bonus in this/ immediately preceding 3 years	Bonus in this/ immediately preceding 3 years	Amount proposed to be transferred to Reserve $<$ average amount of Div. declared in immediately preceding 3 years.
↓	↓	
Rate of Dividend $\geq$ Average rate of Div. in immediately preceding 3 years.	Rate substituted by amount	

Superseding condition

If this year PAT $\leq 80\%$ of average PAT for immediately preceding 2 years no need to maintain aforesaid conditions i.e. company can transfer to Reserve $> 10\%$ without any restriction.

Points to be noted

- Profits are profits after pointing for current & arrears of dep.
- Profits are after tax and after debiting for statutory development reserve.
- Rates of Div. are equity div. rate + portion of div. in excess of fixed rate for participating preference shares.
- Transfer should be only to free reserve.

➤ **VERIFICATION OF DIVIDEND**

- He should examine the Memorandum and Articles of Association of the Company to determine the rights of different classes of shareholders to whom dividend has been paid.
- He should ensure that dividends can only be distributed out of profits. The capital of the shareholders can not be used for the purpose of payment of dividends.
- He should ascertain whether profits earmarked for the purpose of dividend have been computed in accordance with the requirements of section 205 of the Companies Act.
- He should ascertain whether the rate of dividend has been recommended properly in a meeting of the Board of Directors.
- He should inspect the shareholders minute book to verify the amount of dividend declared and confirm that the amount does not exceed the amount recommended by the directors.
- He should see that profits appropriated for payment of dividend are after transfer to reserves an amount in accordance with the rules framed by the Central Government.
- He should examine the list of shareholders as drawn from the Registrar of Shareholders and see that the total amount of dividend payable companies with the Dividend Account.
- If a separate bank account is opened for payment of dividends, he should check the transfer of total amount of dividends payable from the Dividends Account.
- He should verify the amount of unclaimed dividend with the Dividend Account, bank Pass Book and dividend warrants as have been returned undelivered.
- He should see that where the dividend is declared, distributed or paid by a domestic company (not a foreign company), the tax on distributed profit at the rate of 10% is paid within 14 days from the date of declaration, distribution or payment of dividend whichever is earliest. [Section 115(0) of the Income Tax Act, 1961]
- The auditor should see that the dividend which remains unpaid or unclaimed within 30 days of the declaration of the dividend, such unpaid or unclaimed dividend has been transferred to a special bank account entitled "Unpaid Dividend Account of _____ Company Limited / Company Pvt. Limited". The transfer must be made within 7 days from the date of expiry of 30 days. Such an account is to be opened only in a Scheduled Bank.
- If any dividend remains unpaid or unclaimed for a period of seven years from the date of transfer, the amount standing to the credit of the special bank account has to be transferred by the company to the fund called Investor Education and Protection Fund.

AUDITORS DUTY WITH REGARD TO DEPRECIATION

1. Companies Act provides only minimum rates. The company can charge depreciation at a higher % also. (or it means lesser life).
2. The company can adopt different methods for different type of assets provided the same is consistently followed.
3. Change in method of depreciation should be with retrospective effect and only if it is required by statute or accounting standard or if it results in better presentation.
4. The accounts must disclose the methods which have been used to calculate depreciation.
5. Low-value items may be fully depreciated provided this is disclosed appropriately in the accounts.
6. Depreciation should be calculated from the date when the asset is ready to use.
7. When the asset is installed during the year, check that it is only pro-rate depreciation that appears in the accounts.
8. In case of revaluation of assets, check the depreciation on revalued part (whether charged to Profit & Loss Account or revaluation reserve).

PROFESSIONAL MISCONDUCT

Sec.2 (2):

Members deemed to be in practice: If he

- (i) **Engages** himself in practice of accountancy, or
- (ii) **Offers** to perform audit related services or **holds** himself out to the public as an accountant, or
- (iii) **Renders professional** service or assistance in Matters of accountant interest etc., or,
- (iv) **Renders** such other services which as per opinion of the council, to be rendered by C.A. in practice. (Mgt. consultancy service)

Explanation : (1) C.A. who is salaried employer of C.A. in practice shall be deemed to be in practice for limited purposes of training articled clerk.

- (2) C.A. shall be deemed to be in practice if he, in his professional capacity (not in personal/employee's capacity) acts as liquidator, trustee, executor, adviser & same or takes up an appointment made by Govt. or court or other legal authority. However for this purpose his engagement shouldn't be on a salary-cum- full time basis.

Significance of certificate of Practice:

As per judicial ruling;

- (i) Once a member of ICAI appears before I.T. authorities etc. he can so appear only in his capacity as a C.A.
- (ii) Thus for period of suspension, he can't practice as I.T. practitioner even if he is having law degree.
- (iii) Thus, a member of ICAI can't have other capacity, separable from his capacity to practice as a member of the Institute.

Section 7:

A member in practice can't use any other designation than that of a Chartered Accountant nor any other description whether in addition thereto or in substitution therefore. However they can use any other letter etc. indicating degree of other institutions.

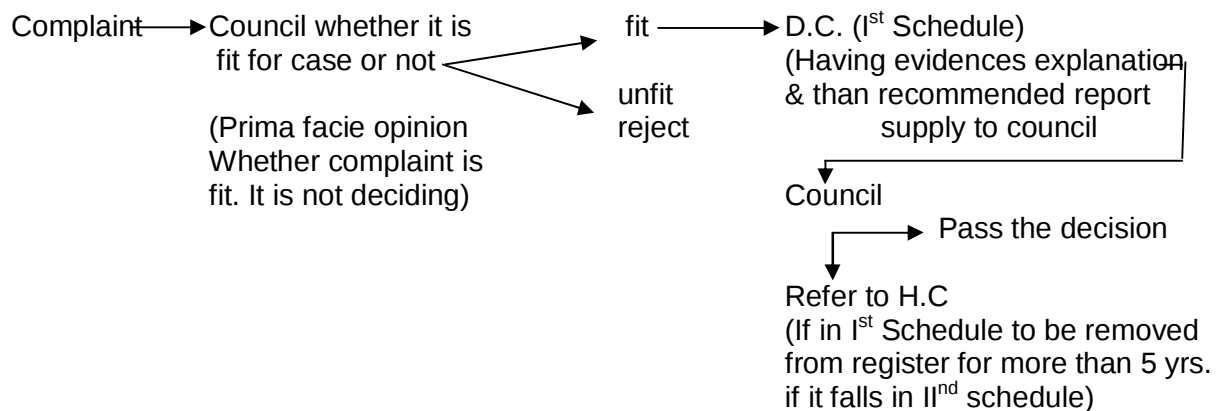
Section 8 : Disabilities for purpose of membership :

- (i) If he isn't 21 yrs. or
- (ii) If he is of unsound mind as per a competent Court, or
- (iii) Undischarged insolvent, or
- (iv) Discharged insolvent but hasn't obtained from the court a certificate stating that his insolvency was by misfortune without any misconduct on his part, or
- (v) Convicted of an offence involving moral turpitude unless he has been granted a pardon etc. or
- (vi) If removed from membership of ICAI due to misconduct.

If the person fails to disclose the fact that he suffers from any of disabilities aforementioned, it will constitute professional misconduct on his part.

Section 21 : Procedure in enquires for disciplinary matters :

Complaint → Council → Disciplinary Committee → Council → High Court (if need arises)



- (i) At first stage, council is framing just prima facie opinion with respect to complaint.
- (ii) It is not deciding whether C.A is guilty or not.
- (iii) Normally no fresh evidences are permitted before council, once the disciplinary committee submitted its report to council. However council may permitted the same at its own discretion.
- (iv) The recommendation report of D.C. in to be given to C. A concerned before submitting it to the council & it is also giving opportunity of being heard.
- (v) The C.A. concerned will appear to council either himself or may be represented by some other C.A (not by Lower)
- (vi) Without any complaint, the council may also take any action suo-moto.

Section 24: Penalty for falsely claiming to be a member :

Any person who :

- (i) Not being member of ICAI represents that he is a member of Institute or uses the designation Chartered Accountant, or
- (ii) Being member of ICAI but not having COP represents that he is in practice or practices as CA, Shall be punished.

Section 27 : Maintenance of Branch office :

Office: Where name Board of firm is affixed or which is described as place of business on any professional stationary. Thus a C.A can have a name plate of himself describing him as Chartered Accountant but not that of the firm at his place of residence, as it will be construed as branch

As a general rule, Each one of such offices should be in separate charge of a member of Institute.

Exception (No separate in charge is needed)

For member practicing in Hilly Areas	For all members
(i) In plains for period ≤ 3 months in winter season, & (ii) Temporary office not to be mentioned as place of Business & (iii) Correspondence continue at permanent office, & (iv) Before coming to plains in every winter & at close of such office in plains, inform ICAI. (v) Name board of firm to be displayed at temporary office only during these 3 months.	(i) If second office is located in same accommodation or premises or (ii) If second office is located in same city, or (iii) If second office is Located within 50 kms. From Municipal limits of city in which 1 st office is situated.

Schedules

First Schedule

(order passed by council. Refer to H.C. only if C.A. is to be removed from register of members for more than 5 yrs.)

→ **Part 1** (13 clauses) CA in practice

→ **Part 2** (3 clauses) CA in service

→ **Part 3** (3 clauses) CA general

Second Schedule

(Straight forward refer to H.C.)

→ **Part 1** (10 clauses)
CA in practice

→ **Part 2** (2 clauses)
CA general

First Schedule

Part I (C.A. in Practice)

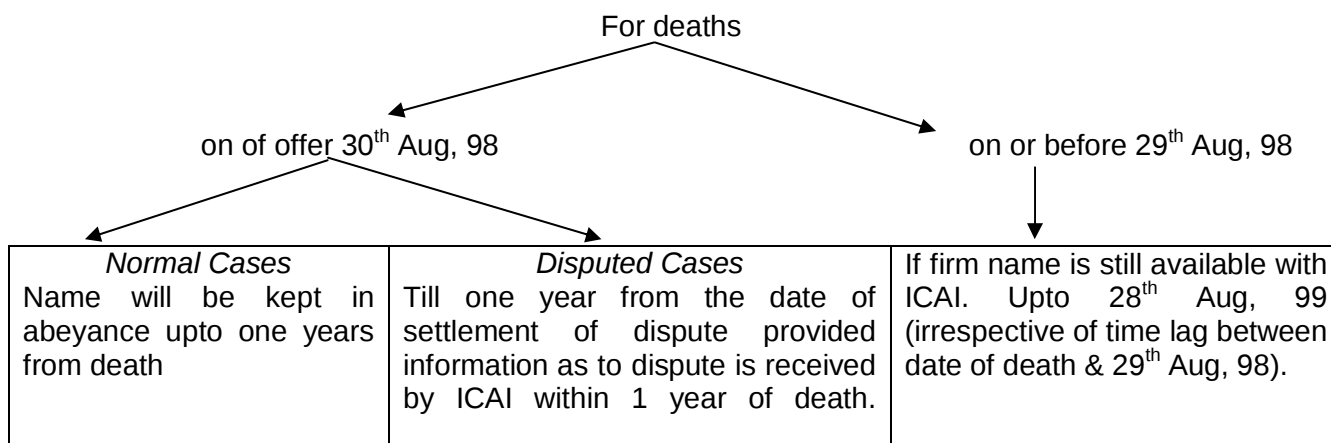
Clause 1 :

Allows any person to practice in his name as a C.A. unless such person is also a C.A. in practice and is in partnership with or employed by himself.

Clause 2 :

Pays / allows / agrees to pay or allow directly or indirectly any share commission or brokerage in fees or profits of his professional business to any person other than a member or partner or retired partner or legal representative of deceased partner.

- ⇒ Widow can continue to receive a share of firm if partnership agreement contains a provision.
- ⇒ Now onwards, on death of sole proprietor, the name of the firm will be kept in abeyance by the institute for one year so that to enable the widow of deceased to sell g/w of the firm.

**Clause 3 :**

Accepts / Agrees to accept any part of the profits of the professional work of a lawyer, auctioneers, broker or other agent who is not a member of institute.

Clause 4 :

Enters into partnership with any person other than C.A. in practice or a person resident without India who but for his residence would be entitled to be registered or whose qualification are recognized by Govt./ Council / provided C.A. shares in fee / profits of business of partnership both within and without India.

⇒ This clause applies only to profession of C.A. and not to other business, which is covered by clause 11.

⇒ Clause 5 :

Secures, either through the services of a person not qualified to be his partner or by means which are not open to a C.A., any professional business.

Clause 6 :

Solicits clients or professional work either directly or indirectly, by circular, advertisement, personal communication or by any other means."

(a) **Adv. And note in press :** As a general rule he **can't advertise**

Exception :

- (i) change in partnership, address and tel. no. having bare statement of fact and no. of insertion and limited distribution of new spares.
- (ii) Classified ad. In journal / news letter of institute for sharing professional work/partnership, etc. provided firm name and address is not given.

(b) **Empanelment for allotment of audit/proff. work :**

- ⇒ Only if penal's existence is known.
- ⇒ No roving enquiries
- ⇒ Quote fee only if enquired.
- ⇒ No printed / cyclostated copies of fee.
- ⇒ Shouldn't respond to empanelment requiring registration or other fee or other deposit. *However as per new notification, a C.A. can respond to tender etc. if required by Govt. agency etc. In this case, he can pay reasonable price for tender document. For earnest money, if services are restricted to C.A. as per law, they can't deposit otherwise they can.*

(c) **Publication in telephone / other directories :**

- ⇒ Section of C.A. belonging to particular town / city.

- ⇒ Normal letters, logical order.
 - ⇒ Reasonable payment, no restriction on entries.
 - ⇒ No impression of publicity.
- (d) **Responding to Tenders, Adv. / Circulars :**
- ⇒ Shouldn't Respond to
 - ⇒ (i) adv. For appointment.
 - (ii) Quotation for services restricted to C.A. and
 - (iii) Inquiry for quotation of fee if it is made to more than one C.A.
 - ⇒ However, they can respond (i) in other areas (other than audit) where they compete with non C.A. and (ii) in outside country (even in audit field) if receipts are in foreign currency (ensure not to constitute undercutting and also confirm to minimum fee restrictions prescribed by ICAI)
 - ⇒ However as per new notification, when matter relates to audit and related services, which as per law can be provided only by a C.A. the member may respond to such adv./queries/letter etc. if same is sought by World bank/IMF/Asian development Bank or similar Institution or any Govt. Co. or entity sponsored by Govt./nationalized Institution or any similar body.
- (e) **Issuing Hand Bills :**
- To persons other than clients such as changes in tax.
- (f) **Publication of Books and Articles :**
- No indication as to association with any firm of C.A.
- (g) **Issue of greeting cards or invitation :**
- Designation and name of the firm may be printed on invitation provided sent to clients relatives and close friends.
- (h) **Roving inquiries :**
- No sending of such inquiries to prospective clients.
- (i) **Seeking work from professional colleagues :**
- Not permissible except in a(ii) i.e. journal.
- (j) **Scope of Representation U/S 225(3) :**
- Merely state that he has acted independently and may indicate willingness but no extra publicity. No derogatory remarks against company.
- (k) **Acceptance of work, emanating from a client introduced by other C.A. :**
- Shouldn't accept. Client should come through the introducing C.A.
- (l) **Public Interview :**
- No publicity, details about firm / professional attainments.
- (m) **Adv. Ur Bondex No. :**
- Prohibition.
- (n) **Web-site :**
- ⇒ CA / CA firm free to create own website (no std. Format, no restriction on colour).
 - ⇒ Website run on 'pull' mode not on 'push'.
 - ⇒ Can mention Website Address on professional stationery.
 - ⇒ Specific 'pull' request for :
 - (i) Nature of services rendered.
 - (ii) Area of Exp. of partners.
 - (iii) Area of exp. of employees.
 - (iv) No. of articled clerks.
 - (v) Nature of assignment handled.

- ⇒ *Can't give* : (i) Name of clients and fee charged; (ii) No logo; (iii) No photograph (however passport size photograph of member can be given) (iv) No Adv. (v) Ref. About website (other than that of ICAI and Govt. related.).
- ⇒ Articles etc. of professional interest can be given.
- ⇒ Bulletin Boards can be provided.
- ⇒ Chat room between client and CA is permitted.
- ⇒ Listing on suitable search engine is permitted if restricted to CA, Indian CPA etc.
- ⇒ Details shouldn't solicit client or adv.
- ⇒ Secrecy of matters of clients through website.
- ⇒ If he is member of a professional body or chamber of commerce offering listing → permitted.
- ⇒ Strict compliance with guidelines is required.
- ⇒ Address of website can be diff. from name of the firm but should be as near as possible to such name of CA/CA firm).
- ⇒ Address of website → intimation to ICAI alongwith annual membership form.
- ⇒ Mention date upto which it is updated.
- ⇒ They can provide services through other websites also provided contact address of CA and professional achievement is not given.

Clause 7 :

Advertises his professional attainment or services or uses any designation or expression other than Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of an University established by law in India or recognized by the Central Government or a title indicating membership of ICAI or any other institute recognized by Central Govt./by Council.

- ⇒ He can't use words like income-tax consultant, cost consultant or management consultant.
- ⇒ Can't use 'Member of Parliament', etc. in addition to that of Chartered Accountant.
- ⇒ Persons eligible otherwise, subject to permission may practice as advocates but can't use designation "Chartered Accountant" and "Advocate" simultaneously.
- ⇒ Name, description and address of member (firm) may appear in any directory or list of members of a particular body (alphabetically). He may provide appropriate directorship held and reasonable personal details (outside Interest) but not name of clients and services offered by his firm.
- ⇒ Photograph and brief particulars in magazine (No payment/No Adv.).
- ⇒ Advertisement is permissible (not bolder than substance)
 - (i) Recruiting staff in own office.
 - (ii) Recruiting staff or acquiring/disposing business/property on behalf of client.
 - (iii) Sale of Business/Property acting as trustee, liquidator or receiver.
- ⇒ Success in exams may be given without any undesirable publicity w.r.t member/firm/clerk.
- ⇒ May appear on T.V. films/Radio, etc. describe themselves as Chartered Accountant qualification but no reference, as to name/address/services of firm. It is a duty of C. A to insure that host doesn't refer to any such thing.
- ⇒ Publicity is permitted for appointment of position of local/national importance, etc. They may mention membership of ICAI but not firm.
- ⇒ Use of glow sign-board/light or large size board is not proper. He may have a name board of himself at residence but not of a firm.
- ⇒ Prospectus of the company in which he is a director shouldn't advertise his professional attainment. Firm name not permissible. Expression like "In association with" , "Associates of" not proper.
- ⇒ Use of logo ⇒ not permissible at all.

Clause 8 :

Accept a position as Auditor previously held by another chartered accountant or restricted state auditor without first communicating with him in writing.

- ⇒ Professional reasons for not accepting Audit fee.
 - (ii) Non-compliance of provisions of section 224 and 225.
 - (iii) Undercutting of fee.
 - (iv) Non-payment of undisputed audit fee (except sick unit)
 - (v) Issuance of qualified Report.
- ⇒ In first three, if he accepts professional misconduct. In (iv), he may accept if he thinks that attitude of retiring auditor wasn't proper and justified. But if he qualified it for good and valid reasons, he should refuse.
- ⇒ If dispute regarding fee not paid, he (incoming) may use his influence in favour of his predecessor to have dispute settled.
- ⇒ If prospective clients tells the member about change of auditor. Ask him if retiring one has been informed, if yes communicate with retiring. If not, ask reasons for change if no valid reasons he shouldn't accept. However, if he chooses to accept, communicate with retiring.
- ⇒ Incoming can act after waiting for reasonable time for a reply.
- ⇒ Mere posting "under certificate of posting" is not sufficient. Positive evidence (acknowledgement) that letter has in fact reached the person.
- ⇒ Applies to all audit assignment including internal concurrent, tax audit, healthy practice for special audit u/s 142(2A) of I.T. Act also.
- ⇒ Outgoing should sent a reply as soon as possible (No violation of confidentiality).
- ⇒ Duty of communication is absolute & required is every case, even when appointment is made by government or when if previous auditor knows about the appointment.
- ⇒ The incoming auditor should communicate with previous auditor who was there in same capacity.
- ⇒ Take care of new point in AAS-4.

Clause 9 :

Accepts an appointment as auditor of a company without ascertaining from it whether requirement of section 225, in respect of such appointment have been duly complied with.

Clause 10 :

Charges/offers to change accepts/offers to accept w.r.t. any professional employment, fee based on a % of profits or which are contingent upon findings or results of such employment, except in cases which are permitted.

- ⇒ Not contingent if fixed by court/public authority.
- ⇒ Exception (may by % of profits) :
 - (i) Receiver or liquidator (% of realization).
 - (ii) Auditor of Co-op. Society (% of paid up/working capital, gross/net income/profit).
 - (iii) Valuer.

Clause 11 :

Engage in any Business (occupation other than profession of C.A. unless permitted by council so to engage).

However, he can always become director (not M.D.) in a company provided he/his partner is not interested in such co., as an auditor.

"General Permission"

- (i) Employment under C.A./C.A. firm.
- (ii) Private tutorship.
- (iii) Authorship of Books/Articles.
- (iv) Holding Life Insurance Agency licence (Renewal Commission.).
- (v) Attending class and appearing in any exams.
- (vi) Holding public elective office (M.P., M.L.A.)

- (vii) Honorary office of charitable – educational institute.
- (viii) Notary public, Justice of peace, Special Executive Magistrate and like.
- (ix) Part time tutorship under coaching organization of institute.
- (x) Valuation of paper, paper setter, head-examiner or moderator for any exam.
- (xi) Editorship of professional journal.
- (xii) Acting as Surveyor/Loss Assessor under Insurance Act.
- (xiii) Recovery consultant
- (xiv) Insurance brokerage.

“Specific Permission”

- (1) Full time/Part time employment in Business concerns provided he/his relative not having sub. intt.
- (2) Full time/Part time employment in non-business concern.
- (3) Managing Director/Whole-time Director concern.
- (4) Intt. In family Business concern.
- (5) Intt. In agriculture/allied activities with help of hired labour.
- (6) Intt. In any educational institute.
- (7) Part time/Full time lectureship for courses other than C.A. exams.
- (8) Part time/Full time tutorship under any educational institute other than coaching org. of institute.
- (9) Editorship of journal other than professional one.
- (10) Any other Business/Occupation considering it to be necessary to take permission.

However, they may act as liquidator trustee, executor, etc., or may take an appointment made by Govt./Court/Legal Authority in professional. capacity provided it is not a salary-cum-full-time basis.

⇒ If not designated as M.D. or W.T.D. but entrusted with whole/substantially the whole of management of affairs of company, deemed to be M.D.

The Council at its 242nd meeting noted the recommendations made to it by the Executive Committee and accordingly passed the following resolution as a part of and in continuation of the existing resolution under Regulation 190A which appears as Appendix no. 9 to the C.A. Regulations, 1988 (2002 edition)

IT IS FURTHER REOLVED that the general and specific permission granted by the Council is subject to the condition that –

- (i) Any member engaged in any other business or occupation, in terms of general or specific permission granted as per Appendix NO. (9) shall not be entitled to perform any attest function except in the following cases:
 - (a) Authorship of books and articles.
 - (b) Holding of Life Assurance Agency Licence for the limited purpose of getting renewal commission.
 - (c) Attending classes and appearing for any examination.
 - (d) Holding of public elective offices such as M.P., MLA & MLC.
 - (e) Honorary office-bearership of charitable, educational or other non-commercial organizations.
 - (f) Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
 - (g) Part-time tutorship under the Coaching Organisation of the Institute.
 - (h) Valuation of papers, acting as paper-setter, head-examiner or a moderator for an examination.
 - (i) Editorship of professional journals – (not in employment)
 - (j) Acting as surveyor and Loss Assessor under the Insurance Act, 1938 (not in employment).

- (k) Acting as Recovery consultant in the Banking Sector (not in employment)
 - (l) Any coaching assignment organized by the Institute, its Regional Councils and Branches of Regional Councils.
 - (m) Engagement as Lecturer in an University, affiliated college, educational institution, coaching organisation, private tutorship, provided the direct teaching hours developed to such activities taken together do not exceed 25 hours a week.
 - (n) Engagement in any other business or occupation permitted by the Executive Committee from time to time.
 - (o) Insurance brokerage.
- (ii) A member who is not entitled to perform attest function shall not be entitled to train articled clerks.

Clause 12 :

Accepts a position as auditor previously held by another in such condition as to constitute undercutting.

Consider the following:

- (i) Quantum of work.
- (ii) Incidental and out Of pocket expenses.
- (iii) Other terms of appointment.

Clause 13 :

Allows a person not C.A. or a member not his partner to sign on his or his firm behalf, any B/S, P&L A/c. report of financial statement,

PART – II

In relation to C.A. in service

- (a) If pays/allows/agrees to pay directly/indirectly to any person any share in emoluments of the employment undertaken by member.
- (b) Accepts/agrees to accept any part of fees, payment or gain from a lawyer, C.A., broker engaged by company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.
- (c) Discloses confidential information acquired in the course of his employment except as and when required by law/permitted by employer.

PART – III

In relation to C.A. (generally)

- (i) If he includes in any statement, return or form to be submitted to council, particulars knowing them to be false.
- (ii) If he, not being a fellow styles himself as a fellow.
- (iii) Doesn't supply information called for, or doesn't comply with requirement asked for, by council or any of its committees.

SECOND SCHEDULE

Referred to H.C. for decisions

PART – I

Professional misconduct in relation to C.A. in practice.

Clause 1 :

Discloses information acquired in the course of his professional engagement to any person other than his client, without consent of his client or otherwise than as required by any law for the time being in force.

⇒ Request for disclosure must come from client.

⇒ *Duty in relation to unlawful act by client :*

- (i) No duty on C.A. to inform I.T. Authorities.
- (ii) No duty to shield him from consequences of tax frauds.
- (iii) Disclosure immediately. If small fraud may be made with submission of current return.
- (iv) Genuine mistake/omission client won't object to make complete disclosure.
- (v) Fraud in past returns/A/c. in which no same C.A. Client is advised to disclose. He may continue to act.
- (vi) Fraud relates to A/c. examined/reported by same C.A. client advised to disclose. If he refuses, disassociate himself and disclose the same in report to authorities.
- (vii) If fraud in returns/a/c. currently being prepared client advised to disclose. Else reservation in his report and disassociate with return.
- (viii) Member's assignment is dispensed with before A/c. completed/reported on/return submitted → no further duty.
- (ix) Relates to A/c. not prepared/reported by member, for example where he is preparing business returns while fraud is there is individual return of partner, he may continue with Business A/c. but under no obligation to do so.
- (x) Impression on Client :
 - (a) Disclosure only penalty, non disclosure with fine/imprisonment.
 - (b) Intimation by member to I.T. authorities about disassociation can start investigation against client.
- (xi) Summon the member to examine him on oath, legal expert advice is taken.
- (xii) For production of Books of Accounts/Documents → Expert advice.

Clause 2 :

If he certifies/submits in his/his firm's name a report of an examination of financial statements unless examination is made by him / a partner / employee / another C.A. in practice.

Clause 3 :

Permits his / his firm's name to be used in connection with estimate of earnings contingent upon future transaction in manner which may lead to belief that he vouches for accuracy of the forecast.

⇒ He may participate in preparing and servicing them provided he clearly indicates source of information, basis of forecasts and major assumption and so long as he doesn't vouch for accuracy of the forecasts.

Clause 4 :

Expresses his opinion on Financial Statement of any Business / Enterprise in which he, his firm or partner has substantial intt. Unless he discloses intt. Also in his report.

- ⇒ Council clarification : He or his firm name shouldn't accept.
 - (i) Accept auditorship of college in which he's lecturer.
 - (ii) Accept auditorship of trust wherein he/partner is either employee or a trustee.
- ⇒ Enterprise/Business in which he's either owner or partner → shouldn't accept.
- ⇒ Enterprise/Business in which his partner/relative has sub. intt. → Disclose the fact if audit the same.
- ⇒ Company in which he is director → shouldn't accept.
- ⇒ Company in which his Partner/Relative is director having sub. Intt. → Disclose the fact if audit the same.
- ⇒ He should take care of the same while acting as Tax Consultant/Financial Advisor also.
- ⇒ Members not to write Books of Account of clients.
- ⇒ St. Auditor not to become its Internal Auditor.

Clause 5 :

Fails to disclose a material fact known to him which is not disclosed in the Financial Statement, but disclosure of which is necessary to make financial statements not misleading
→ Refer to SAP-13 'Materiality' and AS.

Clause 6 :

Fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

Clause 7 :

Is grossly negligent in conduct of his professional duties.

⇒ He should perform it with due skill and care.

⇒ Like in circulation of newspapers (certification).

Clause 8 :

Fails to obtain sufficient information to warrant the expression of opinion as his exception are sufficient material to negate the expression of opinion.

⇒ He shouldn't express it before obtaining required information.

⇒ He should reproduce (brief self-explanatory explanation) the notes of qualificatory nature in report to enable reader to know importance of these qualification.

Clause 9 :

Fails to invite attention to any material departure from generally accepted procedure of audit applicable to the circumstances.

⇒ Refer to AAS .

Clause 10 :

Fails to keep moneys of his client in separate banking A/c. or to use such moneys for purposes other than those for which they are intended.

Explanations :

(i) Advance received by C.A. against services to be rendered doesn't fall under this clause.

(ii) It doesn't apply to expenses to be spent within reasonably short time. These need not be deposited into separate bank account.

PART - II

Members of the Institute Generally.

Clause 1 :

Contravenes any of the provisions of this Act or Regulation made thereunder.

⇒ Mainly in connection with Articles, part-time employment, restriction on fees.

⇒ **Some important points:**

1. Monthly payment of stipend to every article. It must be confirmed beyond all doubts that payment has been made.
2. It is duty of C.A to forward article deed to ICAI.
3. A CA can't take loan from any enterprise in which article is interested. However he may accept the same from any enterprise where in articles farther or relative is interested. But it must not be taken as a consideration for admitting the article into firm.
4. Now no premium can be accepted by C.A
5. Practice work only after obtaining COP.

Clause 2 :

Is guilty of such other act or omission as may be specified by the Council in this behalf, by notification in the Gazette of India.

NOTIFICATIONS

⇒ He shouldn't be cost auditor of company in which he

(i) Is auditor (ii) Is officer/employee; (iii) Partner, or in employment of officer/employee of co.; (iv) Partner or in employment of company's auditor; (v) Indebted for > 1000 Rs., guarantor.

⇒ Member in practice can't become auditor of company., while he's an employee of cost auditor of co.

- ⇒ A member who is an employee shall be deemed to be guilty if he is willfully & grossly negligent in conduct of his duty as employee.
- ⇒ C.A in practice is to maintain proper Books of Accounts including Cash Book / Ledger.
- ⇒ If he accepts more than sp. tax audit assignments (30).
- ⇒ If becomes member of CFA in addition to C.A.
- ⇒ Accepts less fee than specified.

	<i>4 – 7 partner</i>	<i>≥ 8 partner</i>
Large cities	5000	9000
Small cities	3000	6000

Exception :

- (i) Honorary for Charitable, Club.
 - (ii) RRB Branches.
 - (iii) Newly concern (2 yr.)
 - (iv) Certificate/Attestation/Report under IT Act.
- ⇒ A Chartered will be guilty of professional misconduct, if he accepts statutory auditorship of PSU/ listed Co./Govt Co./Other Public Co. having turnover exceeding 50 crores in a year and accepts any other work or services with regard to same undertaking on a remuneration which in total exceeds the fees payable for carrying out the statutory audit of the same.
 - ⇒ As auditor of a concern while he is indebted to the concern or has given any guarantee for limits fixed in the statute & in other cases exceeding Rs. 10,000.

CONCISE GUIDE ON CODE OF CONDUCT AND COMPANY AUDIT

IMPORTANT POINTS TO BE KEPT IN MIND

- 1.** Try to prepare your own notes on the selected topics. By doing so you would be able to summaries 20 pages into 5 pages. The effect of this would be that at the time of revision you will have to revise only 5 pages and not all the 20 pages. Thus you will save your time by 75%.
- 2.** You can develop the habit of revising the whole code of conduct daily in the morning. In the beginning it would take some time but slowly and gradually you would be able otherwise the whole in just 20 minutes. If you will do so than at least your 16 marks are sure.
- 3.** You can also develop the habit of revising at least one AS and one AAS daily. By doing this you will not require to devote any specific time for doing those AS/AAS.

Remember, Whether you are a poor student, an average student, or a good student, you can become a better student.

INTRODUCTION TO CODE OF CONDUCT

The main principles on which the Code of Conduct is based are:

- a.** Independence of Auditor.
- b.** No personal biasness should come in between while performing his professional duty
- c.** Upholding the dignity and prestige of the profession.

It should be noted that in the examination center if you are not able to decide as to whether a particular act constitute professional misconduct or not as per any schedule or its sub-part, you should ask only one question:

Dose that particular "Action of CA" will affect the independence of the Auditor?

If the answer to the above question is YES- than it will constitute Professional misconduct.

If the answer to the above question is NO- than it will not constitute Professional misconduct.

The whole Code of Conduct is presented in the form of chart on the next page. Every effort has been made to include all the amendments made by the Chartered Accountants (Amendment) Act, 2006.

SCHEDULE-I

PART-I: APAESSAAACEA (Andhra Pradesh Assistants Enters Semifinal Similarly 3-American Cyclist Enters Athletics)

- _ Allows others to practice as C.A. in his name unless...
- _ Pays or allows or agrees to pay or allows any share/commission in the fees/profits of professional business
- _ Accepts or agrees to accept any part of the professional work of a lawyer/other agent not member of ICAI.
- _ Enters into partnership with a non-member.
- _ Secures business by means not open to a C.A.
- _ Solicits clients/work by advertisement, circular, etc.
- _ Advertises his professional attainments or uses designation other than C.A unless.
- _ Accepts appointment as C.A. without communicating with previous auditor
- _ Accepts appointment as C.A. Without seeing as to whether the requirement of SEC.225 complied or not.
- _ Charges fees based on fixed % of profit or contingent upon future.
- _ Engages in any business other than C.A. unless permitted by council.
- _ Allows others to sign balance sheet in his name unless

PART-II: (PA)

- _ Pays share in emoluments of employment undertaken by him.
- _ Accepts part of the fees etc. from lawyer, broker engaged by such company.

PART-III: (FNL)

- _ False information given knowingly
- _ Not FCA styles as FCA
- _ Less information or no information given as asked for by ICAI, COUNCIL, etc.

PART-IV: (HD)

- _ Held guilty by any civil or criminal court – punishable.
- _ Disrepute brought to the profession- in the opinion of Council.

SCHEDULE-II

PART-I: DCCEFFGSMM (DC Can Eliminate Few Fund Generating Stations & Marketing Managers)

- _ Discloses confidential information obtained during course of audit.
- _ Certifies F/S checked by outsider
- _ Certifies financial estimates contingent upon future.
- _ Expresses opinion on F/S of enterprise in which substantially interested.
- _ Fails to disclose material facts necessary to make F/S not misleading.
- _ Fails to Report material misstatement known to him.
- _ Grossly negligent or does not exercise due Diligence.
- _ Sufficient information to warrant expression of opinion not obtained.
- _ Material departure from AS/GN/SAP not reported.
- _ Money of the client not kept in separate bank account or not used in reasonable time.

PART-II : (CDFS)

- _ Contravenes any provision of the C.A. ACT or regulation made there under or guidelines issued by council..
- _ Discloses confidential information obtained during course of employment .
- _ False information given knowingly to ICAI, COUNCIL, Director (Discipline), etc.
- _ Defalcates or embezzles moneys received in his professional capacity.

PART-III: H

Held guilty by any civil or criminal court for offence punishable with imprisonment for greater than 6 months.

CLAUSE-3: Accepts or agrees to accept any part of the professional work of a Person who is not a member of the institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

CRUX: A member in practice cannot Accept commission or share in the fees from a person other than member of institute, members of any other professional body or a person having such qualification as may be prescribed by the council or government.

IMPACT OF AMENDMENT BY CA (AMENDMENT) ACT 2006: Earlier a CA in practice cannot accept any commission/brokerage/share in profits of professional business to a non-member but by the recent amendment they are permitted to share fees or profit among members of any other professional body. They are also permitted to share with persons having qualification as may be prescribed from time to time in or outside India. The biggest plus of this amendment would be that the CA in India can form multi-disciplinary firms and offer multi professional services in a competitive and commercial manner. Even most of the multinational and other companies also prefer "one-stop shop" for all their needs.

CLAUSE-4: Enters into partnership, in or outside India, with any person **other than** a chartered accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships.

CRUX: A Chartered Accountant in practice cannot enter into partnership with person other than a CA in practice or a member of any other professional body having prescribed qualifications.

The resident members of institute residing abroad can form partnership firms with any practicing chartered accountant provided the following two conditions are satisfied:

_ Member residing abroad is entitled to be registered as a member of institute under section 4(1)(v), and

_ Whose qualification are recognised by Central Govt. or Council to enter into partnership.

IMPACT OF AMENDMENT BY CA (AMENDMENT) ACT 2006: The amendment has enabled the CA in India to form multi-disciplinary firms and offer multiprofessional services in a competitive and commercial manner. The council or the CG will specify the qualification for permitting such partnership.

CASE LAW - IQBAL HAMID VS. ICAI: The earlier decision made in the case of K.S.DUGAR is reversed in this case. It is now held that a C.A in practice can enter into partnership with a non-member pursuing a business or occupation other than the profession of C.A. provided he is permitted by council of ICAI. Even Council of ICAI clarified at its Meeting on March 1991: Prohibition on entering into partnership with non-Chartered Accountants was confined only to the practice of profession of Chartered Accountants. Thus one can enter into partnership for any other business.

CLAUSE-5: Secure, either through the service of a person who is not an employee of such chartered accountant or who is not his partner or by means which are not open to Chartered Accountant, any professional business Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part.

CRUX: C.A. in Practice cannot secure any professional business:

- By means not open to a Chartered Accountant, or
- Through services of a person **not his employee**.
- Through services of a person **not his partner**.
- Through services of a person **not prescribed in the regulations**.

The above clause is to prevent unnecessary competition amongst C.A.'s in practice, which may lower the dignity of the profession.

IMPACT OF AMENDMENT BY CA (AMENDMENT) ACT 2006: The amendment has permitted to secure any professional business through certain categories of non-member which will be prescribed in the regulations from time to time. This amendment has also allowed securing business through the employee of such Chartered Accountant.

CLAUSE-6: Solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting:

- _ any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice ; or
- _ a member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence;

CRUX: The above clause bans all form of canvassing including issue of circulars, personal communication, etc.

OBJECTIVE: The above clause is to maintain the independence & dignity of C.A. Profession. Service rendered by an accountant is of a personal & intimate nature and its value can be appraised only by personal contacts & experience. Satisfaction of the client is the best advertisement. It is the quality of service, which attracts & retains the clients.

IMPACT OF AMENDMENT BY CA (AMENDMENT) ACT 2006: The total ban on solicitation of professional work is relaxed. The relaxation has been given in the following areas:

- _ Can secure professional work from another CA in practice.
- _ Can respond to tenders or enquiries issued by various users of professional services or organizations

FORMS OF SOLICITING WORK:

1. Advertisement & press note: - Members are not permitted to advertise and even not permitted to circulate letter to a small field of possible clients. Personal canvassing through help of employees also not permitted.

(a) Can advertise for: -

- _ Change in partnership/address of practice/telephone number.
- _ Dissolution of a firm.

But such advertisement should be: -

- Mere statement of facts
- Number of insertions to be considered.
- Appropriateness of the area of distribution of the newspaper or magazine to be considered.

(b) Can advertise in Journal of ICAI intended to give information for: -

- _ Sub-contract work, or
- _ Seeking partnership, or
- _ Seeking salaried employment of an accounting nature.

Provided it contains only the Accountants name, Address, Fax number, email address or Telephone no. But name of the firm/proprietorship cannot be given.

2. Empanelment application: - Can write to an organization for being enrolled on a specific & known panel for allotment of audit. Therefore a CA cannot make roving enquiries by applying to various institutions for allotment of audit.

- _ Can quote fees verbally on specific inquiries from institutions. But cannot send printed or cyclostyled letters quoting fees in reply to such inquiries.
- _ An advertisement for part-time directorship, part-time secretarial work not allowed.
- _ Should not respond to such empanelment in which payment of some

registration fees is required (whether refundable or not)

3. Directories: - Can have his name included in the directory if following three conditions satisfied-

- _ Separate section/category of "Chartered Accountants"
- _ Member/firm should belong to town/city for which directory published.
- _ In normal type (not in bold letters or not in box)
- _ Payments for the entry should be reasonable.
- _ Entry should not be prominent in comparison to other entries.
- _ Entry should not be restricted to a particular chartered accountant/accountants.

_ Entries in alphabetical & logical manner

- Can also have his name in Trade Directory (yellow pages), Internet, Telephone services like 'Ask me services' provided above conditions are fulfilled.

- Not allowed having his name or name of his firm printed in directory by making special request or by paying additional payment.

4. Hand bills issuing: - Cannot distribute handbills bearing the name of C.A. in practice & containing legal provisions (like changes in tax laws), to person other than his regular clients.

5. Publication of Books or Articles: - Not permitted to indicate association with any firm of CA in a book or an article published by him. For example cannot write in book that "XYZ" proprietor of XYZ associates, Chartered Accountant.

6. Greeting card or Invitations: - Greeting cards or invitations not to contain the professional designation, status & qualification of C.A. in practice.

_ But designation Chartered Accountant as well as name of the firm can be used in the:

- Greeting card
- Invitation for Marriages, religious ceremonies, change in office premises, opening or inauguration of office of member,
- Change in telephone number

_ Provided that such greeting cards or invitations sent only to

- Clients,
- Relatives, and
- Close friends of the member

7. Original professional work: - C.A. should not accept the original professional work which emanates from a client introduced to him by another C.A. He should tell the client that he will accept only if it comes through the other C.A. who deals generally with his professional work.

8. Scope of the representation: - Auditor has a right to make representation u/s 225 of companies act, 1956.

_ His representation should be so drafted so that it does not secure needless publicity for him.

_ His representation should not tantamount directly or indirectly to canvassing or soliciting for his continuation as an auditor.

_ He may indicate his willingness to continue as auditor in his letter.

9. Public interview: - While giving any interview etc member should not furnish any details that may result in publicity.

10. Advertisement under box: - Not allowed to insert box number in the newspapers

11. Seeking work from professional colleague: - As per amendment to CA (Amendment) Act 2006 it is open to a CA to apply for or request for

professional work from any other CA.

12. Notification on Development of Website: - Just recently ICAI has allowed its members to develop Website for their profession. The following points should be considered before developing such a website as per guidance note issued by ICAI:

PCS-PLAN & COB-LALI's DSL-ID

- (a) Pull model and not push model-** used for running the website.
- (b) Circulation of Information** – on its own or through E-Mail not allowed.
- (c) Soliciting people to visit Website** – by any mode is not allowed.
- (d) Passport size Photograph** – allowed and no other photograph.
- (e) Logo** – not to be used.
- (f) Advertisement of Website** – cannot be given & no advert. in nature of banner.
- (g) Name of Clients & fees charged** – not to be given
- (h) Chat Rooms** – can be provided, but chatting permitted only between members or between firms and their clients
- (i) Online advice** – can be given
- (j) Bulletin Board** – can be provided
- (k) Listing on Suitable Search Engine** – allowed. But field of search restricted only to the field of chartered accountant or Indian CA, Indian CPA, India Chartered Accountants, etc
- (l) Address of Website** - can be different from name of firm, but it should be as near as possible to individual name/trade name, firm name of CA in practice.
- (m) Link to Websites** – Only to ICAI, Regional Councils and branches, Government, Government Department, Regulatory Authorities, Other professional bodies like AICPA, ICAEW, CICA.
- (n) Intimation to ICAI** – within 30 days of the launch of the website.
- (o) Date up to which updated** – The date up to which the website is updated should be mentioned on website & the information should not be at material variance from the information as per ICAI's records.
- (p) Secrecy of clients matters** – handled through the website should be ensured.
- (q) Listing by CA Societies or other bodies creating data-base** – of CA or CA firm permitted. Similarly if CA or CA firm is a member of a professional body or association or chamber of commerce and they offer listing to the members or firm the same would be permitted.
- (r) Information allowed to be displayed on Firm/Members Website** –

MAY-JAPEN

- Member/Trade/Firm name
- Articled clerks numbers
- Year of establishment
- Job vacancies for CA/Firm of CA/Articleship.
- Assignment handled – only nature of assignment to be given & not name of clients & fees charged from them.
- Partners Details
 - _ Name of partner
 - _ Year of qualification
 - _ Other qualifications
 - _ Telephone no-direct, Residence, Mobile.
 - _ Email & Address
 - _ Area of Experience

- Employees Details
 - _ Professional/other
 - _ Name & Designation
 - _ Area of Experience.
- Nature of services rendered.

(s) Designing of website – should be such as it does not amount to soliciting clients or professional work or advertisement of professional attainments or services.

OTHER IMPORTANT POINTS

1. Notification CA(7)93/2006 dated 18-09-2006

(Minimum Amt chargeable as fees for certain audit)

No. Of partners Population of city Population of city

In firm >3 million <3 million

5 to 9 partners Rs. 6000 Rs. 3500

10 and above Rs. 12000 Rs. 8000

Note: - At least one of the partner of Firm must hold certificate of practice for more than five years

***Exceptions

- Honorary appointments (i.e. without fees) like in Audit of Charitable Institution, Clubs, Provident Funds, etc
- Newly formed company for first 2 years (From date of operation).
- Statutory audit of branches of banks including Regional rural banks
- Audit or certification work under Income Tax Act.
- Sales Tax Audit & Vat Audit.

2. Printing of photograph on Visiting Cards:

The **Committee on ethical Standards (CES)**, a non-standing Committee of the institute, has examined the matter in detail. The Committee noted that the **Institute has permitted display of Passport Size Photograph on the Website of Chartered Accountants** in practice/firm of Chartered Accountants in practice, which runs on a “pull” model.

The Committee further noted the following directions/guidelines as appearing at page 197 of Code of Ethics, 2005 edition:-“Public conscience is expected to be ahead of the law. Members, therefore, are expected to Interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardize their independence.”

In view of the above, the Committee is of the opinion that mostly the business class prints the photograph on their visiting cards for promoting their business and soliciting clients. As such, it is not permissible for the Chartered Accountants in practice to print their photograph on their visiting cards.

3. When ICAI members sign financial documents as CPAs ICAI members having membership of AICPA and having eligibility to sign the financial statements as CPAs (i.e. as members of the AICPA), may do so. Even in this case the ethical standards of ICAI shall apply.

The Council further decided that when the ICAI members sign the financial documents(s) as CPAs, they be financial required to indicate, in an appropriate manner, that their firm is an Indian accounting firm registered with the Institute of Chartered Accountants of India under the Chartered

Accountants Act, 1949. In other words such a member should ensure to appropriately reflect the fact in the relevant document(s) that his firm falls within the purview of the ICAI.

4. CA in practice acting as Recovery Consultant in Banking Sector The members of ICAI in Practice can act as Recovery Consultant for recovery of Non-Performing Assets (NPA) of Banks under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFA&ESI). But can they charge fee on percentage basis as is permitted under Regulation 192 of the Chartered Accountants Regulations, 1988 for 'receiver' or liquidator'?

The Institute is of the view that Recovery Consultant cannot be equated with 'receiver' or 'liquidator' provided under Regulation 192 of the Chartered Accountants Regulations, 1988 and as such, the charging of fee by Recovery Consultant in Banking Sector on percentage basis is not permissible.

5. Inclusion of "Insurance Financial Advisory Services under IRDA act,1999, including insurance brokerage" in definition of "Management Consultancy & other services(Revised Clarification): -

As per the clarification of ICAI the members are not permitted to do any work relating to insurance agency as prescribed under "Insurance Regulatory and Development Authority (Licensing of Insurance agents) Regulations, 2000" and "Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations, 2002", Band the existing position regarding allowing members generally to hold life insurance agency license for limited purpose of getting renewal commission, still hold good as provided in the Appendix (9) to the Chartered Accountants Regulations, 1988 (2002 edition).

It is again clarified that as on date the members in practice are not permitted to render "Insurance Financial Advisory Services under the IRDA Act, 1999 including Insurance Brokerage **as the conditions to be complied with by the members to be eligible to render the aforesaid services are yet to be prescribed by the Institute of Chartered Accountants of India.** The existing position regarding allowing members in practice generally to hold life insurance agency license for limited purpose of getting renewal commission, still hold good as provided in the Appendix (9) to the Chartered Accountants Regulations, 1988 (2002 edition).

6. Listing with bodies creating DATA-BASE for Independent Director

The Code of Ethics, 2005 edition, at page 81 provides as under:

"A number of Chartered Accountants Societies or other bodies are creating data-base of Chartered Accountants or Chartered Accountants' Firms and are offering listing to Chartered Accountants. Such listing would be permitted with or without payment. In case a Chartered Accountants or Chartered Accountants' Firm is a member of a professional body or association or Chamber of Commerce and they offer listing to the members or firm, the same would be permitted.'

7. CA acting as E-Return Intermediary

Since acting as e-Return Intermediary comes within the purview of the definition of "Management Consultancy and Other Services." Appearing at pages 8-10 of Code of Ethics, 2005 edition, it is **permissible**.

8. CA acting as Direct Selling Agent(DSA)

Committee on ethical Standards (CES), a non-standing Committee of the Institute, decided that a CA in practice:

- Not permitted to market any specific product.

- Perform all those services, which a Chartered Accountant can provide.
- Verify credit card credentials.
- Provide services that are in the nature of
 - _ Verification etc.
 - _ Assurance services.
 - _ Management Consultancy & Other Services.

Members are requested to keep in mind the aforesaid decision of the

Committee while acting as Direct Selling Agent (DSA).