

MOCK TEST PAPER -1
FINAL COURSE: GROUP – I
PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory

*Answer any **five** from the rest*

1. (a) Profit of ₹ 30 lakhs on the sale of Urban land is a capital profit. It represents the excess of sale value over the original cost of the asset.

As per Guidance Note on 'Audit of Payment of Dividend', capital profits can be distributed as dividend only if all the following conditions are fulfilled:

- (i) the Articles or the bye-laws or other rules and regulations applicable to the entity, permit such distribution; and
- (ii) it has been realised in cash; and
- (iii) the Board or similar authority is satisfied that net aggregate value of the assets remaining after distribution of that profit will not be less than the book values so that share capital and reserves remaining after the distribution will be fully represented by the remaining assets.

Accounting Standard 10 on "Accounting for Fixed Assets" also requires that any gain arising from disposal of a fixed asset should be recognised in the profit and loss account. Moreover, section 205 of the Companies Act, 1956 does not make any distinction between capital profit and other profit. Thus, all profits which can properly be taken to the profit and loss account are 'profits' for the purposes of section 205 and are, thus, distributable.

- (b) According to SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" when the auditor comes across such circumstances indicating the possible misstatements resulting from the fraud then the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. In this case, the circumstances indicate that the possible misstatement in financial statements is due to fraud and error and the auditor must investigate further to consider effect on financial statements.

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

- (c) SA 620 states that while using the work of an expert, auditor should consider the materiality of the item, nature and complexity of the item, the other audit evidence

available and professional qualifications, experience and reputation in the field of the concerned expert.

The auditor should ensure that the expert has used appropriate source data, has made consistent assumptions, has applied correct methods and that results of expert's work are in line with auditor's overall knowledge of the business and match with results of his audit procedures. The auditor should also ensure that substance of expert's findings is properly reflected in the financial information.

- (d) **Valuation of Work-in-Process:** As per AS 2 (Revised) on "Valuation of Inventories", the inventories also include those assets which are in the process of production for sale in the ordinary course of business apart from finished goods and those materials or supplies to be consumed in the production process or in the rendering of services. It is, thus, necessary for a company to ensure that each and every component of inventory is valued properly. The argument advanced by the company that it is difficult to ascertain the same in view of the multiple processes involved is not acceptable. Because, the Guidance Note on "Audit of Inventories" also recognises the likely difficulties in valuation of work-in-process and states that, "in general, the audit procedures regarding work-in-process are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-process for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production / costing records (for example, cost sheets), hold discussions with the personnel concerned and obtain expert opinion, where necessary".

The argument that the opening and closing work-in-process would be more or less the same is also not justified because the omission of those would lead to distortion in true and fair view. Further, costs incurred for raw materials and the overheads would normally be different and would give rise to different value of opening and closing stock. The Guidance Note even requires the auditor to ascertain the system from which the value of work-in-process is obtained is reliable, and to examine subsequent records of production / sales.

Therefore, in view of the above, the auditor shall have to qualify the audit report in case work-in-process is not valued and shown in the financial statements.

2. (a) **Soliciting Professional Work:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practised so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by him, the association with any

firm of chartered accountants. In this case, Mr. S a chartered accountant, published the book and mentioned his professional experience and his association as a partner with M/s RST, a firm of chartered accountants.

Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning that at present he is a partner in M/s. RST, a chartered accountants firm.

- (b) Clause (11) of Part I of the First Schedule to the Chartered Accountants Act, 1949 debars a chartered accountant in practice from engaging in any business or occupation other than the profession of chartered accountancy unless permitted by the Council of the Institute so to engage. This clause, in effect, has empowered the Council of the Institute to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council had formulated Regulations 190A and 191 to the Chartered Accountants Regulations, 1988 to provide a basis for considering applications of chartered accountants seeking permission to engage in other business or occupation. A member can accept full- time lecturer-ship in a college only after obtaining the specific and prior approval of the Council. Also, becoming a partner in a business with his brother would require specific permission. The chartered accountant is liable for professional misconduct since he failed to obtain specific and prior approval of the Council in each case.
- (c) Clause (2) of Part III of the First Schedule requires a member to supply the information called for by the Council or any of its Committees and Clause (1) of Part II of the Second Schedule requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulation made thereunder. Under the former clause, it is misconduct for chartered accountants generally, if they do not supply the information called for by the Council. The Secretary acts for the Council; hence, request from the Secretary amounts to a request from the Council. Besides, it is also a contravention of Regulation of the Chartered Accountants Regulations, 1988. Thus, failure to submit Form 18 constitutes professional misconduct.
- (d) **Disclosure of material facts:** A Chartered Accountant in practice is deemed to be guilty of professional misconduct under clause 5 of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading". In this case, the Chartered Accountant was aware of the contraventions and irregularities committed by the trust as these were referred to in the confidential report given by the Chartered Accountant to the trustees of the company. However, he had issued the annual accounts without any qualification. On similar facts it was held by the Supreme Court in Kishorilal Dutta vs. P. K. Mukherjee that it was the duty of the Chartered Accountant to have disclosed the irregularities and contravention to the beneficiaries of the fund in the statement of accounts signed by him. Accordingly, in the present case also it has to be held that the Chartered Accountant is guilty of professional misconduct if the amount of irregularities is proved material.

3. (a) Audit strategy is concerned with designing optimised audit approaches that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process as explained in the following paragraphs in fact shall form the basis of audit planning to achieve the audit objectives in the most efficient and effective manner. Audit strategy generally involves the following steps:
- (i) **Obtaining Knowledge of Business:** SA 315 and SA 330 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment” and “The Auditor’s Responses to Assessed Risks” states that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor’s judgement, may have a significant effect on the financial statements or on the examination of audit report. Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands the need to be alert for additional information and the need to share that information with the auditor and the other audit staff.
 - (ii) **Performing Analytical Procedures:** The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.
 - (iii) **Evaluating Inherent Risk:** To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since his last assessment.
 - (iv) **Evaluating Internal Control:** The auditor’s assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is

conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by:

- (1) considering the results of gathering or updating information about the client; and
- (2) making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor proposes to subject to an extended assessment of controls.

Thus, the audit strategy is evolved after considering the engagement objectives, the results of the business review, preliminary judgements as to materiality and identified inherent risks. Audit strategy also considers main points relating to planning and controlling the audit or comments on adequacy of the existing arrangements. Thus, the overall audit plan involving determination of timing, manpower, coordination and the directions in which the audit work has to proceed is dependent upon the audit strategy formulated by the audit firm.

- (b) External confirmation Requests:** SA 505, “External Confirmations”, establishes standards on the auditor’s use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management.

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (i) Inquire as to management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- (ii) Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- (iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with “SA 260 (Revised) Communication with Those Charged with Governance”. The auditor also shall determine the implications for the audit and the auditor’s opinion in accordance with “SA 705 Modifications to the Opinion in the Independent Auditor’s Report”.

- (c) As per SA 501, "Audit Evidence – Additional Considerations For Specific Items" the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting. SA 501 is additional guidance to that contained in SA 500, "Audit Evidence", with respect to certain specific financial statement amounts and other disclosures. .

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management's written representation on (a) the completeness of information provided regarding the inventory and (b) assurance with regard to adherence to laid down procedures for physical inventory count.

By following the above procedure it will be ensured that the physical verification conducted by the management was in order.

4. (a) Flow-Chart Technique for evaluation of Internal Control: This technique can be resorted to for evaluation of the Internal Control System. It is a graphic presentation of internal controls in the organisation and is normally drawn up to show the controls in each section or sub-section.

As distinct from a narrative form, it provides the most concise and comprehensive way for reviewing the internal controls and the evaluator's findings. In a flow chart narratives are reduced to the minimum and by that process, it can successfully bring the whole control structure, specially the essential parts thereof, in a condensed but wholly meaningful manner. Every details relevant from the control point of view and the details about how an operation is performed can be included in the flow-chart.

Essentially, a flow chart is a diagram full with lines and symbols and if judicious use of them can be made, it is probably an effective way of presenting the state of internal controls in the client's organisation. A properly drawn up flow chart can provide a neat visual picture of the whole activities of the section or department involving flow of documents and activities. More specifically it can show –

- (i) at what point a document is raised internally or received from external sources;
- (ii) the number of copies in which a document is raised or received;
- (iii) the intermediate stages set sequentially through which the document and the activity pass;
- (iv) distribution of the documents to various sections, department or operations;

- (v) checking authorisation and matching at relevant stages;
- (vi) filing of the documents; and
- (vii) final disposal by sending out or destruction.

A flow chart is normally a horizontal one in which documents and activities are shown to flow horizontally from section to section and concerned sections are shown as the vertical column needs. These can be sales, purchase, wages, production etc.

Purchases can be linked with sundry creditors and payments, sales with sundry debtors and collections. By this process, a flow chart will become self contained, complete and meaningful for evaluation of internal controls. Generally, a questionnaire is also enclosed with a flow chart, incorporating questions, the answers to which are to be looked into from the flow chart.

(b) Areas in which Due Diligence can take place

- (i) **Commercial/operational due diligence:** It is generally performed by the concerned acquiring enterprise involving an evaluation from commercial, strategic and operational perspectives. For example, whether proposed merger would create operational synergies.
 - (ii) **Financial Due Diligence:** It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.
 - (iii) **Tax Due diligence:** It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax affect of the merger or acquisition.
 - (iv) **Information systems due diligence:** It pertains to all computer systems and related matter of the entity.
 - (v) **Legal due diligence:** This may be required where legal aspects of functioning of the entity are reviewed. For example, the legal aspects of property owned by the entity or compliance with various statutory requirements under various laws.
 - (vi). **Environmental due diligence:** It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.
 - (vii) **Personnel due diligence:** It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.
- (c)** The Companies (Auditor's Report) Order (CARO), 2003, exempts private limited companies from its application which fulfils all the following conditions:

- (i) its paid-up capital and reserves are rupees fifty lakh or less;
- (ii) its outstanding loan from any bank or financial institution are rupees twenty five lakh or less; and
- (iii) its turnover does not exceed rupees five crore.

In the case of M/s A Pvt. Ltd., its paid-up capital is less than ₹ 50 lakhs, turnover is less than ₹ 5 crores since excise duty is not taken into account if it is credited separately to excise duty account; and, it is also implied from the facts that it has not accepted any public deposits. It also fulfils the condition relating to outstanding loan as per the statement on CARO, 2003, issued by the Institute Hence, M/s A Pvt. Ltd. satisfies all conditions and accordingly CARO, 2003 will not be applicable.

5. (a) As per SA 610 (Revised) "Using the Work of Internal Auditor" the statutory auditor has to consider the following before placing reliance on the same".

- (i) Organizational status – whether the same is done internally or by an external agency.
- (ii) Scope of work – What is the nature and depth of the coverage of the assignment.
- (iii) Technical competence – Whether the internal auditor is technically competent to do the work i.e. having adequate technical training and proficiency.
- (iv) Due professional care – Whether his work and reports appear to be properly planned, supervised reviewed and documented.
- (v) Audit Evidence - Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;
- (vi) Conclusions - Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and
- (vii) Response to unusual matters - Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

If the above factors are not satisfactory, the statutory auditor will have to modify his audit program and increase the verification to be carried out.

- (b) (i)** ABC Ltd. had sold goods on credit worth ₹ 5 crores to T Ltd. and, therefore, the sale was complete in all respects. T Ltd' s decision to sell the same in the domestic market at a discount does not affect the amount booked under sales by ABC Ltd. The price discount of 25% offered by ABC Ltd. at the request of T Ltd. was not in the nature of discount given during the ordinary course of trade because otherwise same would have been given at the time of sale itself. Now as far as ABC Ltd. is concerned, there appears to be an uncertainty relating to collectability, which has arisen subsequent to the time of sale. Therefore, it would

be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore such discount should be charged to the profit and loss account separately and not shown as deduction from the sales figure.

- (ii) As per AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The write-back of provision made in respect of inventories in the earlier year does not constitute prior period adjustment since it neither constitutes error nor omission but it merely involves making estimates based on prevailing circumstances when financial statements were being prepared. It is a mere estimate process involving judgement based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item. In this case, Y Ltd. provided ₹ 25 lakhs for inventory obsolescence in 2010-11. In the subsequent year due to change in circumstances, it was determined that 50% of such stock was usable. Revision of such an estimate does not bring the resulting amount of ₹ 12.5 lakhs within the definition either of a prior period item or of an extraordinary item. The amount, however, involved is material and requires separate disclosure to understand the financial position and performance of an enterprise. Accordingly, adjustment in the value of the inventory through prior period item would not be proper.

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

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

- (i) the prospectus was issued without his knowledge or consent and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or
- (ii) he withdrew his consent in writing before delivery of the prospectus for registration; or
- (iii) 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

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

(b) Acceptances, Endorsements and Other Obligations: This item includes the following balances:

- (i) letters of credit opened by the bank on behalf of its customers and
- (ii) bills drawn by the bank's customers and accepted/endorsed by the bank.

Letters of credit: Evaluate the adequacy of the internal controls over LC Forms e.g. custody, maintenance of records, periodical verification, reconciliation etc.

Verify the balance of LC from the Register maintained by the bank to ascertain the amount of LC and payments made under them.

Examine the guarantees of the customers, copies of the LC issued & security obtained for issuing LC.

In respect of other acceptances and endorsements the following procedure may be adopted.

- (1) Examine the arrangements made by the bank with its customers.
- (2) Test check the amounts of bills with the register maintained by the bank.
- (3) Verify whether such bills are marked off in the register on payment at maturity.

Letters of comfort: Where letters of comfort has been issued, verify whether the bank has incurred a potential financial obligation under such a letter. If an obligation has been cast under letters of comfort, ensure that the amount has also been shown as contingent liability in the Balance Sheet.

(c) Examination of claims paid: The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

- (i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share and the balance has been debited to other insurance companies.
- (ii) that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company. Such claims which have been communicated after the year-end for losses which occurred prior to the year end must be accounted for in the year of audit.

- (iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;
- (iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure;
- (v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal of such claims. In such cases, full provision should be made for outstanding claims;
- (vi) that payment made against claims partially settled have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount ;
- (vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and
- (viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.

7. (a) **Haphazard Sampling:** In haphazard selection, the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

Haphazard selection of sample, may be an acceptable alternative to random selection of sample, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units.

When the auditor uses this method, care needs to be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

- (b) **SA 4410 “Engagements to Compile Financial Information”** The objective of a compilation engagement is to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information.

This ordinarily entails reducing detailed data to a manageable and understandable form without the requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the member to express

any opinion on the financial information. Therefore, it is essential that the member clearly brings out the nature of association with the financial statement and the nature of the work performed by him. The following may be noted in this regard.

- (i) The title of the report should be "Accountant's Report on Unaudited Financial Statement and not An Auditor's Report".
 - (ii) The report should be addressed to the appointing authority.
 - (iii) The report should identify the financial information compiled, also stating that it is based on the information provided by the management.
 - (iv) The report should clearly state that the financial statements are not audited.
 - (v) In describing the engagement, ambiguous terms such as review, general review, check, etc. should not be based.
 - (vi) Date of the report should be mentioned.
 - (vii) Name and address of the firm of the member appointed for carrying out the compilation engagement should be mentioned.
 - (viii) Signature and the designation (sole proprietor/ partner) and membership number should appear in the report.
- (c) **Corporate Governance:** The word 'Corporate' is associated by legal enactment for the transaction of a business. Similarly, the word 'Governance' means exercise of authority, direction or control. Thus, the concept of 'Corporate Governance' is the system by which the management of a business entity directs and controls the activities in the best interest of the stakeholder.

As per N. R Narayana Murthy, Chairman, Committee on Corporate Governance, SEBI, Mumbai, February 8, 2003

"Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

Clause 49 of the listing agreement covers SEBI guidelines regarding Corporate Governance. Issues addresses in Clause 49 regarding Corporate Governance are:

- Board's Director including its composition and compensation;
- Provisions regarding Board's Committee including composition and functioning of Audit Committee which is an important pillar of the Corporate Governance;
- Management of subsidiary companies;

- Disclosures of important issues regarding related party transactions, accounting policies, principle of risk management, accounting for proceeds from public issues, right issues, preferential issues, etc;
- Content of management discussion and analysis;
- Information to shareholders;
- CEO/ CFO certification;
- Report of Corporate Governance and compliance certificate.

(d) **Audit Certificate as distinguished from Audit Report:** A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain figures and is in a position to vouchsafe their accuracy as per his examination of documents and books of account. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The 'report' involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

(e) Accounting Ratios in Form 3CD of Tax Audit

- Gross profit/Turnover;
- Net profit/Turnover;
- Stock-in-trade / Turnover;
- Material consumed/Finished goods produced.

These ratios have to be calculated only for assesseees who are engaged in manufacturing or trading activities. This clause is not applicable to assesseees carrying on profession. Moreover, the ratios have to be given for the business as a whole and need not be given product wise. Further, the ratio mentioned in sub-clause (d) need not be given for trading concern.

While calculating these ratios, the tax auditor should assign a meaning to the terms used in the above ratios having due regard to the generally accepted accounting principles. All the ratios mentioned above are to be calculated in terms of value only