

PROFESSIONAL ETHICS

Question 1

Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules there to:

- (a) CA X was appointed as the Auditor of ABC Ltd. for 2007-08. Since he declined to accept the appointment, the Board of Directors appointed CA Y as the auditor in the place of CA X, which was also accepted by CA Y. (4 Marks)
- (b) CA Z who is a leading Income Tax Practitioner and consultant in Jaipur is also trading in derivatives. (4 Marks)
- (c) CA D, a Chartered Accountant prepared a project report for one of his clients to obtain bank finance (long-term) of ₹ 50 lakhs from a Commercial Bank. Consequent to the sanction of the loan by the bank CA D raised a bill for his services @ 2% of the loan sanctioned. (4 Marks)
- (d) CA ZZ who conducted ABC audit of a Marathi daily 'New Era' certified the circulation figures based on Management Information System Report (M.I.S Report) without examining the books of Account. (4 Marks) (November 2008)

Answer

- (a) Board can appoint the auditor in the case of casual vacancy under Sections 224 (5) & 6(a) of the Companies Act, 1956. The non-acceptance of appointment by CA. X does not constitute a casual vacancy to be filled by the Board.

In this case, it will be deemed that no auditor was appointed in the AGM. Hence the appointment of auditor can be made only by the Central Government and the Board appointment is defective in law.

Clause 9 of Part-I of First Schedule states that a chartered accountant is deemed to be guilty of professional misconduct if he "Accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 in respect of such appointment have been fully complied with".

Hence CA. Y is guilty of professional misconduct since he accepted the appointment without verification.

- (b) As per clause 11 of Part-I of First Schedule of CA Act, 1949, a Chartered Accountant is deemed to be guilty of professional misconduct if he “engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage”.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case CA Z is engaged in the occupation of trading in derivatives which is not covered under the general permission.

Hence specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under clause 11 of Part-I of First Schedule of CA Act, 1949.

- (c) Clause 10 of part I to First Schedule to the Chartered Accountants Act prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949, the Council of the Institute has framed regulation 192 which exempts certain professional services from the operation of clause 10.

The services rendered by CA. D are not covered under the said exemption and hence CA. D is liable for professional misconduct.

- (d) According to clause 7 of Part-I of Second Schedule of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he “does not exercise due diligence or is grossly negligent in the conduct of his professional duties”.

In the instant case CA ZZ did not exercise due diligence and is grossly negligent in the conduct of his professional duties since he certified the circulation figures without examining the books of accounts.

To ascertain the number of paid copies verification of remittances from the agents, credit allowed to the agents for unsold copies returned, examination of books of account is essential. Further certification of circulation figures based on statistical information without cross verification with financial records amounts to gross negligence and failure to exercise due diligence.

Hence CA ZZ is guilty of professional misconduct as per clause 7 of part I of Second Schedule of Chartered Accountants Act, 1949.

Question 2

Comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto:

- (a) *H, a Chartered Accountant in practice is a partner in 3 firms. On the personal Letter Heads of H, names/address of all the 3 firms are mentioned. (4 Marks)*
- (b) *D, who conducts the tax audit u/s 44AB of the Income Tax Act, 1961 of M/s ABC, a partnership firm, has received the entire audit fees of ₹ 25,000 in April, 2009 in respect of the tax audit for the year ended 31.3.2009. The audit report was, however, signed on 25.5.2009. (4 Marks)*
- (c) *M/s LMN, a firm of Chartered Accountants having 5 partners accepts an audit assignment of a newly formed private limited company for audit fees of ₹ 5,000. (5 Marks)*
- (d) *P, a Chartered Accountant in practice, accepts appointment as statutory auditor for LMN Pvt. Ltd. Q, brother of P has substantial interest in LMN Pvt. Ltd. (5 Marks) (June 2009)*

Answer

- (a) Under clause (7) of part -1 of First Schedule, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant' on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

Here there is no prohibition for printing names of all 3 firms on the personal letter heads in which a member holding certificate of practice is a partner. Thus, H is not guilty of any professional misconduct in the above case.

- (b) Under section 226(3)(d) of Companies Act, 1956 a person is disqualified from being an auditor if he is indebted to the company for more than ₹ 1,000/-. This provision applies only to an auditor appointed under the Companies Act, 1956.

In the instant Case, D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961. There are no such similar provisions in the Income Tax Act. Thus, D will still be able to do the audit and would not be disqualified. He also does not violate any provision of the CA Act, 1949 and schedules thereto.

- (c) As per the Council General Guidelines, 2008, the minimum audit fees are prescribed depending on the number of partners in a firm and the city in which the audit is to be carried out. A proviso to the said guidelines states that the restriction does not apply for audit of newly formed concerns for 2 accounting years from the date of commencement of operations.

In the instant case, since the audit assignment is of a newly formed private limited company the proviso shall apply and M/s LMN can conduct the audit without violation of any code of conduct.

- (d) As per clause (4) of part I of II schedule, a CA is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements in which his firm or a partner has substantial interest. As per Council General Guidelines, 2008, the above restriction is also made applicable for relatives of the members.

In the instant Case, since Q, a relative has a substantial interest in LMN Pvt. Ltd, P cannot conduct the audit and will be guilty of misconduct.

Question 3

Give your comments with reference to the Chartered Accountants Act, and schedules thereto:

- (a) *Mrs. Fair is a Director of XYZ Private Limited, having 15% share-holdings in the company. During 2003, the company appointed C.A. Mr. Lovely, Mrs. Fair's spouse, as its statutory auditor. On Mr. Lovely's advice, the company issued fresh equity shares in 2003-04, in the ratio of one share for every two shares held by the shareholders of the company. Mr. Lovely used to deliver audit report for subsequent years without any comments or disclosures, thereupon.* (4 Marks)
- (b) *Mr. A, a Chartered Accountant was the auditor of 'A Limited'. During the financial year 2007-08, the investment appeared in the Balance Sheet of the company of ₹ 10 lakhs and was the same amount as in the last year. Later on, it was found that the company's investments were only ₹ 25,000, but the value of investments was inflated for the purpose of obtaining higher amount of Bank loan.* (4 Marks)
- (c) *An advertisement was published in a Newspaper containing the photograph of Mr. X, a member of the institute wherein he was congratulated on the occasion of the opening ceremony of his office.* (4 Marks)
- (d) *Mr. X, a Chartered Accountant and the proprietor of X & Co., wrote several letters to the Assistant Registrar of Co-operative Societies stating that though his firm was on the panel of auditors, no audit work was allotted to the firm and further requested him to look into the matter.* (4 Marks) (November 2009)

Answer

- (a) As per the Companies Act, 1956, the definition of 'Relative' includes husband and wife. In this case Mr. Lovely and Mrs. Fair are spouse of each other. Mr. Lovely should not accept the appointment as statutory auditor of the company, where his wife Mrs. Fair has vulnerable interest. Where the company issued fresh equity shares on Mr. Lovely's advice, it is an apparent evidence of Mr. Lovely's control and direction over the company. Because of fresh issue of equity shares, Mr. Lovely's shareholding became 22.5% (15% + 50% thereof) and thus his wife now has substantial interest (i.e. more than 20%) in the said company. Mr. Lovely did not declare such interest of his wife, as substantial

shareholder in the company in his audit report/s of the subsequent years, as he never offered any comment.

The independence of the auditor would be compromised without a declaration of his substantial interest. So Mr. Lovely is therefore liable for misconduct.

- (b) The primary duty of physical verification and valuation of investments is of the management. However, the auditor's duty is also to verify the physical existence and valuation of investments placed, at least on the last day of the accounting year. The auditor should verify the documentary evidence for the cost/value and physical existence of the investments at the end of the year. He should not blindly rely upon the Management's representation. In the instant case, such non-verification happened for two years. It also appears that auditors failed to confirm the value of investments from any proper source. In case auditor has simply relied on the management's representation the auditor has failed to perform his duty. Accordingly, Mr. A, will be held liable for professional misconduct under clauses (2), (7) and (8) of Part -1 of the Second Schedule to the Chartered Accountants Act, 1949 in terms of Sections 21 and 22.
- (c) Mr. X published an advertisement in a Newspaper containing his photograph on the occasion of the opening ceremony of his office. On this context, it may be noted that the advertisement which had been put in by the member is quite prominent. If soliciting of work is allowed, the independence and forthrightness of a Chartered Accountant in the discharge of duties can not be maintained.

The above therefore amounts to soliciting professional work by advertisement directly or indirectly. Mr. X would be therefore held guilty under Clause 6 of Part-I of the First Schedule to the Chartered Accountants Act, 1949.

- (d) Mr. X, a Chartered Accountant and proprietor of M/s X and Co, wrote several letters to the Assistant Registrar of Co-operative Societies, requesting for allotment of audit work. In similar cases, it was held that the Chartered Accountant would be guilty of professional misconduct under clause 6 of Part I of the First schedule to the Chartered Accountants Act, 1949. The writing of continuous letter to ascertain the reasons for not getting the work is quite alright but in case such either amount to request for allowing the work than Mr. X will be liable for professional misconduct. In fact Mr. X would be therefore held guilty under clause 6 of Part I of the Act.

Question 4

Give your comments with reference to the Chartered Accountants Act, and Schedules thereto:

- (a) *Mr. A, a practicing Chartered Accountant, took over as the executive chairman of Software Company on 1.4.2010. On 10.4.2010 he applied to the Council for permission.*

(4 Marks)

- (b) *Mr. X, a practicing Chartered Accountant, issued a circulation certificate for a periodical on the basis of outward memos, which was later found to be false. (4 Marks)*
- (c) *Mr. Z, a practicing Chartered Accountant, received a sum of ₹ 1 lac on 1.9.2009 from a Client who intends to leave abroad for a period of a year, with a request that his advance tax liabilities to be paid over the three instalments. On 15th September, 2009, 15th December, 2009 and 15th March, 2010. After remitting the 1st instalment of advance tax on 15.9.2009, Z did not keep the Balance Money in a separate Bank account and he is of the opinion he will remit the money within reasonable time as per payment schedule of Advance tax. (4 Marks)*
- (d) *Mr. X, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm. On 31st December, 2008 he leaves the services of the firm. Despite many reminders from ICAI he fails to reply regarding the date of leaving the services of the firm. (4 Marks) (May 2010)*

Answer

- (a) As per Clause (11) of Part I of Schedule I of the Chartered Accountant Act, 1949 a Chartered Accountant in practice, will be deemed to be of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

Thus, Mr. A took over as the executive chairman on 01/04/2010 and applied for permission on 10/4/2010, on the basis of these facts he was engaged in other occupation between the period 01/04/2010 and 10/04/2010, without the permission of the Council and is guilty of misconduct in terms of this clause.

- (b) As per Clause (8) of Part I of Schedule II of the Chartered Accountant Act, 1949 a Chartered Accountant in practice, will be deemed to be guilty of professional misconduct, if he fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

This indicates a Chartered Accountant must determine the extent of information, which, should be obtained by him before he expresses an opinion on the financial statements.

Thus, Mr. X certifies the circulation based on outward memos, without going into the most elementary details of how the circulation of a periodical was maintained, i.e. not verifying the financial records, bank statements, collections for the periodicals, payment of the printer's bills etc. Hence he is guilty of professional misconduct.

- (c) As per Clause (10) of Part I of Schedule II of the Chartered Accountant Act, 1949, a Chartered Accountant in practice will be deemed to be of professional misconduct if he fails to keep moneys of his client other than the fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

The term reasonable time would depend upon the circumstances of the case. Moneys which are intended to be spent within a reasonably short time need not be put in a separate bank account.

Thus, Mr. Z should have kept the balance money after remitting the first instalment of advance tax into a separate bank account. Hence he is guilty of professional misconduct.

- (d) As per Clause (2) of Part III of the First Schedule a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, Mr. X has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant he is held to be guilty of professional misconduct.

Question 5

Give your comments with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) *PQR and Associates, Chartered Accountants have their website and on the letterhead of the firm it is mentioned that "Visit our website: PQR com". In the website the nature of assignments handled, names of prominent clients and fees charged is also displayed.*
(4 Marks)
- (b) *Mr. B is a practising Chartered Accountant holding a valid certificate of practice. He accepted the appointment as Director of the Green World Co. Ltd. Mr. C, a partner of Mr. B is statutory auditor of the said company.*
(4 Marks)
- (c) *YKS & Co., a proprietary firm of Chartered Accountants was appointed as concurrent auditor of a bank. YKS used his influence for getting some cheques purchased and thereafter failed to repay the loan/overdraft.*
(4 Marks)
- (d) *Mr. Mohan is a practising Chartered Accountant. He issued a certificate of consumption which did not reflect the correct factual position of the consumption of raw material by the concerned entity. It is found that the certificate is given on the basis of data appearing in the minutes of meeting of the Board of Directors.*
(4 Marks) (November 2010)

Answer

- (a) The Council of the Institute of Chartered Accountants has issued guidelines for posting the particulars on Website by Chartered Accountants in practice and firms of Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949. According to the guidelines the details in the website should be

so designed that it does not amount to soliciting client or professional work. It is permitted to mention the website address on letterhead but soliciting people to visit website is not permitted. PQR and Associates letterhead invites to people to visit their website. Similarly the website mentions the nature of assignments, names of the prominent clients and fees charged. The nature of assignments is permitted for display only on specific 'Pull' request. And the name of clients, the fees charged is not permitted at all.

PQR & Associates will be held guilty of Professional Misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

- (b) Clause 11 of Part 1 of First Schedule to the Chartered Accountants Act, 1949 prohibits a member to engage in any business or occupation other than the profession of chartered accountants unless permitted by the Council so to engage. It does not prohibit a Chartered Accountant from being a director of a company, except managing director or a whole time director. But if any of the partners is interested in such company as an auditor then he cannot be director of the said company. In the present case Mr. B has accepted the directorship in a Company where his partner Mr. C is an auditor without obtaining specific permission of the council. Hence, Mr. B will be held for Professional Misconduct under Clause 11 of Part 1 of First Schedule to the Chartered Accountants Act, 1949.

Further, the Council of the Institute of Chartered Accountants of India has categorically stated that in cases where a member is a director of a company, the firm, in which the said member is a partner, should not express any opinion on its financial statements. Clause 4 of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that expressing an opinion on financial statement of any business establishment in which the auditor, his firm or a partner of his firm has a substantial interest would constitute misconduct unless he discloses the interest in his report. In cases, where a member of the Institute is a director of a company or a firm in which said member is a partner should not express any opinion on its financial statements. Hence Mr. C, a partner of Mr. B, should vacate the office.

- (c) This is a case which is covered under the expression in other misconduct of the Chartered Accountants Act, 1949. Chartered Accountant is expected to maintain the highest standards and integrity even in his personal affairs and any deviation from these standards calls for disciplinary action. In the present case YKS & Co, being a concurrent auditor used his position to obtain the funds and failed to repay the same to the bank. This brings disrepute to the profession of a Chartered Accountant. This act of YKS & Co is not pardonable.

YKS & Co will be held guilty of other misconduct under section 22 of the Chartered Accountants Act, 1949.

- (d) According to Clause 2 of Part 1 of Second Schedule to the Chartered Accountants Act, 1949 a chartered accountant is held guilty of professional misconduct if he certifies or submits a report of an examination of financial statements unless the examination of

such statements and the related records has been made by him or by a partner or employee in his firm or any other chartered accountant in practice.

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

Clause 7 of Part 1 of Second Schedule to the Chartered Accountants Act, 1949 also applies to this case which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Mr. Mohan will be held guilty of Professional Misconduct under Clause 2 of Part 1 of Second Schedule to the Chartered Accountants Act, 1949.

Question 6

Give your comments with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a) *CA Smart, a practicing Chartered Accountant was on Europe tour between 15-9-10 and 25-9-10. On 18-9-10 a message was received from one of his clients requesting for a stock certificate to be produced to the bank on or before 20-9-10. Due to urgency, CA Smart directed his assistant, who is also a Chartered Accountant, to sign and issue the stock certificate after due verification, on his behalf.* (4 Marks)
- (b) *Mr. Kishore, a practicing Chartered Accountant was appointed by the Central Government to carry out a special audit u/s 233A of the Companies Act, 1956. He accepted the appointment and proceeded with the work without communicating to the statutory auditor of the company.* (4 Marks)
- (c) *Mr. Sodhi, a Chartered Accountant in practice, who is proposed to be removed as the auditor of a company makes unsubstantiated and derogatory remarks against the management of the company in his representation u/s 225 of the Companies Act, 1956.* (4 Marks)
- (d) *A letter is sent by a Chartered Accountant in practice to the Ministry of Finance inquiring whether a panel of auditors is being maintained by the Ministry and if so to include his name in the panel (CV enclosed)* (4 Marks) (May 2011)

Answer

- (a) As per clause 12 of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA Smart allowed his assistant who is not a partner but a member of the Institute of Chartered Accountants of India to sign stock certificate on his behalf and thereby commits misconduct.

Thus, CA Smart is guilty of professional misconduct under clause 12 of Part I of First Schedule of the Chartered Accountants Act, 1949.

- (b) Clause 8 of Part I of the First Schedule to the Chartered Accountants Act, 1949 deems a Chartered Accountant in practice to be guilty of professional misconduct if he accepts a position as auditor previously held by another Chartered Accountant without first communicating with him in writing.

However, the Council has specifically clarified that it is not necessary for the auditor who is appointed to conduct special audit to communicate with the previous auditor, who had conducted a regular audit for the period covered by special audit.

Therefore, Kishore is not guilty of professional misconduct.

- (c) In terms of Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949, the unsubstantiated and derogatory remarks against the Management of the Company by Mr. Sodhi, a Chartered Accountant in practice, in his representation under section 225 of the Companies Act, 1956 tantamount to securing professional work by undignified means.

The Council of the Institute has clarified that the right to make a representation under section 225 (3) of the Companies Act, 1956 does not mean that an auditor has any prescriptive right on a lien to an audit. The wording of this representation should be such that, apart from the opportunity not being abused to secure needless publicity, it does not tantamount directly or indirectly to canvassing or soliciting for his continuance as an auditor.

The letter should merely set out in a dignified manner how he has been acting independently and conscientiously through the terms of office and may, in addition, indicate if he so chooses, his willingness to continue as an auditor if reappointed by the shareholder.

Therefore, Mr. Sodhi is guilty of professional misconduct.

- (d) Clause 6 of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular,

advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the member to make roving inquiries by applying to any such organization for having his name included in any such panel."

Accordingly, the member is guilty of misconduct in terms of the above provision as he has solicited professional work from the Finance Ministry, by inquiring about the maintenance of the panel.