ADVANCED AUDITING AND PROFESSIONAL ETHICS

EXAM TIPS & MNEMONICS

CA PAWAN ROHRA

Email: examdaybook@gmail.com

INTRODUCTION:

There are many students in our fraternity who find this subject difficult and there is always a thought in one's mind that they don't get good marks in subject like Auditing though they have good practical experience. From my opinion, theory subject is based on how you present yourself in your answers; most important is your command over English language.

So with my small effort to help students in the subject of auditing, I have tried to compile some mnemonics in two important topics of auditing i.e. Companies (Auditor's Report) Order, 2003 and Schedules of Professional Ethics as per Chartered Accountants Act, 1949. This document will help you to memorize these clauses and will surely fetch you good marks because you will be able to quote clauses in your answers wherever possible and examiner will also be impressed if you quote correct clauses.

A. Mnemonics – The Companies (Auditor's Report) Order, 2003

- **This is how it is prepared-**

  21 clauses of CARO are divided in two parts:

  1st Part – Clause i to x
  2nd Part – Clause xi to xxi

  Firstly, there is Summary of all the points for fast reference and then there is detailed clauses of complete CARO's 21 Clauses

- **How to learn this –**

  For example -
  Clause i is related to Fixed Asset so mnemonic to it will be Fashion

  These Mnemonics will help you to remember the heading and not the whole clause. As recollecting the heading in exam will enable you to write something about that clause.

  Initial of each clause is used to frame one statements, so there are two statements which cover all 21 clauses of CARO –

  Statement 1 – Fashion In London Is Terrible Due to Italian Clothes Sold in London.

  Statement 2 – Rancho Loves Collecting Pictures, Getting Everyone's Appreciation, Putting Smile on Everyone's Face.

Fast Reference to CARO's Clauses

PART 1

Clause No.	Clause	Mnemonic
i.	Fixed Assets	FASHION
ii.	Inventory	IN
iii.	Loans & Advances	LONDON
iv.	Internal Control System	IS
v.	Transaction with Parties Referred In Section 301 of Companies Act	TERRIBLE
vi.	Deposit of Public	DUE TO
vii.	Internal Audit	ITALIAN
viii.	Cost Records	CLOTHES
ix.	Statutory Dues	SOLD IN
x.	Losses Accumulated	LONDON

PART 2

Clause No.	Clause	Mnemonic
xi.	Repayment of Dues	RANCHO
xii.	Loans & Advances against Security Of Pledge Of Shares, Debentures	LOVES
xiii.	Chit Fund	COLLECTING
xiv.	Proper Records of Trading In Shares	PICTURES
xv.	Guarantee of Loans	GETTING
xvi.	End Use of Funds	EVERYONE'S
xvii.	Application of Short Term Loans to Long Terms	APPRECIATION
xviii.	Preferential Allotments	PUTTING
xix.	Security	SMILE ON
xx.	End Use of Money Raised From Public	EVERYONE'S
xxi.	Fraud	FACE

Introduction to CARO Provisions in detail:

PUBLISHED IN THE GAZETTE OF INDIA EXTRAORDINARY PART II, SECTION 3 — SUB-SECTION (I) BY THE MINISTRY OF FINANCE (DEPARTMENT OF COMPANY AFFAIRS) ON 12TH JUNE, 2003 (and as amended by Notification No. GSR 766(E) dt. 25-11-2004)

G.S.R. 480(E).— In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956 (1 of 1956), read with the Notification of the Government of India in the Department of Company Affairs, number G.S.R. 443(E), dated 18th October, 1972, as amended from time to time and in supersession of order number G.S.R. 909(E), dated 7th September, 1988, published in the Gazette of India, part II, section 3, sub-section (i), except as respects things done or omitted to be done before the supersession, and after consultation with the Institute of Chartered Accountants of India [constituted under the Chartered Accountants Act, 1949 (38 of 1949)], in regard to class of companies to which this order applies and other ancillary matters, the Central Government hereby makes the following Order, namely:-—

1. **Short title, application and commencement**

1. This order may be called the Companies (Auditor's Report) Order, 2003.
2. It shall apply to every company including a foreign company as defined in section 591 of the Act, except the following:—
   i. a Banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
   ii. an insurance company as defined in clause (21) of section 2 of the Act;
   iii. a company licensed to operate under section 25 of the Act; and
   iv. a private limited company with a paid-up capital and reserves not more than fifty lakh rupees and does not have loan outstanding exceeding Rupees Twenty Five lakhs from any bank or financial institution and does not have a turnover exceeding five crores rupees at any point of time during the financial year
3. It shall come into force on the 1st day of July, 2003.

2. **Definitions**

In this Order, unless the context otherwise requires:

a. "Act" means the Companies Act, 1956 (1 of 1956);
b. "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 enters into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of installments 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.

3. 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 accounts 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.

4. Auditor's report to contain matters specified in paragraphs 4 and 5

The auditor's report on the account of a company to which this Order applies shall include a statement on the following matters, namely:—

PART 1

Clause No.	Clause	Mnemonic
i.	**Fixed Assets** (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; (b) 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; (c) if a substantial part of fixed assets have been disposed of during the year, whether it has affected the going concern;	**FASHION**
ii.	**Inventories** (a) whether physical verification of inventory has been conducted at reasonable intervals by the management; (b) 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; (c) 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 account;	**IN**
iii.	**Loans to Companies, Firms or Other Parties** (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301	**LONDON**

	of the Act. If so, give the number of parties and amount involved in the transactions; (b) 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; (c) whether receipt of the principal amount and interest are also regular; and (d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest; (e) has the company taken any loans, secured or unsecured from 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; and (f) 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; (g) whether payment of the principal amount and interest are also regular; and	
iv.	**Internal Control System** 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 continuing failure to correct major weaknesses in internal control system;	**IS**
v.	**Transaction with Parties Referred to in Section 301** (a) whether particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and (b) whether 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 any one financial year)	**TERRIBLE**
vi.	**Deposit of Public** 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 58A, 58AA or any relevant provisions of the Act and the rules framed thereunder, 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 Reserve Bank of India or any Court or any other Tribunal, whether the same has been complied with or not?	**DUE TO**

vii.	**<u>Internal Audit System</u>** 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 crores 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;	**ITALIAN**
viii.	**<u>Cost Records</u>** 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 have been made and maintained;	**CLOTHES**
ix.	**<u>Statutory Dues</u>** (a) 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 be indicated by the auditor. (b) in case dues of income tax/sales tax/wealth tax/service tax/ customs duty/ excise duty/cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the Department shall not constitute the dispute).	**SOLD IN**
x.	**<u>Losses Accumulated</u>** 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 per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;	**LONDON**

PART 2

Clause No.	Clause	Mnemonic
xi.	**<u>Repayment of Dues</u>** 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;	**RANCHO**
xii.	**<u>Loans & Advances against Pledge Of Shares, etc</u>** 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;	**LOVES**
xiii.	**<u>Chit Fund/Nidhi/Mutual Benefit Fund/Societies</u>** whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/mutual benefit fund/societies; a. whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet; b. whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard / doubtful / loss assets; c. whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers; d. whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;	**COLLECTING**
xiv.	**<u>Proper Records of Trading In Shares, Securities, Debentures And Other Investments</u>** 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 investments 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;	**PICTURES**
xv.	**<u>Guarantee For Loans Taken By Others</u>** 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;	**GETTING**

xvi.	**<u>End use of Loan</u>** whether term loans were applied for the purpose for which the loans were obtained;	**EVERYONE'S**
xvii.	**<u>Application of Short term oans to Long term Loans</u>** 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;	**APPRECIATION**
xviii.	**<u>Preferential Allotment Of Shares</u>** 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;	**PUTTING**
xix.	**<u>Security Or Charges</u>** whether security or charges has been created in respect of debentures issued;	**SMILE ON**
xx.	**<u>End Use Of Money Raised from Public</u>** whether the management has disclosed on the end use of money raised by public issues and the same has been verified;	**EVERYONE'S**
xxi.	**<u>Fraud</u>** 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.	**FACE**

B. Mnemonics – Schedules to Professional Ethics under the Chartered Accountants Act, 1949

Professional Ethics has a weight age of **16 Marks** in **Q2** of Paper – 3. This question gives you a good chance to secure marks that why you should impress your examiner with your answers.
For Impressing examiner through your answer in this question you should write small introduction about Professional Ethics in your first answer to Q2.

Introduction:

"The hallmark of noble professional is a strict adherence by its members to a common code of conduct. In India, the ICAI is a premier body which regulates the conduct of its members. A Chartered Accountant being a member of a learned profession should not conduct himself in a manner which is unbecoming the member of institute, therefore all his actions, in a professional capacity should be within the four corners of the Chartered Accountants Act, 1949."

OVERVIEW OF SCHEDULES OF CHARTERED ACCOUNTANTS ACT, 1949 COVERING PROFESSIONAL MISCONDUCT

Schedule	Part	Title
First	I	Professional Misconduct in relation to members in Practice
	II	Professional Misconduct in relation to members in Service
	III	Professional Misconduct in relation to members generally
	IV	Other Misconduct in relation to members generally
SECOND	I	Professional Misconduct in relation to members in Practice
	II	Professional Misconduct in relation to members generally
	III	Other Misconduct in relation to members generally

Mnemonics are given only for **PART I of First Schedule** and **PART I of Second Schedule** as these two covers majority of Clauses i.e. 12 and 10 respectively.

As I said in my initial introduction, writing clauses in your answers will surely fetch you good marks. So you are required to be thorough in **PART I of First Schedule** and **PART I of Second Schedule,** this can be done easily by using Mnemonics given in below tables.

➢ PART I TO FIRST SCHEDULE: PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS IN PRACTICE

Clause No.	Clause	Mnemonic
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.	**NITIN**
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, or • member of any other professional bodies, or • with such other persons having prescribed qualifications.	**SHAH**
3.	**Accepts / Agrees** to accept any part of the profits of the professional work of a person who is not a member of the Institute. However, such a restriction does not apply in respect of following persons: • member of any other professional bodies, or • with such other persons having prescribed qualifications.	**ASKED**
4.	Enters into **partnership** with any person other than the following: • C.A. in practice, or • Member of any other professional body having prescribed qualifications, or • a person resident without India who but for his residence abroad would be entitled to be registered u/s 4(i)(v), or • a person whose qualifications are recognized by Central Govt. or Council for the purpose of permitting such partnerships.	**PARTNER**
5.	**Secures** any professional business through the services of a person who is not an employee or not his partner or by means which are not open to a CA.	**SAMEER**
6.	**Solicits** clients or professional work either directly or indirectly, by circular, advertisement, personal communication or by any other means.	**SHAH**
7.	**Advertises** his professional attainments or services, or uses any designation or expressions other than CA on professional documents, visiting cards, letter heads or sign boards.	**ABOUT**

	However, an recognized degree of university or title indicating membership of ICAI or other recognized institution may be used.	
8.	Accept a position as Auditor previously held by another chartered accountant or certified auditor without first **communicating** with him in writing	**C**
9.	**Accepts an appointment** as auditor of a company without ascertaining whether requirements of Sec. 224 & 225 of Companies Act, 1956, in respect of such appointment have been duly complied with.	**A**
10.	Charges or offers to charge, accepts or offers to accept in respect of any professional employment, fee which is based on a **Percentage of profits** or which are contingent upon findings or results of such employment, except as permitted under regulations.	**PRACTICE**
11.	**Engage** in any Business or occupation other than profession of C.A. unless permitted by council so to engage. However, a member may become director (not being M.D. or WTD) in a company provided he or any of his partner is not interested in such company as an auditor.	**EVERY**
12.	Allows a person not being a member of ICAI in practice or a member not being his partner to **sign** on his behalf or on behalf of his firm, any Balance Sheet, P&L A/c. Report or Financial Statements	**SUNDAY**

- **PART I TO SECOND SCHEDULE: PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS IN PRACTICE**

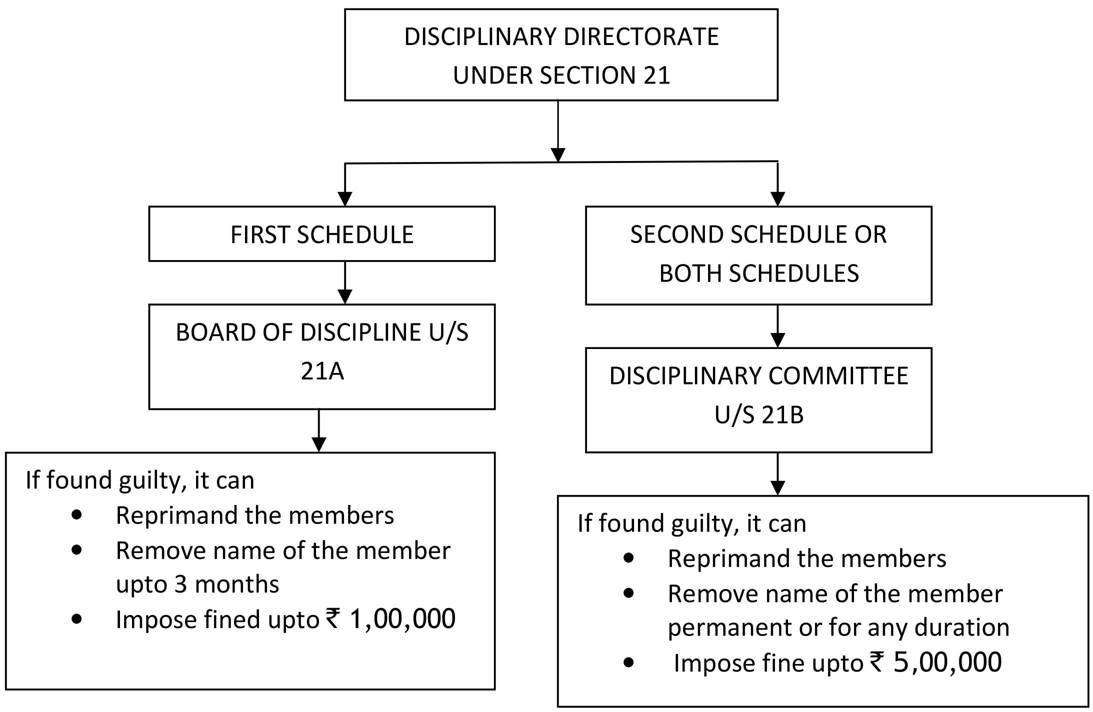
Clause No.	Clause	Mnemonic
1.	**Discloses** the information acquired in the course of his professional engagement to any person other than his client so engaging him without the consent of his client or otherwise than as required by any law.	**DON'T**
2.	**Certifies** or submits in his name or in the name of his firm a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another CA in practice.	**CHEAT**
3.	Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon **future transactions** in manner which may lead to the belief that he vouches for the accuracy of the forecast.	**FRIENDS**

4.	Expresses his opinion on financial statements of any business or enterprise in which he or a partner in his firm has a substantial **<u>interest</u>**.	**IT**
5.	Fails to disclose a **<u>material fact</u>** known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement not misleading where he is concerned with that financial statement in a professional capacity.	**MAY**
6.	Fails to report a **<u>material misstatement</u>** known to him to appear in a financial statement with which he is concerned in a professional capacity.	**MAKE**
7.	Does not exercise due diligence, or is **<u>grossly negligent</u>** in the conduct of his professional duties.	**GOOD**
8.	Fails to obtain sufficient **<u>information</u>** which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.	**INTENTIONS**
9.	Fails to invite attention to any **<u>material departure</u>** from the generally accepted procedure of audit applicable to the circumstances.	**MORE**
10.	Fails to keep moneys of his client other than fees or remuneration or money meant to be expended, in a separate **<u>banking account</u>** or to use such moneys for purposes for which they are intended within a reasonable time.	**BAD**

<u>Suggestion for writing answers of Professional Ethics</u>

- Always Divide your answers in three parts:
    - **Introduction** – Write your clauses in this part of answer (Both clause number and what clause is all about i.e. you have to write complete clause as given in above table)
    - **Analysis** – Write your analysis according to the question asked and the clause you wrote in introduction part.
    - **Conclusion** – Write your conclusion based on your analysis (avoid using 'IF' in your conclusion i.e. your answer should be straight)

      Better way to conclude your answer when a member asked in question is found guilty of his misconduct will be that you should write the consequences he/she may face. (REFER EXAMPLE BELOW)



Any member aggrieved by order of Board or Disciplinary committee can prefer appeal **within 90 days before Appellate Authority u/s 22G.**

To give a clear understanding, I would like to give you one example:

Question:
CA Z who is leading Income Tax Practitioner and consultant in Mumbai is also trading in derivatives.

Answer

As per clause 11 of Part I of First Schedule of Chartered Accountant Act, 1949, a chartered accountant is deemed to be guilty of professional misconduct if he **‘Engage in any Business or occupation other than profession of C.A. unless permitted by council so to engage’**.

However, the council has granted general permissions to be members to engage in certain specific occupation. In respect of all other occupation 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 1 of First Schedule of Chartered Accountant Act, 1949.

Further, CA Z may have to face consequences **under Section 21A of Chartered Accountants Act, 1949 from Board of Discipline under First Schedule that he can be:**

- Reprimand
- His name can be removed for the period up to 3 months year
- Impose fine upto ₹1,00,000/-

In case misconduct is **under second schedule**, you may write – Disciplinary committee-

- Reprimand
- His name can be removed for the period up to permanent or for any duration
- Impose fine upto ₹5,00,000/-

C. SOME TIPS FOR AUDITING IN GENERAL

1) It’s very important that you should complete your Chapter no. 1 from Practice Manual. This chapter can be taken as a replacement of Standard on Auditing (SA) as this covers SA’s on greater extent.
   And day before exam, you should go through only this chapter instead of going for full-fledged SA’s. This will save your time for other important chapters.

2) Do refer Accounting Standard (AS) because auditing cannot be done without AS, both practically as well as theoretically.

   You will surely find questions based on both Standards on Auditing and Accounting Standard in Q1 of your exam. So Standards on Auditing and Accounting Standard plays a vital role in your exam preparation.

3) In theory subject, you should always present your answers in three parts. Same way I have presented for professional ethics i.e. **Introduction, Analysis and Conclusion**.
   While concluding your answers of company law, you can give reference to clauses of professional ethics, if any that fits into your answers.

4) If you mention relevant section numbers of Companies Act or any other Act relating to your answer, it will surely impress your examiner and there are chances that your will get marks for writing section number.

5) Try to cover up **'Company Audit'** properly as this is the same topic in Paper 3 and Paper 4 and this covers approx 35 marks in paper 3 and have equal weight age in paper 4 as well. So, it will save your time in preparation of Paper 4

6) You can always expect one question on Fiscal Law, to be specific on 'Tax Audit" – approx 5 Marks

7) You will be definitely going through the provisions of Revised Schedule VI in Financial Reporting – Paper 1. In audit, you can expect a question on it, so do it once again or do it perfectly in Paper 1 so that you should not do it again and save your time.

8) **It's easy to secure marks in Audit by referring few topics.**

   Weight age (approx):

Based on Standards on Auditing and Accounting Standards -	**35 Marks**
Professional Ethics in Q2	**16 Marks**
Company Audit	**35 Marks**
Total	**86 Marks**

   86 marks out of total 116 marks. This will surely make it easy to secure at least 50 marks or you can say that scoring exemption will be easy with some more efforts.

9) **How to utilize 15 minutes allotted to go through question paper?**
   - Read your question paper thoroughly as to which chapters are asked in the exam.

- Set the sequence in which you will attempt your question. Always start with your best and end with your worst. This will help you secure good marks in your best answers.
- Once you have set your sequence then start framing your answers to the questions you will be attempting initially.

10) It sometime happens that you are not able to attempt one subpart of question in that case leave appropriate space for that answer and try to attempt your next best.
    Attempt the question you left for answering at last.

11) Time Management is very important:
    180 minutes for 100 Marks i.e.1.8 minute/ marks

    You should not allot more time to one single question as it is rightly said that – **6 average answers will fetch you more marks than 5 good.**
    So if you are not able to complete the answer don't stick to it, leave it and go for the next question.

######## ALL THE BEST ########