A COMPLETE GUIDE FOR

ADVANCED AUDITING

(CA FINAL)

Applicable for CA Final May, 2015 Exams onwards

Short Notes for Quick Revision

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CA Sumit Aggarwal

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ADVANCE AUDITING

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- With solved Question Papers for Last 34 Exams
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By

C.A. SUMIT AGGARWAL

Foreword by

C.A. AMARJIT CHOPRA

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Sumit Kumar Aggarwal is a commerce graduate from Bikaner University, having done his graduation from Seth G.L. Bihani S.D. (P.G.) College. He qualified Chartered Accountancy Course in 2005, simultaneously; he also completed his Master in Commerce in 2005. He has cleared various exams conducted by NSE. He also qualified certification course in International Financial Reporting Standard (IFRS) from ICAI in January 2010. He is currently teaching auditing to CA Students & functioning as a Practicing Chartered Accountant. He is also a member of Institute of Certified Management Accountant, USA.

Foreword

Financial Statements are important as these reveal the state of affairs of a particular entity on a particular date as well as the performance of the entity over the accounting period. These need to be transparent and give true and fair view of the state of affairs and of profit/loss for the period. Though the responsibility for preparation of financial statements lies with the managements, the responsibility, to ensure that sound accounting policies and the relevant accounting standards have been complied with, remains with the auditor.

With a view to enable auditor to discharge his duties effectively and efficiently, Standards on Auditing have been laid down. The same are in line with the Standards laid down by International Auditing and Assurance Standards Board (IAASB). The Institute of Chartered Accountants of India have pronounced Standards on Auditing. These Standards lay down the responsibilities of the auditors and the procedures to be followed by them. Any deviation from these Standards has to be explained by the auditor giving the reasons, impact etc. In certain cases he may be required to modify his report.

I am indeed glad to know that CA Sumit Kumar Aggarwal has authored "A Complete Guide For Advanced Auditing" for CA Final students. He has covered the various Standards and other topics meticulously. He has taken pains to include topics on Professional Ethics, Bank Audit, Cost Audit etc. He has also deftly handled the questions with answers from last 34 exams. The effort is laudable and I am sure that the students would be immensely benefitted by the book.

With best wishes

CA. Amarjit Chopra,

Fellow Member ICAI

Preface

It gives me immense pleasure in presenting before the student of C.A. (Final), the first edition of the book on "Advanced Auditing and Professional Ethics".

Auditing is one of the most dynamic subjects in the C.A. curriculum. The Ministry of Company Affairs has replaced the Old "Companies Act, 1956" with new "Companies Act, 2013". The Institute of Chartered Accountants of India has revised most of the Standards on Auditing. The students of Chartered Accountancy are expected to have an expert knowledge of these SAs and other pronouncements.

The present book has been written keeping in view the requirements of C.A. (Final) examination of the Institute of Chartered Accountants of India. The features of this book are as follow:

Salient Features:

- Presentation of whole Syllabus in an easy language to understand the complex subject matter.
- Tabular and graphic presentation to facilitate easy understanding and learning.
- Inclusion of flowcharts on various topics, including Standards on Auditing.
- Presentation of maximum topics in point-wise manner.
- Upto date amendments including Companies Act, 2013, Clause 49 of Listing Agreement, Revised form 3CD – Tax Audit Report etc.
- Illustration of all "Audit Report" as per SA 700, SA 705 & SA 706 at one place (See Chapter 24) for quick understanding of "Audit Report" in different situations with minimum time frame & fast understandability.
- All Example of Engagement Letter as per SA 210, SA 2400, SRE 2410, SRS 4400, SRS 4410 at one place (See Chapter - 24) for quick understanding of Engagement Letter in different situations with minimum time frame & fast understandability.
- All Illustration of Audit Report, Review Report & Certificate as per SA 800, SA 805, SRE 810, SRE 2400, SRE 2410, SAE 3400, SRS 4400, SRS 4410 at one place (See: Chapter - 24) for quick understanding of Audit Report, Review Report in different situations & their comparison with minimum time frame & fast understandability.
- Full coverage of Questions appeared in past 34 exams has been arranged in following manners:
  - ◊ Chapter wise/topic wise
  - ◊ Standard of Auditing wise

- ◊ Accounting Standard wise
  - ◊ Clause wise & Schedule wise (Chapter – Professional Ethics)
  - ◊ Clause wise (Chapter – Audit under Fiscal Law (Form 3CD)
- Graphs at the beginning of every chapter, showing marks allotment in last twenty examinations.
- List of questions including case study's appeared in past 34 examinations given at the end of each chapter. Suggested answer given after Questions, so that student could first try to recall the Law/points/SA/Section/Act related to that case study and try to solved out the case study before seeing the suggested answer. It will enhance their irretrievability power. It will also help students to have an idea of paper style.
- Short Notes of all Chapters given at the end of the book (See Chapter – 26) for Quick revision.
- Table Showing Importance of Chapter on the Basis of Marks Allotment in Past Examinations.
- 80 + practical Question on New Companies Act, 2013.

I am thankful to my students and colleagues for their valuable suggestions while presenting this first edition.

I, also grateful to "***Spiraa Publishing Inc.***" for their efforts in publishing the book.

Suggestions and criticism from all readers would be highly appreciated and acknowledged.

Finally, I hope that students will find this book beneficial from exam point of view. In case of any suggestions, please feel free in writing to me at cacma.sumit@gmail.com

Wishing every success to the readers.

CA Sumit Kumar Aggarwal

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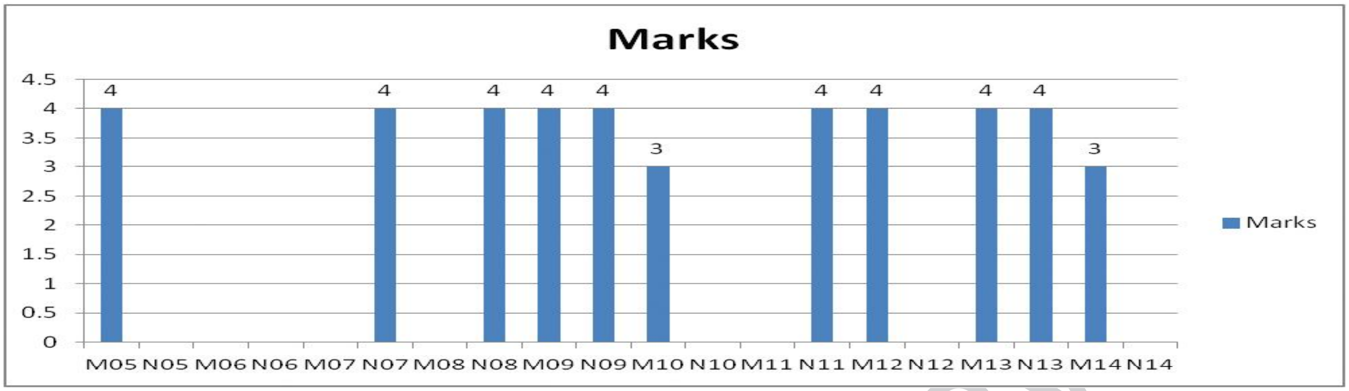
22 PEER REVIEW



1. **Introduction [N07 N08 M10]:** 'Peer Review' is defined as, a regulatory mechanism for monitoring the performances of professionals for maintaining quality of service expected of them for enhancing the reliance placed by the users of financial statements for economic decision-making. The peer review mechanism was established by the Council of the ICAI with the issuance of the Statement on Peer Review in March, 2002. Under peer review one chartered accountant will examine the other chartered accountant to judge the quality of attestation work performed by them. The former is known as Reviewer and the latter is known as practice unit/audit firm. The peer review is administered by Peer Review Board (PRB) constituted by ICAI. The Reviewer shall submit his report to PRB and necessary follow up action may be taken by PRB on such report.

2. **Objective of Peer Review [N07 N08 M10]:** The main objective of peer review is to ensure that (in carrying out their professional attestation service assignments) the members of the Institute:
   - Comply with the technical standards laid down by the ICAI.
   - Ensure that they have proper system for maintaining the quality of attestation services performed by him.
   - To ensure adherence to various statutory and other regulatory requirements.
   - To enhance the reliance placed by the users of financial statements for economic decision making.

   Thus the main objective of peer review is not to find out deficiencies but to improve the quality of services rendered by the members.

3. **Scope of Peer Review [N11 N13]:** Once a practice unit is selected for review, its attestation engagement records pertaining to the Peer review period shall be subjected to review. The Review shall focus on:
   - Compliance with Technical, Ethical & Professional Standards.
   - Quality of Reporting.
   - System and procedures for carrying out assurance services.
   - Training Programs for staff (including Articled and Audit Assistants) concerned with attestation functions, including appropriate infrastructure.
   - Compliance with direction and/or guidelines issued by the Council to the members, including fees to be charged, number of audits undertaken, register for assurance engagements conducted during the year and such other related records.
   - Compliance with directions and / or guidelines issued by the council in relating to article assistants and / or audit assistants, including attendance register, work diaries, stipend payment, and such other related records.

   A Practice Unit means members in practice, whether practicing individually or a firm of Chartered Accountants.

   The entire peer review process is directed at the attestation services which include all those services such as internal audit, concurrent audit etc., which involve provisions of some kind of element of assurance to users. Specifically, the services which have been excluded from the scope of attestation services are all management consulting engagements, representing a client before the authorities, preparing tax returns and providing tax advice, compilation services, testifying as expert witness and providing expert opinions based on facts.

4. **Areas excluded from scope of Peer Reviewer [M14]:** Areas excluded from scope of Peer Reviewer are:

- Management Consultancy Engagements.
- Representation before various Authorities.
- Engagements to prepare tax returns or advising clients in taxation matters.
- Engagements for the compilation of FS.
- Engagement for Due diligence.
- Engagements solely to assist the client in preparing, compiling or collating information other than financial statements.
- Testifying as an expert witness.
- Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws, on the basis of facts provided by the client.

5. **Technical, Ethical and Professional Standards as per Statement on Peer Review [M13]:** As per the Statement, Technical, Professional and Ethical Standards means:

- Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India.
- **Standards issued by the ICAI including:**
  - ◊ Engagement standards
  - ◊ Statements
  - ◊ Guidance notes
  - ◊ Standards on Internal Audit
  - ◊ Statements on Quality Control
  - ◊ Notifications / Directions / Announcements / Guidelines / Pronouncements / Professional standards issued from time to time by the Council or any of its committees.
- **Framework for the Preparation and Presentation of Financial Statements:**
  - ◊ Framework of statements and Standard on Auditing.
  - ◊ Framework for assurance engagements.
  - ◊ Standard on Assurance Engagements.
  - ◊ Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the ICAI.
- Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

6. **Applicability of Peer Review:**

Periodicity of Peer Review	A Practice Unit which has undertaken any of the under-mentioned Assurance Services in the period under Review
Once in 3 Years	• Central Statutory Auditors of Public Sector Banks, Private Sector Banks, Foreign Banks and Public Financial Institutions. • Central Statutory Auditors of Central and State Public Sector Undertakings and Central Cooperative Societies based on criteria (such as turnover or paid up capital etc) as may be decided by the board. • Central Statutory Auditors of Insurance Companies. • Statutory Auditors of asset management companies and mutual fund entities. • Statutory audit of enterprises whose equity or debt securities are listed in India or abroad. • Statutory Audit of entities which have raised funds from public or banks or financial institutions of over Rs. 50 crore during the period under review. • Statutory Audit of Entities which have raised donation and / or contributions over Rs. 50 crore during the period under Review. • Statutory Audit of entities having Net Worth of more than Rs. 500 crore at any time during the period under Review. • Statutory Audit of entities which have been funded by Central and / or State Government(s) scheme of over Rs. 50 crore during the period under Review.

Once in 4 Years	• Statutory / Internal / Concurrent / Systems/ Tax Audit and / or Departmental Review of Branches / Offices of (a) Public Sector or Private Sector and / or Foreign Bank (b) Insurance Companies, (c) Co-operative Banks (d) Statutory Audit of Regional Rural Banks (e) Statutory Audit of NBFC. • Statutory Audit of entities having Net Worth of Rs. 5 Crore or an annual Turnover of more than Rs. 50 Crore during the period under review.
Once in 5 Years	• All other practice units, which are not covered above.

Note:

1. Any Practice Unit not selected for Peer Review, may ***suo moto*** apply to the Board for the conduct of its Peer Review .The Board shall act upon the same within 30 days from the date of receipt of such request.
2. Any Auditee (Client) may request the Board for the conduct of Peer Review of its auditors. The Board shall act upon the same within 30 days from the date of receipt of such request.

7. Peer Review Board:

- The Board shall be constituted by the Council.
- The Board shall consist of maximum of 12 members to be appointed by the Council, of whom at least 6 shall be from amongst the Members of the Council.
- The balance members of the Board shall be drawn from outside bodies and amongst prominent individuals of high integrity and reputation, including but not limited to, regulatory authorities, bankers, academicians, economists, legal professional and business executives.
- The Chairman and Vice-Chairman of the Peer Review Board is appointed by Council from amongst the members of the Council.
- Casual vacancies on the Board shall be filled in by the council.
- The term of a member shall be for 1 year, or such period as may be prescribed by the Council.
- The members of the Disciplinary Committee or the Committee on Ethical Standards or Committee on Financial Reporting and Review Board of the Institute of Chartered Accountants of India shall not be members of the Peer Review Board.

8. Eligibility of Reviewer:

- **A Peer Reviewer shall:**
  - ◊ A member of ICAI.
  - ◊ Be a member, possessing at least 10 years of experience in practice; and Currently active in the practice as per CA Act. 1949.
  - ◊ Should have undergone the requisite training as prescribed by the Board.
  - ◊ Furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
  - ◊ Should have signed the Declaration of Confidentiality as prescribed by the Board.
  - ◊ Should have conducted audit of Level 1 Entities for at least 7 years to be eligible for conducting Peer Review of Level 1 Entities as referred above.
- **A Peer Review should not have:**
  - ◊ Disciplinary action / proceedings pending against him.
  - ◊ Been convicted by a Competent Court Whether within or outside India.
  - ◊ Been found guilty by the Council or the Disciplinary Board or Committee at any time.
  - ◊ Any obligation or conflict of interest in the Practice Unit or its Partners/ Personnel.
- A Reviewer shall not accept any professional assignment from the Practice Unit for a period of 2 years from the date of appointment.

9. The Peer Review Process:

9.1 Stage 1: Selection of Practice Unit and Appointment of Reviewer:

- Notification to the Practice Unit.
- Name of the three reviewer shall be recommended by the Board to the Practice Unit
- The Practice Unit shall select one out of three Reviewers & intimate to the Board within 7 days.
- The Board shall intimate to the selected Reviewer and seek his consent within 7 days.

9.2 Stage 2: Planning: After Reviewer consent, the Practice Unit shall furnish the following information to the

Reviewer within 15 days.

- Complete list of assurance service clients including the nature of service provided and fees charged.
- A note on the policies, procedure and process generally followed by the Practice Unit.
- Detail of any proceedings against the Practice Unit or any of its partners or qualified assistant taken by any regulatory, monitoring or enforcement bodies relating to attest function during the period of 3 years preceding the period of Review or at any time thereafter.

Selection of Sample by the Reviewer:

- After receiving information from the Practice Unit, Reviewer within 15 days select a sample of the assurance services that he would like to review and intimate the same to the Practice Unit.
- If required, Reviewer may also ask further /additional clarification from the Practice Unit.
- After selection process, Reviewer shall give at least 15 days time to the Practice Unit to keep the necessary records of the selected assurance services. Reviewer shall also plan for an on-site Review visit and this on-site Review should not extend beyond 7 working days.
- The Reviewer and Practice Unit will ensure that the entire Review process is completed within 90 days from the date of intimation to the Practice Unit about its selection for Review.

9.3 Stage 3: Execution [N09]:

- The reviewer should carry out the compliance review of the 5 key controls, i.e. independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration for evaluating the degree of reliance to be placed upon Practice Unit.
- The number of assurance service engagements to be reviewed shall depend upon number of factors such as fees charged/ service tax paid by the Practice Unit, size and nature of assurance service engagements, methodology generally adopted by the Practice Unit in providing assurance services etc. The Reviewer may also reduce or enlarge the initial sample size of assurance service after consultation with the Practice Unit.
- The reviewer is required to adopt a combination of compliance approach and substantive approach in the Review process.
  - ◊ **Compliance Approach:** The compliance approach is to assess whether proper control procedures have been established / followed by the Practice Unit to ensure that assurance serviced are being performed in accordance with Technical, Professional and Ethical Standards.
  - ◊ **Substantive Approach:** The Substantive Approach required a Review of the assurance working papers in order to establish the extent of compliance, whether the assurance work has been carried out as per the Technical, Ethical and Professional Standards.
- **Collection of Evidence by Peer Reviewer:** A Peer Reviewer collects evidence by applying the following methods:
- **Inspection:** Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practicing unit.
- **Observation:** Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.
- **Inquiry:** Inquiry consists of seeking appropriate information from the partner/ proprietor of the firm or other knowledgeable persons within the practicing unit. The inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of documentation maintained by the practice unit.

Observation and inquiry may be considered as external independent sources of review evidence and inspection remains the most significant method for confirming the effective observance of control procedures in the practicing unit.

9.4 Stage 4: Reporting [M05 M09]:

- **Preliminary Report of Reviewer:** After completing the on-site review, the reviewer before making his Report to the Board shall communicate his finding in the preliminary report to the Practice Unit if in his opinion, the system and procedures of the practice unit reviewed by him have been found to be deficient with reference to any matter that has been noticed by him or if he wants to seek clarification on any other matters. However, no preliminary report is required in case no deficiencies or non-compliance are noticed by the reviewer.

- **Reply to Preliminary Report:** The Practice Unit within 15 days after the date of receipt of the preliminary report will reply in writing to the Reviewer.
- **Final Clean Report of Reviewer:** If the Reviewer is satisfied with the reply given by the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of report shall also be forwarded to the Practice Unit.
- **Final Modified Report:** If the Reviewer is not satisfied, he shall accordingly submit a modified Report to the board incorporation his reasons for the same and his initial finding and discussion with Practice Unit. In case of modified report issued, Board shall order for a "follow on" Review after a period of 1 year (which may reduce to 6 months) from the date of issue of modified report.

10. **Qualified Assistant:** The reviewer may take the help of a qualified assistant while carrying out peer review. In this context, the Board decided to clarify that a reviewer is permitted to take the assistance of only one assistant who shall be a chartered accountant and a person who does not attract any of the dis-qualifications prescribed u/s 8 or Section 21 of the Chartered Accountants Act, 1949. The name of the qualified assistant shall be intimated to the Board as well as the practice unit before the commencement of the peer review and such a qualified assistant shall also have to sign the declaration of confidentiality. Selected Qualified assistant shall also not have any direct interface either with the practice unit or the Board. Further the selected assistant shall be from the firm of the reviewer and should have been working with him at least 1 year as a member in practice.

11. **Confidentiality:** Strict confidentiality provisions will applicable to all those involved in the peer review process, namely, reviewers, members of the Board, the Council, or any person who assists any of these parties. A Declaration of confidentially shall be signed by the persons who are responsible for the conduct of Peer Review i.e. Reviewer and his Qualified Assistants. All member of the Board shall also sign a declaration of Confidentiality in a manner as may be prescribed by the Board.

12. **Approach of the Reviewer:**

- The reviewer should gain an understanding of the engagement letter. Engagement letter is an important document as it defines the nature and scope of the attestation engagement, practice unit's responsibilities with regard to the engagement.
- The number of attestation engagements to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the questionnaire and the size of the practice unit.
- The practice unit may have policies and procedures for accepting a particular engagement. These policies and procedures may not exist in the form of records in each practice unit. In such a case the reviewer should consider enquiring from the concerned persons about such policies and procedures.
- The reviewer may follow a combination of compliance procedures and substantive.
- procedures throughout the peer review process.

Finally, the reviewer while evaluating records may consider the following:

- Determine that any significant issues, matters, problems that arose during the course of the engagement have been appropriately considered, resolved and documented.
- Determine that adequate audit evidence or other relevant evidence in relation to the engagement is obtained to support the reasonableness of the conclusions drawn; and
- Determine that significant decisions relating to the engagement, use of professional judgement, resolution of significant matters have been properly documented.

13. **Inherent Limitations of Review:** The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of quality of attestation services since it would be based on selective tests. As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject-matter of review, departure from the system may occur and may not be detected.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Peer Review"	N07	4	1 & 2
2	Explain the objectives of Peer Review.	N08	4	
3	Write short notes on "Focus of a Peer Review"	M10	4	
4	Write short notes on "Scopr of Peer Review"	N11, N13	4	3
5	What are the areas excluded from the scope of peer reviewer?	M14	3	4
6	Write short notes on " Technical ethical and professional standards as per statement on peer review"	M13	4	5
7	Explain briefly: Collection of evidences by Peer reviewer.	N09	4	9.3
8	Write short notes on "Preliminary Report under in Peer Review"	M05	4	9.4
9	Write short notes on "Reporting Stage in Peer Review"	M09	4	
10	A, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas a should review in the assessment of independence of the practicing unit.	M12	4	Ans-1

Answer

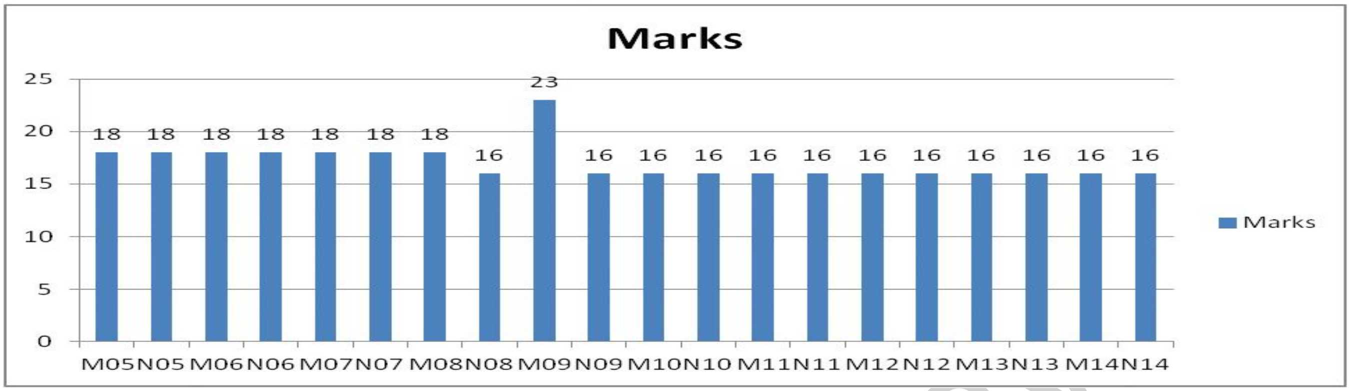
Ans 1:

Peer Review is a regulatory mechanism for monitoring the performances of professionals for maintaining quality of service expected of them. It was established by ICAI in March, 2002. Under peer review one CA will examine the other CA to judge the quality of attestation work performed by them. The objective of peer review is to ensure adherence to various statutory and other regulatory requirements & to enhance the reliance placed by the users of Financial statements for economic decision making.

In the instant case A, a practicing CA should review following controls in respect of assessment of independence of the practicing unit:

- Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
- Does the practice unit communicate these policies and the expected standards of professional behavior to all staff?
- Does the practice unit monitor compliance with policies and procedures relating to independence?
- Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

23 PROFESSIONAL ETHICS



23A The Chartered Accountants Act, 1949 as amended by the Chartered Accountants (Amendment) Act, 2006

No.	Particular	Section
1	Member deemed to be in Practice	2
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3	Class of Member	5
4	Significance of Certificate of Practice (COP)	6
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1. **Introduction - Code of Ethics:** The "Code of Ethics" is essentially a set of professional ethical standards regulating the relationship of CAs with their clients, employers, employees, fellow members of the group and the public in general. The CA Act, 1949 and the Schedules to the Act set out the acceptable forms of behavior of the members of the profession.

2. **Entry of Names in the Register of Member [Section 4]:**
   - A person who cleared the Final Examination and completed the training prescribed by the ICAI (such GMCS course) can become a member of the ICAI and have his name entered in the Register of Member.
   - **Status of Member:** member in practice (must have COP), member in service or member (may not be in practice or service, just having a degree).
   - Member can practice in his individual names or in his sole proprietorship firm or partnership firm.

3. **Class of Member [Section 5]:**

For Full Text of All Chapters with Short Notes & Question Bank – refer Book "A Complete Guide for Advanced Auditing – CA Final.

Available at Leading Bookshops All over India or buy online at www.flipkart.com or www.amazon.in

or write to

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