
*100 % Question Paper from “A Complete Guide for
Advanced Auditing – CA Final”*

By CA Sumit Aggarwal

100 % Syllabus

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Module

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“A Complete Guide for Advanced Auditing – CA Final” By Sumit Aggarwal

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(Module + Practice Manual + Scanner + Short Notes for Quick Revisions)

CA (Final) May 2015 Examination

S.No.	S.No.	Particular	Marks	Hint
1	(a)	As an auditor of RST Ltd. -Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please guide him.	5	SA 320: Refer point 2,5 & 6 of SA 320
	(b)	The financial statements of TC & Co. have been prepared by management of an entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework) to comply with provisions of the contract, management does not have a choice of financial reporting frameworks. As an auditor what considerations would be undertaken while planning and performing audit ?	5	SA 800: Refer point 2,3,4 of SA 800
	(c)	When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization ?	5	Refer SAE 3402
	(d)	In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will in drafting your audit report ?	5	SA 510: Refer Point No. 4.1 of SA 510
2	(a)	As an auditor of garment manufacturing company for the last five years you have observed that new venture of online shopping has been added by the company during current year. As an auditor what factors would be considered by you in formulating the audit strategy of the company ?	6	Chapter # 3: Refer Point # 4 of Chapter # 3
	(b)	A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you for audit of financial statements ?	6	Refer Section 129 & AS 21
	(c)	Write short note on Corporate Responsibility under Sarbanes and Oxley Act.	4	Chapter # 4B: Refer Point # 1 of Chapter # 4B

3	(a)	MG & Co. Ltd. seeks your advice while preparing financial statements the general instructions to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and current liabilities.	4	Chapter # 7B: (Schedule III of Co. Act, 2013) Refer “General Instruction for Preparation of Balance Sheet” of Chapter # 7B.
	(b)	C.A. Ashwin was appointed as auditor of Bristol Ltd. for the year 2013-14. Since he declined to accept the appointment, the Board of Directors appointed CA John as the Auditor in place of C.A. Ashwin and the appointment was accepted by C.A. John. Discuss.	4	Refer: Clause (9) of Part I of First Schedule. Chapter # 23
	(c)	During the bank audit AB & Co. a new Chartered Accountant firm, observed the sale/purchase of NPAs. Please help them by narrating the aspects, relating to sale/purchase of NPAs, to be considered.	4	Chapter # 12: Refer Point # 22 “Guidelines on Sale/Purchase of NPAs” of Chapter # 12.

	(d)	Draft an audit report under following circumstances : (i) Under the Payment of Bonus Act, 1965, a 'report' on the computation of bonus payable. (ii) Auditor's Report in accordance with Regulation 54 of the SEBI (Mutual Fund) Regulation, 1993.	4	Chapter # 1: Refer Guidance Note -3 "Guidance Note on Audit Reports and Certificates for Special Purposes. (for (ii) Point: SEBI Regulation 1993 were replaced by SEBI Regulations 1996).
4	(a)	R and M is an audit firm having partners CA R, CA M and CA G. Mr. S is the relative of CA R holding shares of STP Ltd. having a face value of Rs. 1,51,000. Whether CA R and CA M are qualified to be appointed as auditors of STP Co. ?	4	Chapter # 7C: Refer Point # 3 "Disqualifica tions of Auditors [Section 141(3)] of Chapter 7C.
	(b)	As an auditor, during your interim visit at Marathon Ltd. you observed that internal controls were not in use throughout the period covered under audit. What are the controls objectives you would like to consider to achieve your purpose ?	6	Chapter # 4A: Refer Point # 5.1 of Chapter 4A.
	(c)	Parent Ltd, acquired 51% shares of Child Ltd, during the year ending 31-03-2014. During the financial year 2014-15 the 20% shares of Child Ltd , were sold by Parent Ltd, Parent Ltd, while preparing the financial statements for the year ending 31-3-2014 and 31-03- 2015 did not consider the financial statements of Child Ltd for consolidation. As a statutory auditor how would you deal with it ?	6	Refer Chapter # 9 (CFS), AS 21 & AS 23
5		Comment with respect to Chartered Accountant Act, 1949 ;		

	(a)	Mr. SP. a Chartered Accountant obtains registration as category IV Merchant Banker under the SEBI's Rules and Regulations and act as Advisor to a capital issue of MB Co. Ltd, He designates himself under the caption "Merchant Banker" in client offer documents and 'Advisor to issue' in his own letterheads, visiting cards and documents.	4	Chapter # 23: Refer Section 7 of CA Act, 1949 & Clause 7 of Part I of First Schedule to the CA Act, 1949.
	(b)	A Chartered Accountant having COP entered into partnership with persons, who are not the members of the institute, for the purpose of carrying on business. The share of the chartered account in the profit and losses was 25%. He was to take part in the business and was entitled to represent the firm before Govt. authorities etc. He was operating the bank account of the firm was receiving moneys from customers and was also looking after the affairs of the partnership.	4	Chapter # 23: Refer Clause 4 & 11 of Part I of First Schedule to the CA Act, 1949.
	(c)	CA SG a practicing CA agreed to select and recruit personnel, conduct training program for and on behalf of the client.	4	Chapter # 23: Refer Section 2 of CA Act, 1949. Refer Qst. # 11 of Chapter 23
	(d)	Mr. P a practicing chartered accountant acting as liquidator of AB & Co. charged his professional fees on percentage of the realization of assets.	4	Chapter # 23: Refer Clause 10 of Part I of First Schedule of CA Act, 1949. Refer Qst. # 37 of Chapter 23
6	(a)	The auditor report of company states that proper books of accounts as required by law have been maintained by the company. What is the role of statutory auditor of the company, when a company be said to have not maintained proper books of account ?	4	Refer Section 128 & point # 5.5 (Other Elements to be covered in Audit Report [143 (3)] of Chapter 7

	(b)	Comment with respect to computation of total sales, turnover or gross receipts in business exceeding the prescribed limit under Section 44 AB of Income Tax Act, 1961 and VAT law. (i) Discount allowed in the sales invoice (ii) Cash discount (iii) Price of goods returned related to earlier year (iv) Sale proceeds of fixed assets	4	Refer point 6.4 (a) [Analysis of Sales] of Chapter 16
	(c)	Explain the stepwise approach adopted by the Peer reviewer.	4	Refer Point # 9 of Chapter 22
	(d)	AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor. Please guide him who can be appointed as internal auditor and what would be reviewed by him.	4	Refer Point # 11 (Section 138) of Chapter 7A
7		Write short notes/comment on any four of the following:		
	(a)	Core Investment Companies.	4	Refer Point # 3.5 of Chapter # 15 (Audit of NBFC)
	(b)	Investible funds as defined by IRDA.	4	Refer Chapter #11
	(c)	Areas in which due diligence can take place.	4	Refer Qst. # 10 on Page # 20.17 of Chapter # 20
	(d)	Operational auditing arose from the need of managers responsible for areas beyond their direct supervision.	4	Refer Chapter # 19
	(e)	"Review of the internal audit function has become statutory responsibility for the statutory auditor."	4	Refer SA 610 & Section 143 (3) of Co. Act, 2013 of Chapter # 7

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CA Sumit Aggarwal

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- 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.
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Phone: 011-45553634 Email: info.spiraa@gmail.com

Also Available on amazon.in and flipkart.com

ISBN 935196433-7



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- With Short Notes for Quick Revision

By

C.A. SUMIT AGGARWAL

Foreword by

C.A. AMARJIT CHOPRA

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NEW DELHI

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First Edition	:	December, 2014
ISBN	:	978-93-5196-433-9
Price	:	Rs. 595/-
Published by	:	<i>Spiraa Publishing Inc</i>
Regd. Office	:	B -8/232 Ist Floor, Sector -5, Rohini -110085. Delhi -110085
Phone	:	011-45553634
Email	:	info.spiraa@gmail.com
Printed at	:	Raja Offset Printers, Delhi

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About the Author

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.
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- 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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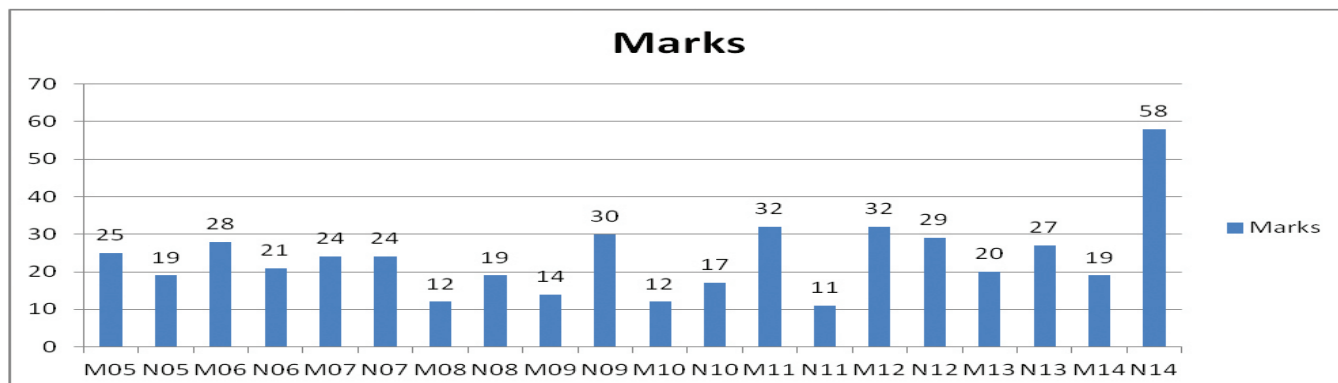
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	General Clarification (GC)-AASB/2/2004 on SA 210 (Refer SA 210)	
	General Clarification (GC)-AASB/1/2002 on SA 620 (Refer SA 620)	

SA 240**THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS (W.E.F. 1ST APRIL' 2009)**

1. **Characteristics of Fraud:** Misstatement in the financial statements can arise from either fraud (intentional) or error (unintentional). Fraud refers to intentional misrepresentation of financial information by one or more individuals among employees, management those charged with governance, or third parties. The auditor is concerned with fraud that causes a material misstatement in the financial statements.
2. **Responsibility for the Prevention and Detection of Fraud:** The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance and for this purpose they should implement and continuously operate an adequate system of internal control which may reduce the opportunities for fraud to take place.
3. **Auditor's Responsibilities relating to fraud in an audit of Financial Statements [N09]:**
 - An auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free material misstatement, whether caused by fraud or error.
 - When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit.
 - As described in SA 200, due to the inherent limitation of an audit, there is an unavoidable risk that some material misstatement of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
 - The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it.
 - It is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.
 - The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management can easily manipulate accounting records.
 - If conditions cause the auditor to believe that a document may not be authentic or that terms in document have been modified, the auditor shall investigate further.
 - Where responses to inquiries of management or TCWG are inconsistent, the auditor shall investigate the inconsistencies.
4. **Objectives:** The objectives of the auditor are:
 - To identify and assess the risks of material misstatement in the financial statements due to fraud.
 - To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud. and
 - To respond appropriately to identified or suspected fraud.
5. **Professional Skepticism:** Professional skepticism means an approach that would ensure that if something is wrong, it is detected. This attitude of auditor helps him in identifying and evaluating
 - Matter that increase the risk of material misstatements resulting from fraud or error,
 - Circumstances that make the auditor to suspect material misstatements, and
 - The question of managements' representations reliability. The auditor is entitled to accept the records and documents as genuine unless, there is some evidence to the contrary.
6. **Discussion with the Audit Team:** The auditor must discuss with the other members of the audit team regarding the possibility and suspicion of material misstatement in the financial statement resulting from fraud or error. This discussion should occur notwithstanding the engagement team member's beliefs that management and those charged with governance are honest and have integrity.

- 7. Risk Assessment Procedures and Related Activities:** When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by SA 315, the auditor should perform the following procedures to obtain information for use in identifying the risks of material misstatement due to fraud:-
- 7.1 Enquiring Management and Others within the Entity:** The auditor should enquire the management on the following matters:
- Management understands regarding the accounting and internal control systems to prevent and detect error.
 - Awareness of any known fraud by the management.
 - Management's process for identifying & responding to the risks of fraud in the entity, including any specific risks of fraud.
 - Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
 - Management's communication, if any, to employees regarding its views on business practices and ethical behavior.
 - For those entities that have an internal audit function, the auditor should make inquiries of internal auditor.
- 7.2 Enquiring Those Charged with Governance**
- He should obtain an understanding of how they supervise management's processes.
 - The auditor shall ask whether they have knowledge of any fraud affecting the entity.
- 7.3 Unusual or Unexpected Relationships Identified:** The auditor should evaluate whether unusual or unexpected relationships identified in performing analytical procedures, may indicate risks for material misstatement due to fraud.
- 7.4 Other Information:** The auditor should consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.
- 8. Evaluation of Fraud Risk Factors:** The auditor should evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. However, fraud risk factors may not necessarily indicate the existence of fraud.
- 9. Identification and Assessment of the Risks of Material Misstatement Due to Fraud:**
- In accordance with SA 315, the auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.
 - The auditor should, based on a presumption that there are risks of fraud in revenue recognize, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.
 - The auditor should treat those assessed risks due to fraud as significant risks and accordingly, to the extent not already done so, the auditor should obtain an understanding of the entity's related controls, including control activities, relevant to such risks.
- 10. Auditor Response:**
- 10.1 Responses to the Assessed Risks of Material Misstatement Due to Fraud:**
- In accordance with SA 330, the auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. In determining overall responses, the auditor should:
 - Assign and supervise audit team as per their capability;
 - Evaluate whether accounting policies adopted by the entity, indicate fraudulent financial reporting, resulting from management's effort to manage earnings; and
 - Incorporate surprise element in the selection of the nature, timing and extent of audit procedures.
- 10.2 Responses to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level:** The auditor should design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.
- 10.3. Responses to Risks Related to Management Override of Controls:** Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent

financial statements by overriding controls. The auditor should design and perform audit procedures in the area relating to (a) Journal Entries (b) Accounting Estimates, and (c) Unusual transactions. The auditor should also determine whether the auditor needs to perform extra audit procedures.

11. Evaluation of Audit Evidence:

- The auditor should evaluate whether analytical procedures are consistent with the auditor's understanding of the entity and its environment.
- When the auditor identifies a misstatement, the auditor should evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor should evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations.
- If the auditor identifies a misstatement, and the auditor has reason to believe that it is or may be the result of fraud and that management is involved, the auditor should re-evaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the NTE of audit procedures.
- When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud; the auditor should evaluate the implications for the audit.

12 Auditor Unable to Continue the Engagement [N06]: If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounter exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities.
- Consider whether, it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- If the auditor withdraws:
 - ◊ Discuss with the appropriated level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the same; and
 - ◊ Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the same.

13 Management Representations: The auditor should obtain a management representation that:

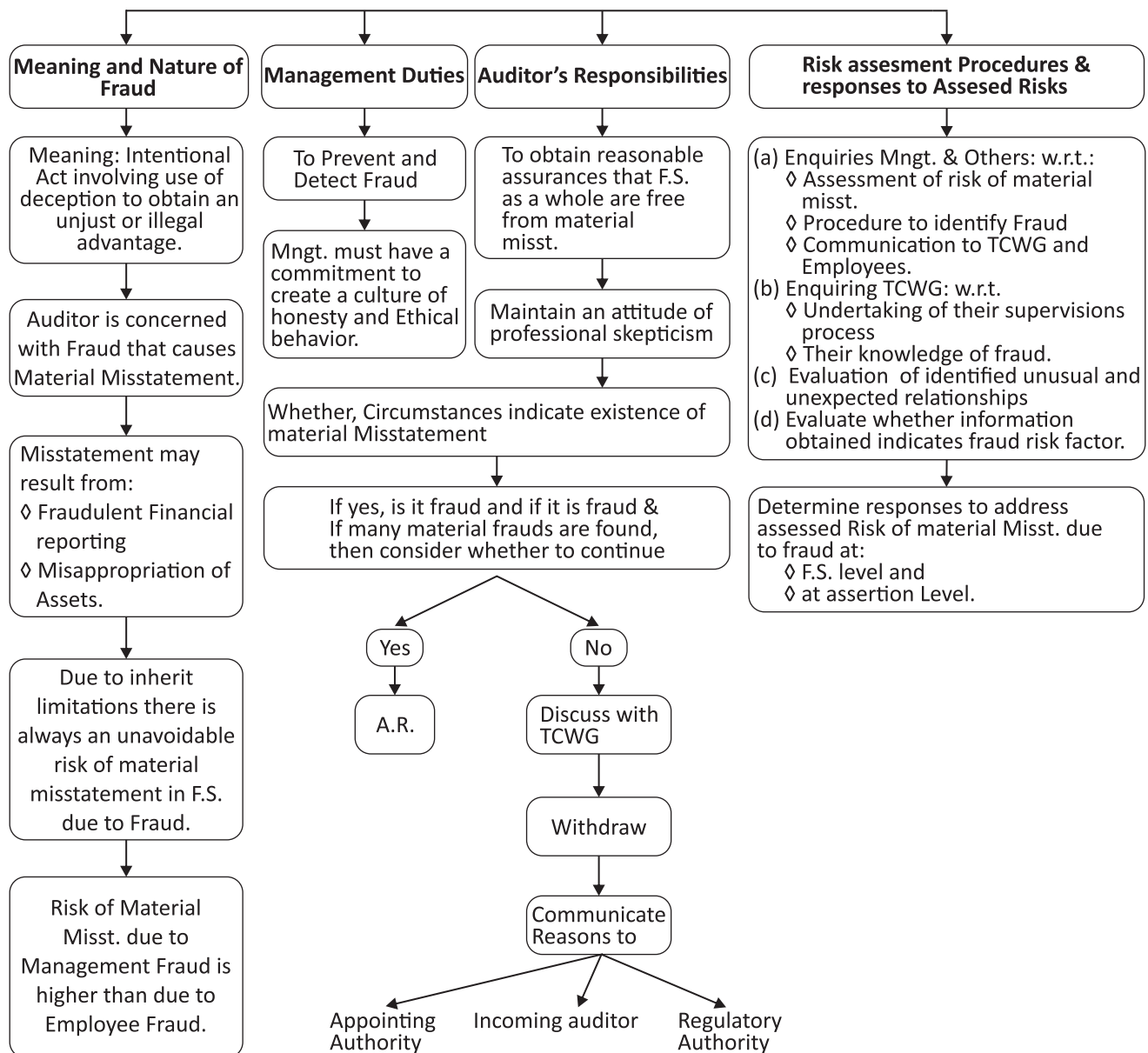
- They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.
- They have disclosed to the auditor the result of its assessment of the risk of fraud.
- They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving (a) Management; (b) Employees who have significant roles in internal control; or (c) Others; and
- They have disclosed to the auditor, its knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

14. Communications to Management and TCWG: If the auditor has identified a fraud or has indication of fraud, the auditor should communicate these matters to the appropriate level of management on a timely basis. He should also communicate with TCWG, any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities.

15. Communications to Regulatory and Enforcement Authorities: As per SA 200, the auditor should not disclose the client's information to anybody without the client's permission or under any regulatory requirement. But in certain circumstances, the statute, the law or courts may override the duty of confidentiality.

16. Documentations: The auditor should document the following in his working papers:

- The risk factors identified at present.
- The auditor response to those risk factors.
- Inquiring of management regarding the risk of fraud in the entity.
- Entity programme for prevention or detection of fraud.

Summary SA 240

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.	N09	6	3
2	As a Statutory Auditor, how would you deal with a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit.	N06	5	12
3	The teeming and lading fraud was detected and the amount involved was subsequently deposited by the Executive Director of the company and, therefore, need not be reported upon.	N99	4	Ans - 1
4	The Managing Director of 'the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company.	N99 M05	4	

5	While conducting statutory Audit of ABC Ltd., you come across IOUs amounting to Rs. 2 crores as against a cash balance shown in books of Rs. 2.10 crores. You also observe that despite similar high balances throughout the year, small amounts of Rs. 50,000 are withdrawn from the bank to meet day-to-day expenses.	J09	5	Ans - 2
6	In the course of audit of A Ltd. you suspect that the management has indulged in fraudulent financial reporting. State the possible source of such fraudulent financial reporting.	M12	6	Ans - 3
7	M/s Honest Limited has entered into a transaction on 5th March, 2013, near year-end, whereby it has agreed to pay Rs. 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2013. Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach?	N13	5	Ans - 4
8	In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.	M14	5	Ans - 5

Answer

Ans - 1:

- The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements".
- First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment.
- Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report.
- Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors.
- Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management. Finally, the auditor shall have to report under CARO, 2003 indicating the nature and amount involved in respect of fraud noticed during the year.

Ans - 2:

- 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.

Ans - 3:

As per SA 240, “The Auditor’s responsibilities relating to Fraud in an Audit of Financial Statements”, fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. It may be accomplished by manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared. or Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information or intentional misstatements involve intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure etc.

It often involves management override of controls, misappropriation of assets etc, that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
- Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to significant and unusual transactions.
- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity’s purchasing agents in return for inflating prices, payments to fictitious employees).
- Using an entity’s assets for personal use (for example, using the entity’s assets as collateral for a personal loan or a loan to a related party).

Ans - 4:

As per SA 240 on “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, fraud can be committed by management overriding controls using techniques such as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or to achieve other objectives.

Keeping in view the above, it is clear that Company has passed fictitious journal entries close to the end of an accounting period to manipulate the operating results. Also Auditor’s enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable. Accordingly, the auditor would adopt the following approach:

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor should:

- Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the auditor appointment or, in some cases, to regulatory authorities;
- Consider whether it is appropriate to withdraw from the engagement, where withdrawal is legally permitted; and
- If the auditor withdraws:
 - ◊ Discuss with the appropriate level of management and TCWG, the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and
 - ◊ Determine whether there is a professional or legal requirement to report to the person(s) who made

the auditor appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Ans - 5 : Auditors Responsibilities Relating to Fraud

- As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of FS", the primary responsibility for the prevention and detection of fraud rests with both TCWG and management. In addition an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the FS taken as a whole are free from material misstatement, whether caused by fraud or error.
- As per SA 580, "Written Representations (WR)", If management does not provide one or more of the requested WR, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.
- The auditor shall disclaim an opinion on the FS if the auditor concludes that there is sufficient doubt about the integrity of management such that the WR are not reliable; or management does not provide the WR.
- Further the auditor is also required to report as per Paragraph 4 (xxi) of CARO, 2003, if there is 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.
- In the given case, in the course of audit of K Ltd., its auditor Mr. N observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report, which was not provided by the management despite of many reminders. Mr. N also insisted for WR in respect of fraud on/by the company. For this request also management remained silent.
- Hence, the fact is required to be reported as per Paragraph 4(xxi) of the CARO, 2003 and the auditor should also disclaim an opinion on the FS.

SA 315

IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND INTERNAL CONTROLS (W.E.F. 1ST APRIL' 2008)

1. **Scope of this SA:** This SA deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control.
2. **Objective:** The objective of the auditor is to identify and assess risks of material misstatement at the financial statement level and assertion levels. To obtain this objective the auditor should perform risk assessment procedures which include:
 - Inquiries with management
 - Analytical Procedures
 - Observation and Inspection

Where Auditor has performed other engagements with the same entity, auditor should consider whether information obtained during previous engagements is relevant for identifying the risk of material misstatement. If Auditor intends to use his/her previous experiences with the entity, he shall determine whether changes have occurred since previous audit that may affect its relevance on current audit.
3. **Obtaining an understanding of the Entity and its Environment:** Obtaining an understanding of entity and its environment including entity's internal control is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit. Auditor is required to obtain an understating of following as a part of risk assessment procedures:
 - Industry, regulatory, and other external factors including applicable financial reporting framework.
 - The nature of the entity, including:
 - ◊ Its operations;

- ◊ Its ownership and governance structures;
- ◊ The types of investments that the entity is making and plan to make; &
- ◊ The way that the entity is structured and how it is financed;
- The entity's selection and application of accounting policies, including the reasons for changes thereto.
- The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- The measurement and review of the entity's financial performance.

Auditor should use his professional judgment to determine the extent of understanding required. Auditor primary consideration is whether the understanding that has been obtained is sufficient to meet the objective stated in the SA.

4. Internal Control:

4.1 Meaning of Internal Control: Internal Control may be defined as the process designed, implemented and maintained by TCWG, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to

- Reliability of financial reporting,
- Effectiveness and efficiency of operations,
- Safeguarding of assets, and
- Compliance with applicable laws and regulations.

4.2 Components of Internal Control: It includes the followings:

4.2.1 Control Environment: The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people.

4.2.2 Risk Assessment Process: The entity's risk assessment process forms the basis for how management determines the risks to be managed. If that process is appropriate to the circumstances, including the nature, size and complexity of the entity, it assists the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

4.2.3 Information System: The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to:

- Initiate, record, process, and report entity transactions;
- Resolve incorrect processing of transactions;
- Process and account for system overrides or bypasses to controls;
- Transfer information from transaction processing systems to the general ledger;
- Capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortisation of assets; and
- Ensure information required to be disclosed by the applicable FRF is accumulated, recorded, processed, summarized and appropriately reported in the F.S.

4.2.4 Risk for which Substantive Procedures Control Activities relevant to Audit: Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

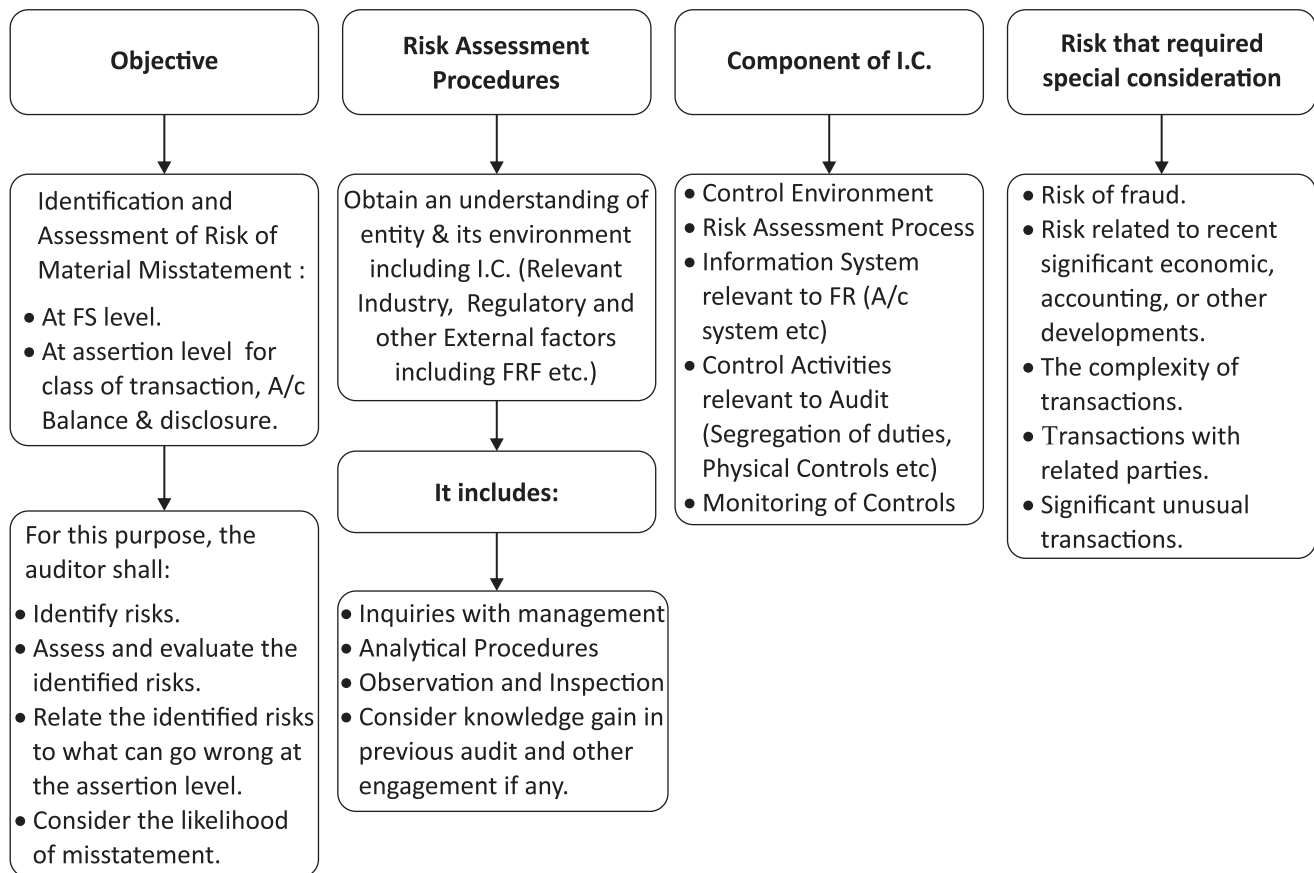
4.2.5 Monitoring of Controls: Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective actions.

4.3 Material Weakness in Internal Control:

- The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control.
- The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by SA 260.

5. Identifying and Assessing the risk of Material Misstatement:

- 5.1 The Auditor shall identify and assess the risks of Material Misstatement at:**
- The **financial statement level**; and
 - The **assertion level** for classes of transactions, account balances, and disclosures; to provide a basis for designing and performing further audit procedures.
- 5.2 For this purpose, the Auditor shall:**
- Identify risks,
 - Assess and evaluate the identified risks,
 - Relate the identified risks to what can go wrong at the assertion level,
 - Consider the likelihood of misstatement.
- 5.3 Risk that requires Special Consideration:** In exercising judgment as to which risks are significant risks, the auditor shall consider the following:
- Whether the risk is a risk of fraud;
 - Risk is related to recent significant economic, accounting, or other developments;
 - The complexity of transactions;
 - Whether the risk involves significant transactions with related parties;
 - The degree of subjectivity in the measurement of financial information; and
 - Whether the risk involves significant unusual transactions.
- 5.4 Risk for which Substantive Procedures alone do not provide Sufficient Appropriate Audit Evidence:** Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them.
- 5.5 Revision of Risk Assessment:** The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. The auditor shall revise the assessment and modify the further planned audit procedures accordingly.
- 6. Conditions and Events that may indicate risk of Material Misstatement:**
- Operation exposed to volatile market, for example, future trading.
 - Going concern and liquidity issues including loss of significant customers.
 - Changes in the industry in which the entity operated.
 - Entities or business segments likely to be sold.
 - Change in the IT environment.
 - Changes in key personnel including departure of key executives.
 - Constraints on the availability of capital and credit.
 - Changes in the supply chain.
 - Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end.

SUMMARY SA 315

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	While commencing the statutory audit of B Company Limited, the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level.	N05	4	Ans - 1
2	What are general matters to be considered by an auditor while taking up a engagement?	N07	4	Ans - 2
3	Z Ltd. has its entire operations including accounting computerized. As the audit partner you are concerned about inherent and control risk for material financial statement assertions. What could be the areas you look forward for deficiencies and risk identification?	M11	4	Ans - 3
4	While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement?	N12	8	Ans - 4
5	As the auditor of a large multi locational company, in the planning process, you are requested to identify the inherent audit risk at the account balance and class of transaction level.	M13	4	Ans - 5
6	What are the major sources of obtaining information about the client's business?	N07	4	Ans - 6

Answer

Ans - 1: Assessment of Risk and Acceptable Level

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” establishes standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components:

Inherent risk, control risk and detection risk. SA 315 and SA 330 require that the auditor should use professional judgment to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. “Detection risk” is the risk that an auditor’s substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures. When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level. The auditor should use his professional judgment to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or a disclaimer of opinion as may be appropriate.

Ans - 2: The Auditor should Consider the following General Matter while taking up a New Engagement:

- General Economic factors:
 - ◊ The market and competition
 - ◊ Cyclical or seasonal activity
 - ◊ Government policies
- The industry: important conditions affecting the client's business
 - ◊ The market and competitions
 - ◊ Cyclical or seasonal activity,
 - ◊ Changes in product technology
 - ◊ Business risk
- The entity:
- Management and ownership
- Operating Management
- The entity's business - products markets, suppliers, expenses, operations.
 - ◊ Nature of business (for example manufacturing whole seller, financial services, import /exports).
 - ◊ Location of production facilities, warehouses, offices.
 - ◊ Employment (for example, by location, supply, wage levels, union contracts, pension commitments, Government regulation)
 - ◊ Products or services markets.
- Financial performance-factors concerning the entity's financial condition and profitability.
- Reporting environment-external influences which affect management in the preparation of the financial statements.
- Taxation both direct and indirect.
- Legislation
- Regulatory environment and requirements

Ans -3:

The auditor in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, should make an assessment of inherent and control risk for material financial statement assertions. In a CIS environment the risk of a Material financial statement ascertain being erroneously stated could arise from the deficiencies in the following case as

- Program Development and maintenance.
- Operations including processing of data.

- System software support.
- Physical CIS security.
- Control over access to specialized utility program.

These deficiencies would tend to have a negative impact on all application systems that are processed through the computer.

Ans - 4: Substantive Procedures to be performed to assess the risk of material misstatement:

As per SA 330, "The Auditor's Response to Assessed Risk", substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures.

Test of Details: The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size.

Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts

Ans -5: Evaluating Inherent Risk - To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors, 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. Inherent audit risk at the level of Account Balance and Class of Transactions is:

- Quality of the accounting system.
- Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation.
- The complexity of underlying transactions and other events which might require using the work of an expert.
- The degree of judgement involved in determining account balances.
- Susceptibility of assets to loss or misappropriation, for example, assets which are highly desirable and movable such as cash.
- The completion of unusual and complex transactions, particularly at or near period end.
- Transactions not subjected to ordinary processing.

Ans - 6: The Auditor can Obtain Information about Client's Business from the following Sources:

- The client's annual Reports to shareholders.
- Minutes of meetings of shareholders, board of directors and important committees.
- Internal financial management report for current and previous periods including budgets, if any.
- The previous year's audit working papers and other relevant files.
- Discussions with the client.
- Visits to the client's premises and plant facilities to the management.
- The client's policy and procedures manual.

- Relevant publications of the ICAI and other professional bodies, industry publication, trade Journals, magazines, newspapers or text books.
- Consideration of the state of the economy and its effects on the client's business.

SA 330**THE AUDITOR'S RESPONSES TO ASSESSED RISKS (W.E.F. 1ST APRIL' 2008)**

- 1. Scope of this SA:** This SA deals with the auditor's responsibility to address the risk of material misstatement identified and assessed by the auditor in accordance with SA 315 "Identify and assessing the risk of material misstatement through understanding the entity and its environment".
- 2. Objective:** The auditor should design and perform further audit procedure whose NTE are based on and are responsive to the assessed risks of material misstatement at the financial statement level. The overall objective of this exercise is to reduce audit risk to an acceptable low level by obtaining sufficient appropriate audit evidence.
- 3. Audit procedures Response to the Assessed Risks of Material Misstatement at the Assertion level:**
 - 3.1 Further Audit Procedures:** In designing further audit procedures to be performed, the auditor should:
 - Consider the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, accounts balance, or disclosure (i.e. the inherent risk); and whether the risk assessment takes into account the relevant controls (i.e., the control risk).
 - Obtaining more relevant or reliable audit evidence because of a higher assessment of risk (e.g. third party evidence).
 - 3.2 Test of Controls:** The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence for effectiveness of relevant controls when:
 - He expects that the controls are operating effectively, or
 - Substantive audit procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

The auditor should perform test of controls for a particular time or throughout the period.
 - 3.3 Using Audit Evidence obtained during an Interim Period:** When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor should:
 - Consider significant change to those controls, if any; and
 - Determine the additional audit evidence to be obtained for the remaining period.
 - 3.4 Using Audit Evidence obtained in Previous Audit:** The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment. If auditor is using audit evidence obtained during previous audit, he should examine, whether significant changes in controls have occurred subsequent to the previous audit. If there have been changes, the auditor should test the controls in the current audit. If there have not been such changes, the auditor should test the controls at least once in every third audit, and should test some controls in each audit. Factors that may warrant a re-test of controls are:
 - A deficient control environment.
 - Deficient monitoring of controls.
 - A significant manual element to the relevant controls.
 - Personnel changes that significantly affect the application of the control.
 - Changing circumstances that indicate the need for changes in the control.
 - Deficient general IT-controls.
 - 3.5 Control over Significant Risk:** When the auditor plans to rely on controls over significant risk, the auditor should test those controls in the current period.
 - 3.6 Evaluating the Operating Effectiveness of Controls:**
 - A material misstatement detected by the auditor's procedures a strong indicator of the existence of

a significant deficiency in internal control. However, the absence of misstatement does not provide audit evidence that controls are effective.

- The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level and TCWG.

4. Substantive Procedures: The audit should design and perform substantive procedures for each material class of transactions, account balance, and disclosure. The auditor substantive procedures related to financial statement closing process include:

- Reconciliation of financial statements with the underlying accounting records; and
- Examining material journal entries and other adjustments made during the course of preparing the financial statements.

When the auditor has determined a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When substantive procedures are performed at an interim date, the auditor should also cover remaining period by performing substantive procedures.

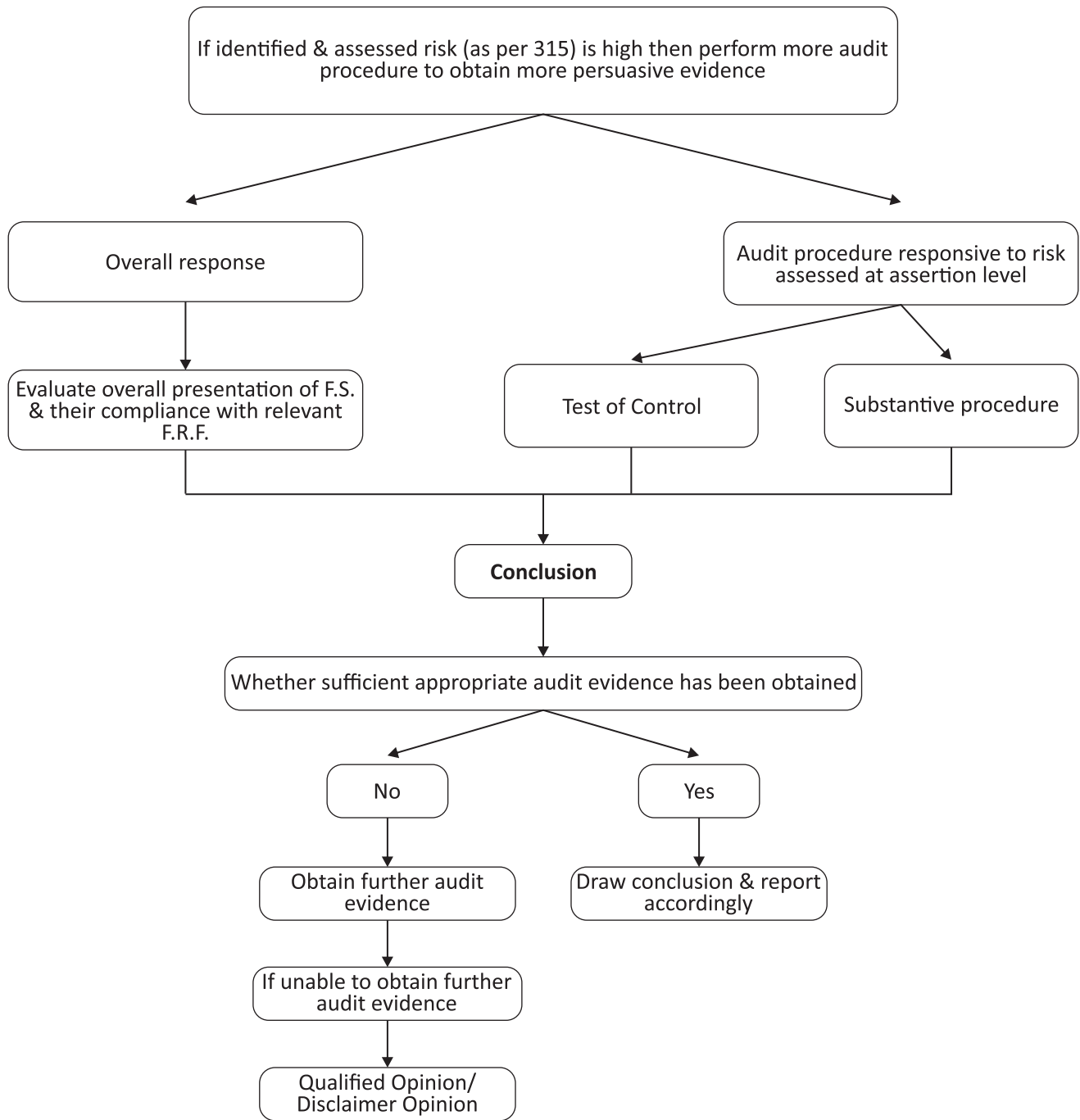
5. Adequacy of Presentation and Disclosure: The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable FRF.

6. Evaluating the sufficiency and Appropriateness of Audit Evidence: The auditor should conclude whether sufficient appropriate audit evidence has been obtained. If the auditor has not been obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor should try to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or a disclaimer of opinion.

7. Documentation: The auditor should document:

- The overall responses to address the assessed risk of misstatement at the financial statement level.
- The NTE of the further audit procedures performed.
- The linkage of those procedures with the assessed risks at the relevant assertion level.
- The result of the audit procedures.

If auditor use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor should document the conclusions reached about relying on such controls that were tested in a previous audit.

Summary SA 330

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	In the course of audit of Z Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.	M13	4	Ans - 1

Answer

Ans - 1:

As per SA-330 on “The Auditor’s Responses to Assessed Risks”, changes may affect the relevance of the audit evidence obtained in previous audits such that Auditing Standards, Statements and Guidance Notes. There may no longer be a basis for continued reliance.

The auditor’s decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment. Factors that may warrant a re-test of controls are:

- A deficient control environment.
- Deficient monitoring of controls.
- A significant manual element to the relevant controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT-controls.

SA 505

EXTERNAL CONFIRMATIONS (W.E.F. 1ST APRIL' 2010)

1. Definitions:

- 1.1 External Confirmation:** Audit evidence obtained as a direct written response to the auditor from a third party in paper, electronic or other form.
- 1.2 Positive Confirmation Request:** A request that the confirming party respond directly to the auditor both in case of agreement and disagreement with the information provided in the request.
- 1.3 Negative Confirmation Request:** A request that the confirming party respond directly to the auditor only if the confirming party disagree with the information provided in the request. It is considered to be less persuasive than the positive confirmation request. Auditor should use them only if all of following are present:
- The assessed level of inherent and control risk is low.
 - internal Control is effective.
 - A large number of small balances are involved.
 - A substantial number of errors is not expected; and
 - The auditor has no reasons to believe that respondents will disregard these requests.

2. External Confirmation Process: The process includes: -

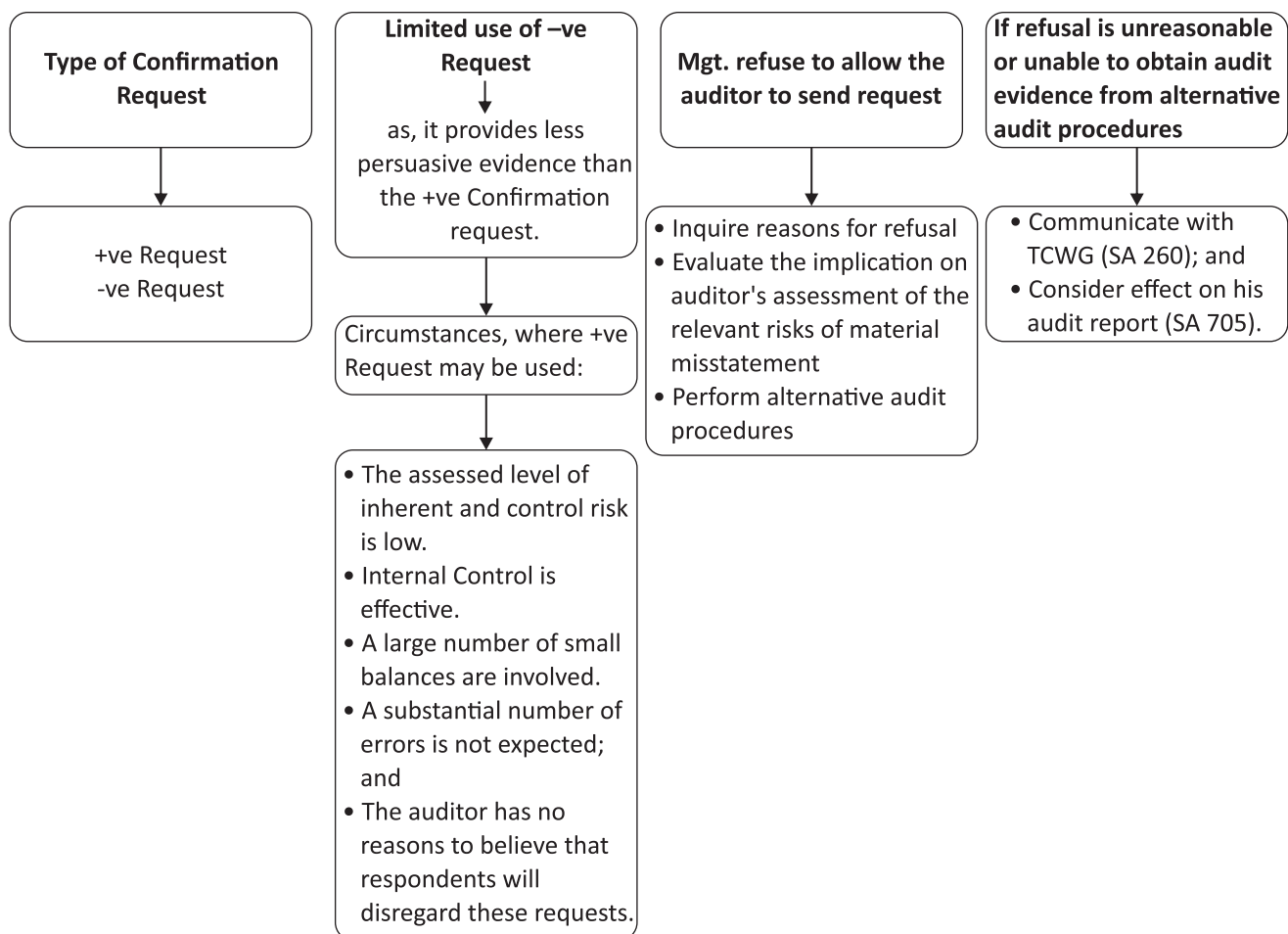
- Selecting items for confirmation.
- Designing the confirmation request.
- Communicating the confirmation request to the appropriate third party.
- Obtaining the response from third party.
- Evaluating the information or lack thereof, including the reliability of that information.

3. Management’s refusal to allow the Auditor to send a Confirmation Request [M05] [M11]: In such case, the auditor should:

- Inquire management’s reasons for refusal and seek audit evidence as to their validity and reasonableness.
- Evaluate the implication 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
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.
- If the auditor concludes that management’s refusal is unreasonable, or auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, then the auditor should communicate with TCWG (SA 260) and consider effect on his audit report (SA 705).

4. **Situations where External Confirmation may be required [M07]:**
- Accounts balances and their components.
 - Bank Balance and other information from bankers.
 - Confirmation of loans from others.
 - Stock held by third parties.
 - Investments purchased but delivery not taken.
5. **Reliability of Response:** If auditor has doubts about the reliability of response, then he should obtain further audit evidences to resolve these doubts. If response is found to be unreliable, it may indicate fraud risk factor, and then he should consider its effect on NTE of other audit procedures.
6. **No response to Positive Confirmation Request:** In that case, the auditor should follow up with second and sometimes a third request to those who do not respond. Where the auditor is unable to obtain response, the auditor should use alternative procedures. However, if auditor determines that response is necessary & thus alternative audit procedures do not provide sufficient appropriate audit evidences, he should determine its effect on audit report.
7. **Evaluating results of the Confirmation Process:** The auditor should evaluate whether the results of the external confirmation process provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.

Summary SA505



No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	As a Statutory Auditor, how would you deal with the following? "The accountant of C Ltd has requested you, not to send balance confirmations to a particular group of debtors since the said balances are under dispute and the matter is pending in the Court".	M05	4	3
2	The management of S Ltd. requests you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an appropriate response?	M11	6	
3	Situations where external confirmations can be used.	M07	4	4
4	Moon Limited replaced its statutory auditor for the Financial year 2008-09. During the course of audit, the new auditor found a credit item of Rs. 5 lakhs. On enquiry, the company explained him that it is a very old credit balance. The creditor had neither approached for the payment nor is he traceable. Under the circumstances, no confirmation of the credit balance is available. Comment.	N09	5	Ans - 1
5	The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. Accede to this request?	M13	4	Ans - 2
6	During the course of audit of Star Limited the auditor received some of the confirmation of the balances of creditors outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of Sundry Creditors there are number of creditors of small balances except one, old outstanding of Rs. 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.	M14	5	Ans - 3

Answer

Ans - 1:

This is a case of external confirmation, covered by SA 505 "External Confirmation". The identities of creditors are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation.

It might be a case that an income of Rs 5 lakhs had been hidden in previous year/s. The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members.

Q:-The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. accede to this request?

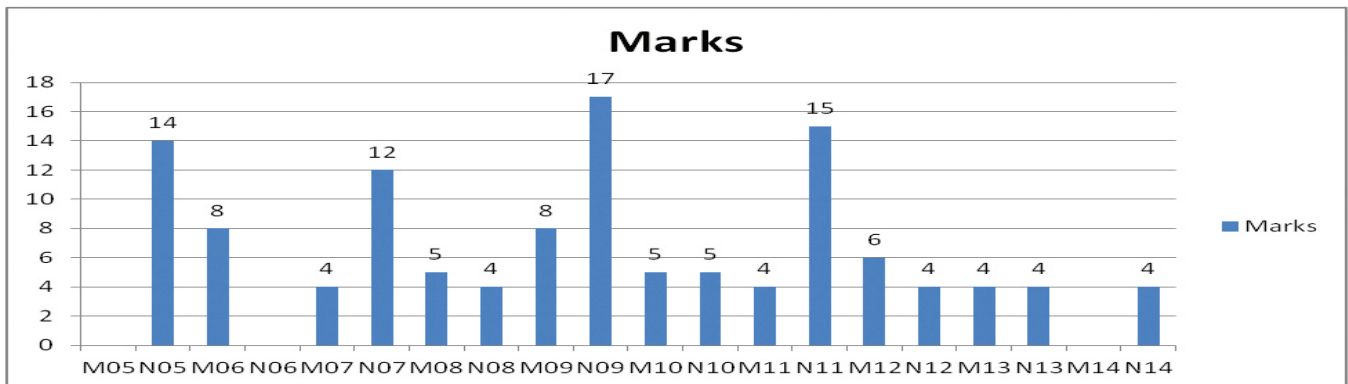
Ans - 2:

- 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. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute with the creditors, etc. The management, for example, might make such a request on the grounds that due to a dispute with the particular creditor, the request for confirmation might aggravate the sensitive negotiations between the entity and the creditor.

- In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain creditors, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request.
- If the auditor of H Ltd agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding that matter. While considering the validity of request, in case the auditor of H Ltd reaches at a conclusion that the same was not valid, he may appropriately modify the report.

Ans - 3:

- As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.
- In the instant case, the auditor sent the negative confirmation requesting the creditors having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of Rs. 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request.
- But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.



1. **Introduction:** Audit under the fiscal law is conducted on the behalf of the Government for detecting and preventing tax evasion, like; VAT Audit under the VAT Act, Excise Audit under the Excise Act and various audits under the Income Tax Act, such as the Tax Audit u/s 44AB, the audit of charitable trusts u/s 12A, audit u/s 35D, 35E, 80IA, 80IAB, 80IB, 80-IC, 80-ID, 80-IE, 142(2A), etc.
2. **Audit of Indirect Tax [N03 N05 N11]:** Audit of indirect tax includes VAT audit, Sales Tax Audit, Customs and Excise audit, Entertainment tax audit, wealth tax audit etc.
Excise duty or sales tax is to be included in the sales only if it is a part of the sales price. It is recovered separately and is not to be treated as a part of sales. Sales by the commission agent will be considered a part of sales, only if the ownership of the goods sold by the agent continues to vest in principal at the time of sale.
3. **Scope of Indirect Tax Audit:** The indirect tax audit could cover the entire gamut of indirect taxation, or can be focused on the specified areas of concerns. Some of the areas of concern in indirect tax could be as under:
 - Non availment, or short, or excess availment of export incentives.
 - Goods imported duty free, or at concessional rates, subject to the compliance with the necessary conditions
 - Availment and utilisation of CENVAT credit.
 - Examination of the applicability of central excise and the availability of exemption on the activity and products.
 - Valuation of goods as per applicable rules.
 - Transfer pricing issues. The method of production, or marketing and distribution.
 - Procedural non compliance, which could lead to demand and losing benefits.
4. **Methodology / Step of Indirect Tax Audit [N03 N05 N11]:** The indirect tax audit would involve the following steps:
 - Evaluation of internal controls.
 - Collection of information about the company and the industry with particular information with regards to imports, percentage of customs, amount of removals, quantum of CENVAT, proportion of credit etc.
 - Design the audit programme depending on the evaluation of internal controls.
 - The staff conducting the audit should be properly trained, and they should be conversant with the applicable laws and procedures.
 - The report on indirect tax audit should also provide specific comments on the Statutory information, and the material matters reported by way of an executive summary, as well as the assertion or qualification.
5. **Audit of Public Trusts [Section 12A of the Income Tax Act]:** Exemption from audit is available under the u/s 11 & 12 of the Income Tax Act 1961 by complying following conditions:
 - Application for the registration of the trust shall be made in the prescribed form.
 - Total income of the trust, without giving effect to the provisions of Section 11 & 12 is less than the exemption limit, which is not chargeable to income tax in any previous year, i.e. Rs. 200000 for the A.Y. 2013-14.

If the total income of the trust, without giving effect to the provisions of Section 11 & 12, is more than the exemption limit, which is not chargeable to income tax in any previous year, then the accounts of trust should be audited and the audit report should be submitted in Form 10B.

5.1 Audit Programme as per the ICAI Guidance Note on Audit of Public Charitable Trusts [M09]: The audit programme discussed in the Guidance Note is discussed below:

- Obtain resolution and a letter of appointment passed by the trustee, specifying his appointment and the scope of audit.
- Communicate with the previous year's auditor.
- Obtain previous year's Balance Sheet and the list of books of accounts and records maintained by the trust.
- Obtain a certificate from the management regarding the system of accounting and the internal controls.
- Obtain a list of institutions/activities run by the trust.
- Obtain a certified true copy of trust deed.
- Check the books of account and other records having regard to the system of accounting and internal control.
- **Vouch the transactions of the trust to satisfy that:**
 - ◊ the transaction falls within the ambit of the trust;
 - ◊ the transaction is properly authorised by the trustees, or other delegated authority;
 - ◊ all incomes due to the trust have been properly accounted for, on the basis of the system of accounting followed by the trust;
 - ◊ all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting, followed by the trust; and
 - ◊ amounts shown as applied towards the object of the trust are covered by the objects of the trust as specified in the document governing the trust.
- Obtain a trial balance, balance sheet and profit & loss on the closing date, certified by the trustees.

5.2 Compliance with Accounting Principle: The Auditor Should:

- Ensure that all the assets have been verified and correctly valued.
- Ensure that all the liabilities have been properly recorded.
- Scrutinize that all the investments of the trust are properly classified and valued.
- Examine the recoverability of the outstanding dues to the trust.

5.3 Applicability of Accounting Standards: Accounting standards will not apply if all the activities of such organisations are not of commercial, industrial, or business in nature (e.g. an activity of collecting donations and giving them to flood affected people). In other words, exclusion of an entity from the applicability of the AS would be permissible only if no part of the activity of such entity is commercial, industrial or business in nature. Even if a very small portion of the activities of an entity is considered to be commercial, industrial or business in nature, then it cannot, claim exemption from the application of AS. The AS would apply to all its activities, including those which are not commercial, industrial or business in nature.

5.4 Annexure to Audit Report of Public Charitable Trust: The auditor should obtain from the trustees a certified list of persons specified under the Section 13 (3). These persons are author/trustees/manager of the trust, or any relative thereof, and the person who has contributed to the trust, a sum in excess of Rs. 50000/- by the end of the previous year. He should also obtain from the trustees a statement for the various items specified in the annexure to form 10B.

6. Tax Audit Provisions under VAT Law

6.1 Necessity of VAT Audit: Reason for prescribing an audit under the VAT law by a Chartered Accountant, is that under the VAT system, a major thrust is to be laid on the 'self assessment' meaning, thereby the tax liability calculated and paid by the tax payers through their periodical returns will be accepted by and large, and the tax payers will not be called to substantiate the taxability shown by them in the returns, by producing books of account and other relevant material. The assessments with books of account will be an exception. Therefore, there is a strong need to see that the tax payers discharge their tax liability properly while filing the returns. This can be ensured only where the particulars furnished by the tax payers are verified by an independent auditor in minute details, by going not only through the books of account, but

also by analysing and interpreting the provisions of the State-Level VAT Laws, and reporting whether any under-assessment was made by the dealer requiring additional payment, or whether there was any excess payment of tax warranting refund to the tax payer. If no audit is prescribed under the VAT law, the chances of evasion of VAT tax will increase, causing revenue leakage for the Government. It is, therefore, essential, that the audit of the proposed VAT system is attempted on a regular basis. However, it is not possible to conduct the audit of all the VAT dealers. Therefore, the criteria for audit can be the amount of turnover, or the class of dealer dealing in the specified commodities.

6.2 The role of the Tax Auditor under VAT: The role of the tax auditor vis-a-vis the tax administrators is that the auditor while discharging his function finds out whether the turnover of sales/purchases is shown correctly in the returns and is backed up by the accounts and other relevant documents; the deductions claim by the tax payer from the turnover of sales are genuine and are supported by valid documents; the claim of the input tax credit has been properly made, i.e. it has not been claimed on the higher side or on such purchases, which are not eligible for grant of input tax credit.

6.3 Steps required in preparation of Tax Audit under VAT [N07 M10]: VAT is a tax on the value added to the commodity at each stage in the production and distribution chain. VAT is an indirect tax on consumption and it is collected at each stage of sale. The essence of VAT Law is that it provides a credit set off for the input tax, i.e., the tax paid on purchases, against the output tax, i.e., the tax payable on sales. The following steps have to be taken by the auditor while auditing under VAT Law:

- Knowledge of the client's business
- Knowledge about the VAT law and allied laws
- Obtaining a list of accounting records maintained by the auditee
- Ascertaining the major accounting policies adopted by the auditee
- Evaluation of internal control etc

Following provisions of VAT Law need to be understood in detail:

- Credit for input/supplies (and its accounting)
- Credit in case of capital goods
- Credit for goods lying in stock at inception of VAT Scheme
- Utilizing of VAT credit for set off
- VAT on sales
- Valuation of inventories/capital goods

6.4 Approach to Tax Audit under VAT: The audit approach of the tax auditor under the value added tax system will be more or less similar to the approach which is adopted by the auditor while conducting the tax audit u/s 44AB of the Income-tax Act, 1961. However, the reporting requirements vary to a considerable extent. Audit programme for the VAT audit should be designed on the basis of the specific compliance and reporting requirements under the VAT Law. The following points are relevant:

(a) Analysis of Sales:

- The turnover of sales/purchases of goods has been properly determined keeping in view not only the generally accepted accounting policies but the definition of turnover of sales in the relevant VAT law. The sales turnover arrived at, by applying the generally accepted accounting policies, may not be the same as that required under the VAT law. For example, the sale proceeds of a fixed asset will not form a part of turnover or sales as per the generally accepted accounting policies, but will form a part of turnover or sales for the purpose of VAT law. Similarly, the price of goods returned is deducted from the turnover or sales even if the returns are from the sales effected in the previous years, while under VAT law, the goods returned are to be deducted only if they are made within the prescribed time, say 6 months from the date of sale.
- The sales as per the financial statements may include the turnover or sales effected by all the branches, but for the purposes of VAT law the turnover or sales of only those branches will be included which are included in one registration certificate.

(b) Purchases and Input Credit:

- The turnover of purchases should be tested by applying audit checks that will enable the auditor to get the purchases eligible for the grant of input tax credit segregated from other purchases.

- Further, the purchases on which the input tax credit is available in full and the purchases on which it is available partially should also be ascertained correctly.
- The auditor should also get the exact amount of input tax credit available, compare the same with the credit claimed in the returns and report on the excess/short claim of the credit in the returns filed.

(c) Filing of Returns: The auditor is also required to comment on the timely filing of the returns under the VAT law. For this purpose, he should list out the due dates of filing of returns and find out the reasons for delay in filing the returns if any.

(d) Composition Scheme: The auditor is also required to give his report on the composition scheme. He should ascertain that the auditee is eligible for composition and whether it has paid the requisite composition fee and complied with all the procedural formalities in relation thereto.

(e) Consolidation of Returns: The auditor should check the consolidation of returns filed for all the periods covered in the year under audit, both for the State-Level VAT Law and the CST Act, 1956. These returns are to be reconciled with the books of accounts and the documentary evidences available.

6.5 Audit Report under the VAT law:

- At the end of the audit the auditor has to arrive at his conclusion on the matters to be reported in the audit report. The format of the audit report is generally prescribed under the relevant VAT law.
- The auditor is expected to give his opinion on the adequacy of accounting records, correctness and completeness and arithmetical consistency of returns filed.
- Further he has to state the basis of his opinion of the accounts, financial statements and the documents verified by him to arrive at the above conclusion.
- The auditor is also expected to give the summary of the additional tax liability, or any additional refund arising on his verification of the returns together with the books of account.
- The auditor can make a qualified opinion or an unqualified opinion. He can also report any disclaimer where he finds that the accounting records were insufficient to enable him to frame either a unqualified opinion or a qualified opinion.

7. Tax Audit u/s 44AB of Income Tax Act

7.1 Applicability of Tax Audit u/s 44AB: Tax Audit will apply in following situations:

- Every person carrying on business, the total sales, turnover or gross receipt exceeds Rs 1 crore (w.e.f. FY 2012-13).
- Every person carrying on profession, whose gross receipt from the profession exceeds Rs 25 lacs (w.e.f. FY 2012-13).
- In the case of an assessee carrying on a business of the nature specified in sections 44AE, 44BB or 44BBB, tax audit will be required if he claims that his income to be lower than the presumptive income deemed under those sections.

In the case of a person whose accounts of business or profession have been audited under any other law, then it is not required for the tax auditor appointed u/s 44AB to give his opinion, as to whether or not the accounts give a true and fair view. It would only be necessary for him to annex a copy of the audited accounts as well as a copy of the audit report given by the Statutory auditor with his report in form No. 3CA along with form No. 3CD.

7.2 As per Guidance Note issued by ICAI, following point should be keep in mind for determining the limit for applicability of Tax Audit:

- Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.
- Special rebate allowed to a customer can be deducted from the sale if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.
- Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of financial charges and is not related to turnover. The same should not be deducted from the figure of turnover.
- Turnover discount is in the nature of trade discount and should be deducted from the figure of turnover even if the same is allowed at periodical intervals by separate credit notes.
- Sales return should be deducted from the figure of turnover even if the returns are from the sales made in the earlier year/s.

- Sale proceeds of fixed assets would not form part of turnover since these are not held for resale.
- Sale proceeds of property held as investment property will not form part of turnover.

7.3 Qualification/dis-qualification of Tax Auditor:

- The tax audit is to be conducted by an "Accountant" as defined in the Explanation to Section 288(2) of the Income Tax Act, 1961. According to the section, the term "Accountant" means:
 - ◊ A Chartered Accountant within the meaning of the CA Act, 1949, and
 - ◊ Any other person who is entitled to be appointed as an auditor of the company under the Section 139 of the Companies Act, 2013
- **Some important points that are relevant in this regards are:**
 - ◊ Tax audit can be conducted either by the Statutory auditor or by any other CA in full time practice.
 - ◊ A Chartered Accountant can include a firm of Chartered Accountants.
 - ◊ A relative of the assessee can be appointed as an auditor.
 - ◊ A Chartered Accountant who writes and maintains the books of accounts of the assessee and the Internal Auditor (whether working with the organisation or practicing independently) cannot be a Tax Auditor.
 - ◊ A person who is an employee of the assessee, or, an employee of a concern under the same management, cannot be its auditor.
 - ◊ A CA or CA firm, who is appointed as tax consultant of the assessee, can conduct tax audit u/s 44AB.
- A Chartered Accountant cannot be the auditor of more than 60 concerns. .
- The tax auditor is required to upload the tax audit report directly in the e-filing portal.
- The audit of the head office and branch offices of the assessee shall be regarded as one tax audit assignment.
- Tax auditor should communicate with the previous auditor.
- A CA should not accept the tax audit of a person to whom he is indebted for more than Rs. 10000/-. The limit of Rs. 10000/- shall be the aggregate amount in respect of the proprietor and/or the partner/s of the firm of CA.
- Management can remove tax auditor where there are valid grounds for such removal. This may arise where, the tax auditor has delayed the submission of audit report u/s 44AB for an unreasonable period and if it found that there is no possibility of getting the audit report uploaded before the specified date. However tax auditor cannot be removed on the ground that he has given an adverse audit report. If there is any unjustified removal of tax auditors, the Ethical Standards Board constituted by the Institute can intervene in such cases. No other CA should accept the audit assignment if the removal of his predecessor is not on valid grounds.
- The auditor should qualified his report, if statue governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statement have not been so prepared. On the other hand where there is no statutory requirement for preparation and presentation of FS on accrual basis, and the FS have been prepared on a basis other than "accrual", the auditor should describe in his audit report, the basis of accounting followed, without making it a subject matter of a qualification.
- **The professional reason for not accepting the appointment include:**
 - ◊ Non compliance with the provision of the Company Act as mentioned in Code of Ethics issued by ICAI under clause (9) of Part 1 of 1st Schedule to CA Act, 1949.
 - ◊ Non-payment of undisputed audit fees by auditees other than in case of sick unit for carrying out the Statutory audit under the Company Act or various other act.
 - ◊ Issuance of qualified report.

7.4 Accounting Standards and the Income Tax Act [N01 M09 N09]:

- **Section 145 (1):** As per the Section 145(1) of the Income Tax Act, 1961, the income chargeable under the "Profit and Gains of Business or Profession" or, "Income from Other Source" has to be computed in accordance with either cash or mercantile system of accounting, as regularly employed by the assessee.
- **Section 145(2):** As per the Section 145(2) the Central Government has the power to issue certain accounting standards to be followed by assessee. Accordingly, the Central Government has notified two Accounting Standards that are called AS (IT). These are to be followed by all the assessee following the mercantile system of accounting. Those who are following the cash system of accounting need not follow the Accounting Standards. These notified AS (IT) are:

- ◊ Disclosure of accounting policies.
- ◊ Disclosure of prior period and extraordinary items, and changes in the accounting policies.

Further, it may be noted that there is no material difference between AS(IT)-I and AS(IT)-2 notified by the Government and the corresponding A-1 and AS-5 of the ICAI respectively.

- **Section 145(3):** As per Section 145(3), the Assessing Officer has the powers to reject the books of accounts and may make an assessment in the manner provided in Section 144." Assessment u/s 144 can be made in following circumstances:
 - ◊ Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee.
 - ◊ Where the methods of accounting has not been regularly followed by the assessee.
 - ◊ Where the AS notified u/s 145(2) have not been regularly followed by the assessee.
- **Therefore the auditor has to ensure that:**
 - ◊ The entity follows either the cash or accrual method of accounting.
 - ◊ The entity complied with AS notified u/s 145(2).

7.5 Tax Audit Report: Tax Audit Report required to be furnished u/s 44AB shall have the following:

- **Form No. 3CA:** Where a person who carries on business or profession, and who is required by, or under any other law, to get his accounts audited.
- **Form No. 3CB:** Where a person who carries on business or profession, but not being a person referred to above.
- **Form No. 3CD:** This is the form containing certain points on which the tax auditor has to provide information. These points require factual information about the assessee. The auditor should consider the following aspect with regards to Form No. 3CD.

While furnishing the particulars in Form No.3CD, it would be advisable for the tax auditor to consider the following:

- If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.
- If there is any difference of opinion between the auditor and the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points.
- If any particular clause in Form No.3CD is not applicable, the auditor should state that the same is not applicable.
- In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year.
- In case the auditor is given incomplete information, or information is given in parts, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters with respect to whatever information is not furnished to him. In the absence of relevant information, the tax auditor would have no other option but to state in his report that the relevant information has not been furnished by the assessee.
- The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.

7.6 Revision of Tax Audit Report [N08]: The Tax Audit Report cannot be revised later. However when the accounts of assessee are revised in the following circumstances, the tax auditor may have to revise his Tax Audit Report also.

- Revision of accounts of a company after its adoption in the AGM
- Change in law with retrospective effect.
- Change in interpretation of law (CBDT Circular, Notifications, and judgements etc.)

The Tax Auditor should state clearly that, it is a revised report & specify the reason for such revision with a reference to the earlier report.

7.7. Format of Form 3CA, 3CB & 3CD:

Format of Form 3CA**[See rule 6G(1)(a)]****Audit report u/s 44AB of the Income - tax Act, 1961, in a case where the accounts of the business or profession of a person have been audited under any other law**

*I / we report that the statutory audit of M/s. _____ (Name and address of the assessee with Permanent Account Number) was conducted by *me / us / M/s. _____ in pursuance of the provisions of the _____ Act, and *I/we annex hereto a copy of *my / our / their audit report dated _____ along with a copy of each of :-

(a) the audited *profit and loss account / income and expenditure account for the period beginning from _____ to ending on _____.

(b) the audited balance sheet as at, _____; and

(c) documents declared by the said Act to be part of, or annexed to, the *profit and loss account / income and expenditure account and balance sheet.

2. The statement of particulars required to be furnished u/s 44AB is annexed herewith in Form No. 3CD.

3. In *my / our opinion and to the best of *my / our information and according to examination of books of account including other relevant documents and explanations given to *me / us, the particulars given in the said Form No.3 CD are **true and correct** subject to the following observations/qualifications, if any:

- a.
- b.
- c.

XYZ & Co.
Chartered Accountants

Signature
(Name of the Member)
(Designation)
(Membership No.)
(Firm Registration No.)
(PAN:)

Date :

Place :

Notes :

1. *Delete whichever is not applicable.
2. Where any of the requirements in this Form is answered in the negative or with qualification, give reasons therefore.

Format of Form 3CB**[See rule 6G(1)(b)]****Audit report u/s 44AB of the Income - tax Act 1961, in the case of a person referred to in clause (b) of sub - rule (1) of rule 6G**

1. *I / we have examined the balance sheet as on, _____, and the *profit and loss account / income and expenditure account for the period beginning from _____ to ending on _____, attached herewith, of _____ (Name), _____ (Address), _____ (Permanent Account Number).

2. *I / we certify that the balance sheet and the *profit and loss / income and expenditure account are in agreement with the books of account maintained at the head office at _____ and ** _____ branches.

3.(a) *I / we report the following observations / comments / discrepancies / inconsistencies; if any:

(b) Subject to above, -

(A) *I / we have obtained all the information and explanations which, to the best of *my / our knowledge and belief, were necessary for the purpose of the audit.

(B) In *my / our opinion, proper books of account have been kept by the head office and branches of the assessee so far as appears from *my / our examination of the books.

(C) In *my / our opinion and to the best of *my / our information and according to the explanations given to *me

/ us, the said accounts, read with notes thereon, if any, give a **true and fair** view :-

(i) in the case of the balance sheet, of the state of the affairs of the assessee as at 31st March, ;and

(ii) in the case of the *profit and loss account / income and expenditure account of the *profit / loss or *surplus / deficit of the assessee for the year ended on that date.

4. The statement of particulars required to be furnished u/s 44AB is annexed herewith in Form No.3CD.

5. In *my/our opinion and to the best of *my / our information and according to explanations given to *me / us, the particulars given in the said Form No.3 CD are **true and correct** subject to following observations/qualifications, if any:

- a.
- b.
- c.

XYZ & Co.
Chartered Accountants

Signature
(Name of the Member)
(Designation)
(Membership No.)
(Firm Registration No.)
(PAN:)

Date :

Place :

Notes :

1. *Delete whichever is not applicable.
2. **Mention the total number of branches.

Format of Form 3CD

[See rule 6 G(2)]

Statement of particulars required to be furnished u/s 44AB of the Income Tax Act, 1961

Clause			Particulars
1			Name of the assessee
2			Address
3			Permanent Account Number
4			Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, customs duty, etc. if yes, please furnish the registration number or any other identification number allotted for the same.
5			Status
6			Previous year
7			Assessment year
8			Indicate the relevant clause of section 44AB under which the audit has been conducted.
			<i>If business and turnover RS 1.0 crore clause (a), If profession and gross receipts Rs. 25.0 Lacs clause (b), If audit u/s 44AE, 44BB, 44BBB clause (c) and If audit u/s 44AD clause (d) to be mentioned.</i>
9.	(a)		If firm or Association of Persons, indicate names of partners/members and their, profit sharing ratios.
			<i>Details of partners/members during the entire previous year have to be furnished. Profit sharing ratio includes loss sharing ratios. Specific ratio of remuneration and interest not covered.</i>

	(b)	If there is any change in the partners / members or their profit sharing ratios, Since the last date of preceding year, the particulars of such change.
10.	(a)	Nature of business or profession. [If more than one business or profession is carried on during the previous year nature of every business or profession]
	(b)	If there is any change in the nature of business or profession, the particulars of such change.
11	(a)	Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.
		- As per Rule 6F books of account to be kept and maintained by person carrying on certain professions specified in sec.44AA Legal, Medical, Engineer, Architect, Accountancy, Technical consultancy, Interior decorator, Authorised Representative, Film artist, Company Secretary, IT professional and every other Professionals whose total gross receipts Rs.1.20 Lacs in any of the 3 years immediately preceding previous year or likely to exceed during the year is required to maintain book of account. Sec. 44AA(2) provides that persons carrying on business or profession, other than those specified in sub-section (1), shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act.
	(b)	List of books of account maintained and the address at which the books of accounts are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of accounts are not kept at one location, please furnish the addresses of locations along with the details of books of accounts maintained at each location.)
	(c)	List of books of account and nature of relevant documents examined.
12		Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section.)
		Where assessee maintaining regular books has more than one business including business under presumptive basis and P&L prepared includes income of business under presumptive basis, the apportionment of common expenditure should be arrived at by a fair and reasonable estimate on the basis of evidence in possession or as provided by assessee and satisfied. If not satisfied with reasonableness of apportionment, he should indicate by a suitable note. Where assessee maintain regular books for his main business and no books for some additional businesses which fall under presumptive basis but net income credited to main profit & loss a/c should state the amount of income appearing in P&L with a suitable note expressing his inability to verify the said figure.
13.	(a)	Method of accounting employed in the previous year.
		The hybrid system of accounting (mixture of cash & mercantile) has been discontinued w.e.f AY 1997-98. However assessee may adopt cash system of accounting for one business and mercantile system of accounting for other business. Once the choice of method of accounting is decided, the assessee must follow consistently the method of accounting employed. A company governed by the Companies Act, 2013 cannot follow cash system of accounting unless exempted under the Companies Act, 2013.
	(b)	Whether there has been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.
		A change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under sub-clause (b). This is due to the fact that as per the requirements of AS-1 and AS (IT)-1 such changes and the impact of such changes will be disclosed in the financial statements.

	(c)	If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.
		<i>It may be noted that a change in the method of valuation of stock will amount to only to a change in an accounting policy and hence such a change need not be mentioned under sub-clause 13(b) but should be mentioned in the financial statements.</i>
	(d)	Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed u/s 145 and the effect thereof on the profit or loss.
14.	(a)	Method of valuation of closing stock employed in the previous year.
		<i>It is not necessary to indicate any change in the method of valuation of closing stock under this clause. Any such change in the method of valuation of closing stock would amount to change in an accounting policy and needs to be disclosed in the FS as required by AS-1 and AS(IT).</i>
	(b)	Details of deviation, if any, from the method of valuation prescribed u/s 145A, and the effect thereof on the profit or loss.
15.		Give the following particulars of the capital assets converted into stock in trade.
		<i>For furnishing the particulars required by clause 15, the provisions of section 2(47), 45(2), 47(iv), (v) and 47A have to be kept in mind. The clause does not require details regarding the taxability of capital gains or business income arising from such deemed transfer.</i>
	a.	Description of Capital assets
	b.	Date of acquisition
	c.	Cost of acquisition
	d.	Amount at which the asset converted into stock-in-trade.
16.		Amounts not credited to the profit and loss Account, being, -
		<i>Under this clause various amounts falling within the scope of section 28 which are not credited to the P&L A/c are to be stated. The information under sub - clauses (a), (d) and (e) of clause (16) is to be given with reference to the entries in the books of account and records made available to the tax auditor for the purpose of tax audit u/s 44AB.</i>
	(a).	The items falling within the scope section 28;
		• <i>Profits & gains of business</i> • <i>Compensation on termination</i> • <i>Income from trade, professional association</i> • <i>Profit on sale of licence under Import control order</i> • <i>Cash assistance against exports</i> • <i>Customs or excise repayable</i> • <i>Profit on DEPB , DFRC</i> • <i>Benefit or perquisite</i> • <i>Interest, salary, bonus received by a partner from such firm</i> • <i>Sum received for not carrying out any activity</i> • <i>Sum received under a Keyman insurance</i> • <i>Any sum received on any capital assets (demolished, destroyed, discarded) if such expenditure was allowed u/s 35AD</i>
	(b).	The proforma credits, drawbacks, refunds of duty of customs or excise or service tax or refunds of sales tax valued added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
		• <i>The details of claims, if admitted (with in the relevant PY) as due by the concerned authorities but not credited to the P&L A/c , are to be stated.</i>

		• <i>In case of cash basis of accounting, it should be clearly brought out, since the admittance of claims during the relevant PY without actual receipt has no significance in cases where cash method of accounting is followed.</i> • <i>Where such amounts have not been credited in the P&L A/c but netted against the relevant expenditure/income heads, such fact should be clearly brought out.</i>
	(c).	Escalation claims accepted during the previous year;
		<i>The escalation claims accepted during the PY but not credited to the P&L A/c are to be stated. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making of claims by the assessee or claims under negotiations or claims which are sub-judice cannot constitute claims accepted. The Auditor should take a professional judgment about acceptance of claim based on facts and circumstances of each case.</i>
	(d).	Any other item of income;
	(e)	Capital receipt, if any.
		<i>The Capital receipt, if any, which has not been credited to the P&L has to be stated. Eg: Capital subsidy of promoter's contribution, Govt. Grant in relation to specific fixed asset, profit on sale of fixed assets, Compensation for surrendering certain rights, Loss/expenditure/liability recovered u/s 41(1).</i>
17.		Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish: (a) Details of property (b) Consideration received or accrued (c) Value adopted or assessed or assessable
		• <i>S. 43CA applicable where assessee transferred an asset (other than a capital asset) being land or building or both and the value of such an asset is less than the value adopted by any SG authority for the purpose of payment of stamp duty. In such a case for purpose of computing profit & gains from such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of consideration.</i> • <i>S. 50C applicable where assessee transferred a capital asset being land or building or both and the value of such an asset is less than the value adopted any SG authority for the purpose of payment of stamp duty. In such a case, for purpose of section 48, the value so adopted or assessed or assessable by stamp duty authority shall be deemed to be the full value of consideration.</i> • <i>The auditor has to furnish the details about the nature of property i.e. whether the property transferred by him is land or a building along with the address of such property.</i>
18.		Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form :--
		<i>The claim of depreciation has now been made mandatory by Finance Act 2001 by over-ruling 243 ITR 056 (SC) CIT Vs. Mahendra Mills Ltd, which laid that depreciation claim is optional.</i> • <i>Assessee need not be the registered owner of the assets for claiming depreciation. Refer case "Mysore Minerals Ltd Vs CIT 239 ITR 775 (SC)"</i>
	(a).	Description of asset/block of assets.
	(b).	Rate of depreciation.
	(c).	Actual cost or written down value, as the case may be.
	(d).	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of--
	i)	Modified Value Added Tax credit claimed and allowed under the Central Excise rules, 1944, in respect of assets acquired on or after 1st March, 1994,

			<i>VAT Credit eligible on capital goods should be reduced from the cost of the assets for the purpose of claim of depreciation. The assessee should not include duty paid on capital goods eligible for CENVAT credit as part of the cost of fixed assets, otherwise he will not eligible to claim the CENVAT credit. if the CENVAT credit is claimed and allowed but which has not been deducted from the cost of the asset, such credit should be deducted from the cost and appropriate disclosure should be made separately for such adjustment. The tax auditor should also verify that the amount of CENVAT credit deducted from cost of capital goods tallies with the credit availed on this account.</i>
		ii)	Change in rate of exchange of currency, and
			<i>Where assessee acquired any asset in any previous year from outside the country for the purposes of business/profession and in consequence of change in rate of exchange during the previous year after acquiring the asset and if there is an increase or reduction in the liability of assessee expressed in Indian currency at the time of making payment towards repayment of the monies borrowed either directly or indirectly in any foreign currency. Then the increase or reduction in the liability during the previous year irrespective of method of accounting is to be added or deducted from the cost of asset as defined in clause (1) of section 43. Extent of addition or reduction will be limited to the exchange difference actually paid during the PY.</i>
		iii)	Subsidy or grant or reimbursement, by whatever name called.
			• <i>As per Explanation 10 to section 43(1) where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the CG or a SG or any authority in the form of a subsidy or grant or reimbursement then, so much of the cost shall not be included in the actual cost of the asset to the assessee.</i> • <i>Where subsidy cannot be directly relatable to the asset acquired, such proportionate amount to all the assets in respect of which the subsidy is so received, shall not be included in the actual cost of the asset to the assessee.</i> • <i>Subsidy coming within the scope of Explanation 10 to section 43(1) in respect of asset acquired in any earlier year(s) and received during the year has to be deducted from the written down value of such assets in the year of receipt.</i>
	(e)		Depreciation allowable.
	(f)		Written down value at the end of the year.
19			Amounts admissible u/s
	a. b. c. d. e. f. g. h. i. j. k. l. m. n. o. p. q. r	32AC 33AB 33ABA 35(1)(i) 35(1)(ii) 35(1)(ia) 35(1)(iii) 35(1)(iv) 35(2AA) 35(2AB) 35ABB 35AC 35AD 35CCA 35CCB 35CCC 35CCD 35D	• <i>In case the assessee has obtained a separate Audit Report for claiming deductions under any of these sections, he must make a reference to that report while giving the details under this clause.</i> • <i>The Tax Auditor should indicate the amount debited to the P&L and the amount actually admissible in accordance with the applicable provisions of law.</i> • <i>The amount not debited to the P&L but admissible under any of the Sections mentioned in the clause have to be stated. On the basis of the conditions prescribed in the concerned Section, the amount admissible there under and report the same.</i> • <i>An assessee may be eligible for deduction under one or more subsections of section 35. In such case, the Tax Auditor should state the deduction allowable under each sub-section separately under applicable part, i.e. the amount deductible in respect of the amount debited in P&L A/c and the amount not debited to the P&L A/c.</i> • <i>In case the auditor relies on a judicial pronouncement, he may mention the fact in his observations para provided in Form No.3CA or Form No.3CB, as the case may be.</i>

	s T u		35DD 35DDA 35E	
20	(a)		Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)]	
			<i>If an employer would have given dividend or profit share to his employee then it would not have been allowed as an expense, since it is appropriation of profits. Therefore under this clause the auditor is required to ensure that the assessee is not showing dividend/ share in profits paid as bonus or commission which are otherwise deductible. The amount only is to be quantified. There is no need to an expression of opinion as to admissibility or otherwise of the said payment.</i>	
	(b)		Details of contributions received from employees for various funds as referred to in section 36(1)(va):	
			<i>The requirement is only in respect of the disclosure of the amount and the tax auditor is not expected to express his opinion about its allowability or otherwise. Under this clause, following information to be provided: (a) Serial number (b) Nature of fund (c) Sum received from employees (d) Due date for payment, The actual amount paid (e) The actual date of payment to the concerned authorities</i>	
21.			Please furnish the details of amounts debited to the profit and loss account, being in the nature of capital, personal, advertisement expenditure etc.	
	(a)	(i)	Expenditure of capital nature	
		(ii)	Expenditure of personal nature	
			<i>Personal expenses debited to the P&L A/c are to be specified under this sub-clause as they are not deductible in the computation of total income u/s 37. Section 143(1)(e) of the Companies Act 2013 specifically requires the auditor to inquire whether personal expenses have been charged to revenue account. In the case of a person whose accounts of the business/profession have been audited under any other law, the tax auditor will have to report in respect of personal expenses debited in the P&L A/c . In the case of a person who carries on business/profession but who is not required by or under any other law to get his accounts audited, the tax auditor will have to verify the personal expenses if debited in the expenses account while conducting the audit and verify the amount of expenses mentioned under this clause.</i>	
		(iii)	Expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party	
			• <i>Section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the expenditure of this nature should be segregated and reported under this clause.</i> • The trade union or labour union though promoted or formed by a political party may have a distinct legal entity. Expenditure incurred by way of advertisement given in the souvenir, brochure, pamphlet or journal published by the trade union or the labour union is not required to be indicated.	
		(iv)	Expenditure incurred at clubs as entrance fees and subscriptions	
			<i>The amount of payments made to clubs by the assessee during the year should be indicated under this clause. The payments may be for entrance fees as well as membership subscription and for catering and other services by the club, both in respect of directors and other employees in case of companies and for partners or proprietors in other cases. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. If they are personal in nature, they are to be shown</i>	

			<i>separately under clause 21 (a) (ii)</i>
		(v)	Expenditure incurred at clubs being cost for club services and facilities used
		(vi)	Expenditure by way of penalty or fine for violation of any law for the time being force
			• <i>It must be borne in mind that the tax auditor while reporting under this clause is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law. He is only required to give the details of such items as have been charged in the books of accounts. This clause covers only penalty or fine for violation of law and not the payment for contractual breach or liquidator damages. The tax auditor should also take into consideration the concept of materiality.</i> • <i>Where the penalty or fine is in the nature of penalty or fine only, the entire amount thereof will have to be stated. As discussed above, with reference to certain penalty/penal interest courts have held that it is partially compensatory payment and partially in the nature of penalty. In such a case, on the basis of appropriate criteria, the amount charged will have to be bifurcated and only the amount relating to penalty may be stated. Violation of law is not a normal incidence of business.</i>
		(vii)	Expenditure by way of any other penalty or fine not covered above
		(viii)	Expenditure incurred for any purpose which is an offence or which is prohibited by law
	(b)		Amounts inadmissible u/s 40(a):
		(i)	As payment to Non-resident referred to in sub-clause (j) A. Details of payment on which tax is not deducted (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of payee
			B. Details of payment on which tax has been deducted but has not been paid during the previous year or subsequent year before expiry of time prescribed u/s 200(1) (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of payee (V) Amount of tax deducted
		(ii)	As payment referred to in sub-clause (ia) A. Details of payment on which tax is not deducted (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of payee
			B. Details of payment on which tax has been deducted but has not been paid during the in the previous year or subsequent year before expiry of time prescribed u/s 139(1) (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of payee (V) Amount of tax deducted Amount out of V deposited if any
			<i>Such details are also required to be given for each individual payee prescribed u/s 40(a)(ia). Tax auditor should also verify that the particulars given under this clause do not differ from the particulars given under clause 34 of Form no. 3CD to the extent applicable.</i>
		(iii)	Under sub clause (ic) [wherever applicable]

		(iv)	Under sub clause (iia)
			<i>The amount of Wealth Tax paid is not allowed as a deduction u/s 40(a)(iia) and thus is required to be reported under clause 21(b)(iv).</i>
		(v)	Under sub clause (iib)
			<i>New sub clause 40(a)(iib) w.e.f. A.Y. 2014-15 to provide that (a) any amount paid by way of a royalty, license fees, service fees, privilege fees, service charge or any other fees or charge by whatever name called, which is levied exclusively on; or (b) which is appropriated, directly or indirectly from, a SG undertaking by the SG is inadmissible expenditure. The Tax auditor should verify any such payment made by SG undertaking to the SG and should report under clause 21(b)(v).</i>
		(vi)	Under sub clause (iii) (A) Date of payment (B) Amount of payment (C) Name and address of Payee
			<i>The amount of salary which is paid outside India or to a non-resident in respect of which tax has not been deducted but which is required to be deducted under the applicable provisions of the Income Tax Act or tax has not been paid after deduction, the same is not allowed as a deduction u/s. 40(a)(iii) and the same is required to be reported under clause 21(b)(vi). This information is required to be given for each individual payee.</i>
		(vii)	Under sub clause (iv)
			<i>Section 40(a)(iv) provides that any payment to a provident or other fund established for the benefit of employees of the assessee shall be disallowed, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head "Salaries". The auditor is also required to report the same under item (vii) of this sub - clause.</i>
		(viii)	Under sub clause (v)
			<i>Any tax paid by an employer on non-monetary perquisites is exempt in the hands of the employee as per section 10(10CC). Further, as per section 40(a)(v) the tax paid by the employer on non-monetary perquisites provided to employees shall not be deductible in computing profits and gains from business or profession. The tax auditor is required to report the amount of such tax paid by the employer, in case it is debited to the profit and loss account under clause 21(b)(viii)</i>
	(c)		Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible u/s 40(b)/40(ba) and computation thereof;
			<i>Salary, bonus, commission or remuneration or interest are not admissible, unless the following conditions are satisfied: (a) Remuneration is paid to working partner(s). (b) Remuneration or interest is authorised by the partnership deed and is in accordance with the partnership deed. (c) Remuneration or interest does not pertain to a period prior to the date of partnership deed.</i> <i>The tax auditor may note that the information required to be reported is the amount of inadmissible expenditure as per section 40(b) or 40(ba) and not the total amount debited to P&L A/c.</i>
	(d)		Disallowance/ deemed income u/s 40A(3):
		A	On the basis of the examination of books of account and other relevant documents/ evidence, whether the expenditure covered u/s 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details:

		• <i>The tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs.20,000 or Rs.35000 made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should be verified by the tax auditor with the books of account in order to ascertain whether the conditions for specific exemption granted under clauses (a) to (I) of Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause excepting clauses of Rule 6DD.</i> • <i>Where the assessee incurs any expenditure in respect of a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeding Rs. 20,000/- , no deduction would be allowed in respect of such expenditure. In case of payment made for plying, hiring or leasing of goods carriage, limit is Rs.35,000/- instead of Rs.20,000/-.</i>
	B	On the basis of the examination of books of account and other relevant documents/ evidence, whether the payment referred to in section 40A(3A) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft If not, please furnish the details of amount deemed to be the profits and gains of business or profession u/s 40A(3A);
		<i>As per the provisions of section 40A(3A) where any allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during the previous year the assessee makes payment in respect thereof, otherwise than an account payee cheque drawn on a bank or account payee bank draft exceeding Rs.20,000, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income tax with respect to that PY. In case of payment made for hiring or leasing of goods carriage, limit is Rs.35,000/- instead of Rs.20,000/-</i>
	(e)	provision for payment of gratuity not allowable u/s 40A(7),
		• <i>As per section 40A(7), the deduction shall be allowed in relation to any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year.</i> • <i>The tax auditor should call for the order of the Commissioner of Income tax granting approval to the gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed. In case not allowable, the same is to be stated under this sub-clause.</i>
	(f)	any sum paid by the assessee as an employer not allowable u/s 40A(9);
	(g)	particulars of any liability of a contingent nature
		<i>The assessee is required to furnish particulars of any liability of a contingent nature debited to the P&L A/c. The tax auditor may not be able to immediately ascertain the details of contingent liabilities debited to the P&L A/c without a detailed scrutiny of various account heads e.g. outstanding liabilities, provision etc. Wherever necessary, a suitable note should be given by the tax auditor as to the non-availability of such particulars relating to the contingent liabilities.</i>
	(h)	amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income;
		<i>In general an assessee may have besides his business income, income from agriculture which is exempt under sub-section (1), share of profit in a partnership firm which is exempt under sub-section (2A), income from dividends referred to in section 115-O which is exempt u/s 2(34), long term capital gains on the transfer of equity shares which is exempt under 2(38) etc. In all such cases the expenditure relating to the income which is not included in total income is inadmissible u/s 14A. In case of an investment in a partnership firm, while</i>

		<i>the interest and the salary received by the partner are taxable, the share of profit is exempt. The amount of inadmissible expenditure depends on the facts and circumstances of each case. Computation to be made as per Rule 8D of Income Tax Rules.</i>
	(i)	Amounts inadmissible under the proviso to section 36(1)(iii).
		<i>Any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was put to use, shall not be allowed as a deduction. The Tax Auditor while determining the admissible/inadmissible amount u/s 36(1)(iii) should also keep in mind the requirements of Accounting Standards 16 of Indian GAAP – “Borrowing Cost”.</i>
22		Amount of Interest inadmissible u/s 23 of the Micro, Small and Medium Enterprise Development Act, 2006.
23		Particulars of payments made to persons specified u/s 40A(2)(b).
		• <i>Section 40(A)(2) provides that expenditure for which payment has been or is to be made to certain specified persons listed in the section may be disallowed if, in the opinion of the AO, such expenditure is excessive or unreasonable having regard to: (i) the fair market value of the goods, services or facilities for which the payment is made; or (ii) for the legitimate needs of business or profession of the assessee; or (iii) the benefit derived by or accruing to the assessee from such expenditure.</i> • <i>The following steps may be taken by the tax auditor in this connection: (a) Obtain full list of specified persons as contemplated in this section. (b) Obtain details of expenditure/ payments made to the specified persons. (c) Scrutinise all items of expenditure/ payments to the above persons.</i>
24		Amounts deemed to be profits and gains u/s 33AC or 33AB or 33ABA or 33AC.
		The auditor is required to report the deemed income chargeable as profits and gains of business under the above sections.
25		Any amount of profit chargeable to tax u/s 41 and computation thereof.
		<i>Section 41(1) provides that where any allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any PY the assessee obtains any amount, whether in cash or in any other manner whatsoever, in respect of such loss or expenditure or some benefits in respect of trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him is chargeable to tax as business income.</i>
26	(A)	In respect of any sum referred to in clause (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which:-- Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was
		<i>u/s 43B the following amounts shall be allowed as deduction in the year in which amounts are actually paid: (a) Any tax, duty, cess or fee etc (b) Employer's contribution to PF (c) Any bonus, commission payable to its employees (d) Interest on loan or borrowing from Public Financial institution etc (e) Interest on any loan or advance from a schedule bank (f) Any sum payable to employee in lieu of any Leave credit.</i>
	(a)	paid during the previous year;
		<i>In respect of the liability which pre-existed on the first day of the previous year is allowable as deduction if paid during the previous year. This is required to be reported in clause 21(i)(A).</i>
	(b)	not paid during the previous year;
26	(B)	was incurred in the previous year and was

	(a)	paid on or before the due date for furnishing the return of income of the previous year u/s 139(1);
		<i>In respect of the liability which is incurred in the previous year is allowable to the extent it is paid on or before the due date for furnishing the return of the income u/s 139(1). Such items are to be disclosed in clause 26(B)(a). If the assessee is following the cash basis of accounting, sums referred to in clause (a), (b), (c), (d), (e) and (f) of section 43B which are debited to the P&L A/c will be allowable as they would have been actually paid during the year.</i>
	(b)	not paid on or before the aforesaid date. (State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost etc. is passed through the profit and loss account.)
		• <i>Date of signing of audit report would be earlier to due date. The payment made after audit report date but before the date of filing, will still be eligible for deduction. Where due date for filing of return of income is extended, payments made upto the extended due date also qualify for deduction.</i> • <i>In case, any sum has been paid before the due date of filing the return, the date and the amount of payment along with the amount paid should also be disclosed.</i>
27	(a)	Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.
	(b)	Particulars of income or expenditure of prior period credited or debited to the profit and loss account.
		• <i>This clause would be relevant only in those cases where the assessee follows mercantile system of accounting. Under cash system of accounting, expenses debited/ income credited to the profit and P&L A/c would be current year's expenses/income even though they may relate to earlier years.</i> • <i>Material adjustments necessitated by circumstances which though related to previous periods but determined in the current period, will not be considered as prior period items. In such cases, though the expenditure may relate to the earlier year, it can be considered as arising during the year on the basis that the liability materialised or crystallised during the year and such cases will not be reported under this clause. Similar consideration will apply in relation to income also.</i> • <i>As per AS-IT-II material charges or credits which arise in current year as a result of errors or omissions in accounts of earlier years will be considered as prior period items.</i>
28.		Whether during the previous year the assessee has received any property, being share of a company not being a company in which the public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2)(viiia), if yes, please furnish the details of the same.
29.		Whether during the previous year the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib), if yes, please furnish the details of the same.
30.		Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque. [Sec. 69D]
		<i>The amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid in the P.Y. in which the amount was borrowed or repaid, as the case may be. However, in case the amount borrowed under this section has been deemed as income of the borrower, then the borrower shall not be liable to be assessed again in respect of such amount under this section on repayment of such amount.</i>
31	*(a)	Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year :

		(i)	Name, address and permanent account number (if available with the assessee) of the lender or depositor;
		(ii)	Amount of loan or deposit taken or accepted;
		(iii)	Whether the loan or deposit was squared up during the previous year;
		(iv)	Maximum amount outstanding in the account at any time during the previous year;
		(v)	Whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.
		(i)	*(These particulars needs not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)
			• <i>If the total of all loans/deposits from a person exceed Rs.20,000/- but each individual item is less than Rs.20,000/-, the information will still be required to be given in respect of all such entries starting from the entry when the balance reaches Rs.20,000/- or more and until the balance goes down below Rs.20,000/.</i> • <i>In the absence of satisfactory evidence, the guidance given by the Council of the ICAI to the tax auditors has been to make a suitable comment in his report as suggested below.</i> • <i>"It is not possible for me/us to verify whether loans or deposits have been taken or accepted otherwise than by an account payee cheque or account payee bank draft, as the necessary evidence is not in the possession of the assessee".</i> • <i>A current account is not excluded from the definition of the term "deposit". if the transactions in a current account exceed Rs.20,000/-, it will be necessary to give the information against this sub-clause.</i> • <i>In case of mixed account, the transactions relating to loans and deposits should be segregated from other accounts and the transactions relating to loans and deposits (including temporary advances) should be stated under this clause.</i> • <i>Advance received against agreement of sale of goods is not a loan or deposit.</i> • <i>Op.balance of loan taken in earlier years is not specifically required to be disclosed.</i> • <i>For giving figures of maximum amount o/s at any time during the year the Op. balances will have to be considered.</i> • <i>Even if the loans are taken free of interest the information will still have to be given.</i> • <i>Security deposits against contracts, etc. will be covered by the definition of 'deposit'</i> • <i>Loans and deposits taken or accepted by means of transfer entries in the books of account constitute acceptance of deposits or loans. Hence, such entries have to be reported under this clause.</i>
			• <i>Share application money advance supported by appropriate documentation is neither deposit nor loan.</i>
	(b)		Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year: --
		(i)	Name, address and permanent account number (if available with the assessee) of the payee;
		(ii)	Amount of the repayment;
		(iii)	Maximum amounts outstanding in the account at any time during the previous year;
		(iv)	Whether the repayment was made otherwise than by account payee cheque or account payee bank draft.
			• <i>Section 269T is attracted where repayment of the loan or deposit is made to a person, where the aggregate amount of loans or deposits held by such person either in his</i> • <i>own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such deposit is Rs.20,000 or more.</i>

		• All repayments made to any person where the loan or deposit along with interest is Rs.20,000 or more are to be reported under this sub-clause, even though the amount of repayment may be less than Rs.20,000. The tax auditor should verify such repayments and report accordingly. • Loan or deposits discharged by means of transfer entries constitute repayment of loan or deposits otherwise than by account payee cheques or account payee bank drafts. Hence, such entries have to be reported under this clause.
	(c)	Whether the taking or accepting loan or deposit, or repayment of the same were made by account payee cheque drawn on a bank or account payee bank draft based on the examination of books of account and other relevant documents. (The particulars (i) to (iv) at (b) and comment at (c) above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company of a corporation established by a Central, State or Provincial Act).
32	(a)	Details of brought forward loss or depreciation allowance, in the following manner, to the extent available: (a) Serial Number (b) Assessment Year (c) Nature of loss / allowance (in rupees) (d) Amount as returned (in rupees) (e) Amounts as assessed (give reference to relevant order) Remarks
		Any assessment, rectification, revision or appeal proceedings pending at the time of tax audit have to be disclosed in the remarks column by way of information. If consequential orders for any revision/apellate order is yet to be passed, the same can be disclosed along with impact thereof if material.
	(b)	whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.
	(c)	Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year, If yes, please furnish the details of the same.
	(d)	whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.
	(e)	In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73, if yes, please furnish the details of speculation loss if any incurred during the previous year.
33.		Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA). (a) Section under which deduction is claimed. (b) Amounts admissible as per the provision of the Income Tax Act, 1961 and fulfils the conditions, if any, specified under the relevant provisions of Income Tax Act, 1961 or Income Tax Rules, 1962 or any other guidelines, circular, etc, issued in this behalf.
		Chapter VIA of the Act deals with various deductions they have been categorised under the Act as follows: A. Deduction in respect of certain payments. B. Deduction in respect of certain incomes. C. Other Deductions.
34	(a)	Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes please furnish:
	(1)	Tax deduction and collection Account Number (TAN)
	(2)	Section
	(3)	Nature of payment
	(4)	Total amount of payment or receipt of the nature specified in column (3)

		(5)	Total amount on which tax was required to be deducted or collected out of (4)
		(6)	Total amount on which tax was deducted or collected at specified rate out of (5)
			Further, certificate u/s 195/197 can be issued for no deduction or lower deduction of tax at source. In case the payer deducts/recipient collects tax at source at a rate lower than the specified rate on the basis of certificate issued u/s 195 or 197, the lower rate or nil rate, as the case may be will be considered as the specified rate for the purpose of reporting under this clause.
		(7)	Amount of tax deducted or collected out of (6)
		(8)	Total amount on which tax was deducted or collected at less than specified rate out of (7)
		(9)	Amount of tax deducted or collected on (8)
		(10)	Amount of tax deducted or collected not deposited to the credit of the Central Government out of (6) and (8)
			It may be seen that tax deducted but deposited late will not be required to be reported in this clause.
	(b)		whether the assessee has furnished the statement of tax deducted or tax collected within the prescribed time. If not, please furnish the details: (a) Tax deduction and collection Account Number (TAN) (b) Type of Form (c) Due date for furnishing (d) Date of furnishing, (e) if furnished Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported
			In Clause 34(b) only with regard to the statement not filed within the prescribed time to be mentioned.
	(c)		whether the assessee is liable to pay interest u/s 201(1A) or section 206C(7). If yes, please furnish: (a) Tax deduction and collection Account Number (TAN) (b) Amount of interest u/s 201(1A)/206C(7) is payable (c) Amount paid out of column (2) along with date of payment.
35	(a)		In the case of a trading concern, give quantitative details of principal items of goods traded :
			The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded. The information is required to be given to the extent available with the auditee.
		(i)	Opening Stock;
		(ii)	Purchases during the previous year;
		(iii)	Sales during the previous year;
		(iv)	Closing Stock;
		(v)	Shortage/excess, if any.
	(b)		In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products :
			This clause requires that quantitative details of "principal items" of raw materials and finished goods should be given. Therefore, information about petty items need not be given. Normally, items which constitute more than 10% of the aggregate value of purchases, consumption or turnover may be classified as principal items.
	A.		Raw Materials:
		(i)	Opening stock;

		(ii)	Purchases during the previous year;
		(iii)	Consumption during the previous year
		(iv)	Sales during the previous year;
		(v)	Closing stock;
		(vi)	*Yield of finished products;
		(vii)	* Percentage of yield;
		(viii)	*Shortage/excess, if any.
	B.		Finished products/By-products :
			<i>In case the By-products are continuously generated, similar records of quantitative details should be maintained and given in respect of by-product also.</i>
		(i)	Opening stock;
		(ii)	Purchases during the previous year;
		(iii)	Quantity manufactured during the previous year;
		(iv)	Sales during the previous year;
		(v)	Closing stock;
		(vi)	Shortage/excess, if any.
			(*Information may be given to the extent available.)
36.			In the case of a domestic company, details of tax on distributed profits u/s 115-O in the following form: -
	(a)		Total amount of distributed profits;
	(b)		amount of reduction as referred to in section 115-O(1A)(i);
	(c)		amount of reduction as referred to in section 115-O(1A)(ii);
	(d)		Total tax paid thereon;
	(e)		Dates of payment with amounts.
			<i>Information about the date of declaration/distribution of dividend or payment of dividend is not required to be given.</i>
37.			Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the cost auditor
			• <i>The tax auditor should ascertain from the management whether cost audit was carried out and if yes, enclose the copy of the report of such audit. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of any material observation made in such cost audit report which may have relevance to the tax audit conducted by him.</i> • <i>In cases where cost audit which might have been ordered is not completed by the time the tax auditor issues his report, he has to state "No" in this report since cost audit is not completed and the cost audit report is not available with the assessee.</i> • <i>The information is required to be given in respect of that cost audit report which is received upto the date of tax audit report.</i>
38.			Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the auditor.
			<i>Same audit procedures is applied as given for Clause 37.</i>

39.		Whether any audit was conducted u/s 72A of the Finance Act, 1994 in relation to valuation of taxable services. Finance Act, 1994 in relation to valuation of taxable services, if yes, give the details, if any, of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the auditor.
		Same audit procedures is applied as given for Clause 37.
40.		Details regarding turnover, gross profit, etc., for the previous year and preceding previous year:
		<i>These ratios have to be calculated only for assessees who are engaged in manufacturing or trading activities. This clause is not applicable to assessees 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 (5) need not be given for trading concern or service provider.</i>
	1	Total Turnover of Assessee
		<i>The aggregate amount for which sales are effected or services rendered by an enterprise. The terms gross turnover and net turnover are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts.</i>
	2	Gross profit/Turnover;
	3	Net profit/Turnover;
		<i>The net profit may be shown before or after tax.</i>
	4	Stock-in-trade/Turnover;
		<i>For the purpose of calculating the ratio mentioned in (4), only closing stock is to be considered. The term 'stock-in-trade' used therein does not include stores and spare parts or loose tools. The term "stock-in trade" would include only finished goods and would not include the stock of raw material and WIP since the objective here is to compute the stock turnover ratio.</i>
	5	Material consumed/Finished goods produced.
		<i>The details required to be furnished for principal items of goods traded of manufactured or services rendered. The relevant previous year figures are to be taken from last previous year audit report. In case the preceding previous year is not subject to audit, nothing should be mentioned in the relevant column.</i>
41		Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income-tax Act, 1961 and Wealth tax Act, 1957 alongwith details of relevant proceedings.
		• <i>Normally, the Indirect tax laws such as Central Excise Duty, Service Tax, Customs Duty, Value Added Tax, CST, Professional Tax etc would be covered as other tax laws. Hence, the cess or duty like Marketing Cess, Cess on Royalty, Octroi Duty, Entry Tax etc. would not be covered as other tax laws.</i> • <i>It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause. If there is any adjustment of refund against any demand, the auditor shall also report the same under this clause.</i>
In terms of our report attached For ABC & Company Chartered Accountants Firm Registration No. _____ Name of Partner/Proprietor Designation Membership No. _____ Place : _____ Date : _____		

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	What is your understanding about the term "Audit of Indirect Taxes"? Explain the steps involved in the Indirect Tax Audit.	N03	8	2,4
2	Enumerate some of the areas of concern in an audit of indirect taxes.	N05	6	
3	Briefly explain the steps involved in audit under Indirect Tax.	N11	8	
4	Draft an Audit Programme for conducting the audit of a Public Trust registered u/s 12A of the Income Tax Act, 1961.	M09	4	5.1
5	Write short notes on "Major steps required in preparation on Tax audit under VAT.	M10	5	6.3
6	What are the steps for the Audit under the State level "Value Added Tax (VAT)?"	N07	8	
7	As the tax auditor of a non-corporate entity u/s 44AB of the Income Tax Act, 1961, how would you ensure compliance of section 145 of the Income Tax Act, 1961?	M09	4	7.4
8	Discuss briefly Accounting standards to be followed by assesseees under the Income-tax Law.	N09	4	
9	In the context of tax audit u/s 44AB of the Income-tax Act, 1961, discuss the provisions of Section 145 of the said Act regarding the method of accounting and accounting standards notified thereunder.	N01	8	
10	State whether a Tax audit report can be revised and if so state those circumstances.	N08	4	7.6
11	A Co-operative Society having receipts above Rs 40 lakhs gets its accounts audited by a person eligible to do audit under Co-operative Societies Act, 1912, who is not a Chartered Accountant? State with reasons whether such audit report can be furnished as tax audit report u/s 44AB of the Income Tax Act, 1961?	N09	3	Ans-1
12	XYZ Private Limited is engaged in the wholesale business of buying and selling silk sarees. The accounts are maintained under the Companies Act from 1st October to 30 September each year. The Chief Accountant of the Company is requesting the tax auditor to conduct tax audit u/s 44AB of the I.T. Act for the period for which accounts have been maintained under the Companies Act. As the tax auditor of XYZ Private Limited, how will you react to the Chief Accountant's request.	M03	8	Ans-2
13	Mr. A engaged in business as a sole proprietor presented the following information to you for the FY 12-13. Turnover made during the year Rs.124 lacs. Goods returned in respect of sales made during FY 10-11 is Rs.20 lacs not included in the above. Cash discount allowed to his customers Rs.1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount Rs.5 lacs. Kindly advice him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.	N13	4	Ans-3
14	State with reasons whether an auditor conducting tax audit 'certifies' or 'reports' on information contained in the statement of particulars attached to the tax audit report u/s 44 AB of Income-tax Act, 1961	N00	4	Ans-4

Question Bank related to Form 3 CD

No.	Question Bank	Exam	Marks	Clause of 3CD	Refer Point/ Ans.
1	Write short notes on "Method of accounting in Form No. 3CD of Tax Audit".	M07	4	13	Clause 13

2	T Ltd's previous year ended on 31st March 2012. During that period it made a claim for refund of customs duty which was admitted as due by the customs authorities during April 2012. T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 13(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year. Further T Ltd. had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 13(b) of New Form 3CD which requires reporting on change in accounting method employed; Comment. (Modified as per New form 3CD)	M12	6	13(b) 16(b)	Ans-5
3	A leading jewellery merchant used to value his inventory at cost on LIFO basis. However, for the current year, in view of requirements of AS-2, he changed over to FIFO method of valuation. The difference in value of stock amounted to Rs 55 Lakhs which is higher than that under the previous method. In such a situation, what are the reporting responsibilities of a Tax auditor u/s 44AB of Income Tax Act, 1961?	M02	7	14	Ans-6
4	While conducting the tax audit of A & Co., you observed that it made an escalation claim to one of its customers, but which was not accounted as income. What is your reporting responsibility?	M11	4	16 ©	Ans-7
5	While writing the audit program for tax audit in respect of A Ltd. You wish to include possible instances of capital receipt if not credited to Profit & Loss Account which needs to be reported under clause 16(e) of form 3CD. Please elucidate possible instances. (Modified as per new form 3CD)	M13	4	16 (e)	Clause 16
6	As a tax auditor, how would you report on "Capital expenditure incurred for Scientific Research Assets.	M06, N12	4,2	19	Clause 19
7	Write short notes on "Expenditure incurred at clubs".	N11, N12	2,2	21(a) (iv)	Clause 21
8	As a tax auditor, how would you report on "Labour charges paid on which tax is deducted at source at an inappropriate rate.	M06	4	21(b)	Ans-8
9	As the tax auditor of a Company, how would you report on payments exceeding Rs 20000/- made in cash to a supplier against an invoice for expenses booked in an earlier year.	M08	5	21(d)	Ans-9
10	Mr. R the Tax Auditor finds that some payments inadmissible u/s 40 A(3) were made and advised the client to report the same in form 3CD. The client contends that cash payments were made since the other parties insisted upon the same and did not have Bank Accounts. Comment.	N10	5	21(d)	Ans-10
11	Comment: Mr. P carries on the business of dealing and export of diamonds. For the year ended 31st March 2000, you as the tax auditor, find that the entire exports are to another firm in USA, which is owned by Mr.P's brother.	M01	4	23	Ans-11
12	As a tax auditor how would you deal and report the following: (i) An assessee has paid Rent to his brother Rs.2,50,000/- and paid interest to his sister Rs. 4,00,000/-	N11	2	23	Ans-12

13	As a tax auditor how would you deal and report the following: (i) An assessee has borrowed Rs. 50 lakhs from various persons. Some of them by way of cash and some of them by way of Account payee cheque / Draft.	N11	3	31	Refer Clause 31
14	ABC Printing Press, a proprietary concern, made a turnover of above Rs. 43 lacs for the year ended 31-03-2009. The Management explained its auditor Mr. Z that it undertakes different job work orders from customer. The raw materials required for every job are dissimilar. it purchases the raw material as per specification/requirements of each customer, and there is hardly any balance of raw materials remains in the stock, except pending work-in-progress at the year end. Because of variety and complexity of materials, it is rather impossible to maintain a sock register. Give you comments.	N09	5	35 (b) 11 (b)	Ans-13
15	Write short notes on "Accounting ratios in Form 3CD of Tax Audit".	N07	4	40	Clause 40
16	As a tax auditor, which are the accounting ratios required to be mentioned in the report in case of manufacturing entities? Explain in detail any one of the above ratios and how does it help the tax auditor in his analytical review.	N05	8	40	Clause 41

Answer

Ans-1:

Proviso to section 44AB lays down that where the accounts of an assessee are required to be audited by or under any other law, it shall be sufficient compliance with the provisions of this section, and if such person get the accounts of such an organization audited under such other law before the specified date, and is furnished by that date, the report of the audit as required under such other law and a further report by an accountant in the form is prescribed under this section.

Tax audit shall be conducted by an "Accountant" as explained in u/s 288 of the IT Act. If the Statutory audit is conducted under any other law (by a person other than a Chartered Accountant), then the tax audit shall be separately done by a Chartered Accountant, and his report shall be given in Form 3CA and 3CD. The report of the Statutory auditor shall also be annexed to form 3CA.

Ans-2:

As per the circular No. 561/22.5.1990 issued by CBDT, in case of a company, where the previous year and accounting year are different, the tax auditor would have to carry out the tax audit in respect of the period covered by the relevant financial years and submit his report in Form 3CB, as required in rule 6G (I) (b) of the Income Tax Rules.

In the given case, in view of the above circular, Tax Audit can be conducted only in respect of the financial year, and not for the year ending 30th September. So the Chief Accountant's request is not valid.

Ans-3:

Special rebate allowed to a customer can be deducted from the total sales if it is in the nature of trade discount. Applying the above stated points to the given problem:

Particular	Amount in Lacs
Total Turnover	124

Less: Goods Returned	20
Less: Special rebate allowed to customer in the nature of trade discount would be deducted	5
Balance	99

As the limit for tax audit is Rs. 1 crore, therefore, he would not be required to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

Ans-4:

- Section 44AB of the Income-Tax Act, 1961 requires the auditor to submit the audit report in the prescribed form (3CA/3CB) and setting forth prescribed particulars (3CD). The statement of particulars as required in Form 3CD are required to be annexed to the main audit report.
- The audit report is in two parts. The first part requires the auditor to give his opinion as to whether or not the accounts audited by him give a true and fair view (3CA/3CB) and the second part of the report is in the form of an "Annexure" containing statement of particulars in respect of certain specified matters (3CD). The tax auditor has to report whether particulars contained in form 3CD are true and correct.
- In this context, it is important to appreciate the distinction between the terms 'report' and "certificate". Briefly speaking, the terms "certificate" is used where the auditor verifies the accuracy of facts while the terms "report" is used in case the auditor is expressing an opinion. Hence, it can be said that an auditor conducting tax audit 'certifies' the information contained in the statement of particulars. However; having regard to the distinction, it is significant to examine whether all the clauses included in the statement of particulars are capable of being simply certified on the basis of books of account or there are some clauses in respect of which different auditor (s) may hold different opinion.
- For example Clause 18 of new form 3CD (Applicable from F.Y. 2013-14) relating to depreciation would require the auditor to exercise judgement having regard to the facts and circumstances of the case, etc. Thus, there are several matters 'on which the auditor is required to exercise judgement while giving his report on various amounts included in the statement of particulars.
- There can also be situations leading to difference of opinion between the tax auditor and the assessee. Therefore, it can be said that an auditor conducting tax audit "reports" on certain information, apart from certifying certain factual information contained in the statement of particulars annexed to the tax audit report u/s 44AB of the income- tax Act, 1961.

Ans-5:

- Reporting requirement under Form 3 CD: As per Clause 16(b) of Form 3CD, the details of the Refund of custom duty, if admitted as due by the concerned authorities but not credited to the P & L A/c are to be stated, but the Credits/Claims which have been admitted as due after the relevant previous year need not be reported. In the instant case, the action of T Ltd. in not crediting the claim to the P&L A/c and also not reporting of the same in Clause 16(b) of Form 3 CD is in order.
- Further Clause 13(b) of new form 3CD (Applicable from F.Y. 2013-14) requires reporting when there is change in the method of accounting employed vis-a-vis the accounting method employed in the immediately preceding year. However, change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under Clause 13(b).
- It may be noted that change in the method of valuation of stock will amount to a change in accounting policy. However, it should be disclosed in the financial statements, but need not be mentioned under sub-clause (b). In the instant case, non-reporting of the change in the method of closing stock valuation from FIFO to Weighted average Cost basis, in clause 13(b) of Form 3CD is in order. Hence in the above situation, there is no reporting requirement under Clause 16(b) and Clause 13(b).

Ans-6:

The change in the method of valuation of stock is not a change in method of accounting, as it is only a change in accounting policy. However, in the income tax act, this is considered under the method of accounting. Under the income tax act, if the change in method of valuation is bonafide, and is regularly and consistently adopted in the subsequent years as well, such change would be permitted to be made for tax purpose. In the given case, the change in the valuation of stock from LIFO to FIFO basis is pursuant to the mandatory requirement of the AS2 "Valuation of Inventories", and therefore, should be viewed as bonafide change.

Apart from this, the tax auditor in his report has to specifically refer to the method for valuation of the stock under the Clause 14 in new form 3CD (Applicable from F.Y. 2013-14).

- Method of valuation of closing stock employed in the previous year”.
- Details of deviation, if any, from the method of valuation prescribed u/s 145A and the effect thereof on the profit or loss.

The auditor has to see whether the method of stock valuation is followed consistently from year to year, and to ensure that the method followed for the valuation of stock, results in correct profits or loss. The change from LIFO to FIFO is bonafide, the disclosure of which would have to be made in the financial statements.

Ans-7:

A tax auditor has to report under the clause 16(c) of New Form 3CD (Applicable from F.Y. 2013-14) on any escalation claim accepted during the previous year and not credited to the Profit & Loss account. If the assessee is following cash basis of accounting with reference to his item, it should be clearly brought out, since the acceptance of claims during the relevant previous year without the actual receipt has no significance, if the cash method of accounting is followed.

Escalation claims should normally arise pursuant to a contract (including contracts entered into in the earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making claims by the assessee or claims under negotiations cannot constitute accepted claims. After considering the relevant factors as outlined above, a decision whether to report or not, can be taken.

Ans-8:

Section 40(a) of the Income-tax Act, 1961 specifies that the amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including the supply of labor for carrying out any work on which tax is deductible under chapter XVII-B and such tax has not been deducted, or after deduction has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed u/s 200(1), shall not be deducted in computing the total income. Therefore, if tax is deducted at an inappropriate rate, the amount is disallowable u/s (40)(a)(ia) of the income-tax act. This fact needs to be reported in Clause 21(b) of New Form 3CD (Applicable from F.Y. 2013-14) where all the amounts inadmissible u/s 40(a) are to be reported. In case the assessee submits that the rate is proper, though in the auditor's view it is improper, the tax auditor should exercise his judgment, and accordingly should report in Clause 21(b) of Form 3CD.

Ans-9:

Disallowance u/s 40A(3) is attracted, if the assessee incurs any expenses in respect of which aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft exceeds Rs. 20000/-. However, the exemption is provided in respect of certain expenditure in Rule 6DD. In such a case, disallowances u/s section 40A (3) would not be attracted. Under the clause 21 (d) of Form 3CD, the amount inadmissible u/s 40A(3), read with Rule 6DD, have to be reported.

In a given case, the invoice for expenses has been booked in an earlier year. However, since the payment for the same is made during the current year by cash exceeding Rs. 20000/-, the reporting thereof would be necessary in clause 21(d) of Form 3CD. The entire amount paid as above, to be disallowed u/s 40A(3) of the Income Tax Act, 1961.

Ans-10:

The audit U/s 44AB of the Income Tax Act, 1961 requires that the tax auditor should report, whether in his opinion the particulars in respect of Form 3CD are true and correct. The form 3CD is not a report of tax auditor. The report is in the form of 3CA or 3CB.

Disallowance u/s 40A(3) is attracted if the assessee incurs any expenses in respect of which the aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft exceeds Rs. 20000/-. However, an exemption is provided in respect to certain expenditure in Rule 6DD. In such cases, disallowances u/s section 40A (3) would not be attracted. Under the clause 21 (d) of Form 3CD, the amount inadmissible u/s 40A(3), read with Rule 6DD, have to be reported.

In a given case, cash payment made on the insistence of other parties on the contention that they do not

have bank accounts is not covered under the list of exceptions provided under Rule 6DD. Hence, Mr. R has to report the payments inadmissible u/s 40A (3) under clause 21 (d) of Form 3CD.

Ans-11:

Export payment to relative: Clause 23 of New Form 3CD (Applicable from F.Y. 2013-14), requires the tax auditor to specify particulars of payments made to persons specified u/s 40(A)(2)(b) of the Income Tax Act, 1961. Person specified in the said section are relatives of an assessee and sister concerns, etc. In the given case, however, Mr. P has not made any payments to his brother. On the contrary, he must have received payments from him against the exports made, and, thus, this clause would not be applicable to him. However, as a part of his normal audit planning, the auditor would be required to verify whether the exports are genuine.

Ans-12:

Tax Audit Report -Payment of Rent and Interest: A tax auditor has to report under Clause 23 of new form 3CD (Applicable from F.Y. 2013-14) which deals with the particulars of payments made to persons specified u/s 40A (2) (b). The specified persons include Husband, Wife, Brother, Sister or any other Lineal Ascendant or Descendant. In the given case, an assessee has paid rent to his brother Rs.2,50,000 and interest to his sister Rs.4,00,000 may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to:

- Fair market value of the goods, services or facilities for which the payment is made: or
- For the legitimate needs of business or profession of the assessee; or
- The benefit derived by or accruing to the assessee from such expenditure.

Hence this fact needs to be reported in the Tax Audit Report accordingly.

Ans-13:

The explanation given by the entity for the use of varieties of raw materials may be valid. But the auditor is required to verify the specified job-orders received, and the different raw materials purchased for each job separately. The auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom.

The auditor also has to report and certify under the clause 35(b) and clause 11(b) of New Form 3CD (Applicable from F.Y. 2013-14), read with the Rule 6G(2) of the Income Tax Act, 1961, about the details of stock and accounts books (including stock register) maintained. He, or his staff, must verify the closing stocks of the raw materials, WIP and finished goods of the concern, at least on the date of its balance sheet. In case the said details are not properly maintained, he has to specifically mention the same with reasons for non-maintenance of stock register by the entity.

Topic
Introduction
It is conducted on the behalf of the Government for detecting and preventing tax evasion.
Audit of Indirect Tax
It includes VAT audit, Sales Tax Audit, Customs and Excise audit, Entertainment tax audit, wealth tax audit etc.
Scope of Indirect Tax Audit
1) Non availment, or short, or excess availment of export incentives. 2) Goods imported duty free, or at concessional rates. 3) Availment and utilisation of CENVAT credit. 4) Examination of the applicability of central excise and the availability of exemption. 5) Valuation of goods as per applicable rules. 6) Transfer pricing issues. 7) The method of production, or marketing and distribution. 8) Procedural non compliance, which could lead to demand and losing benefits.
Methodology of Indirect Tax Audit
1) Evaluation of internal controls 2) Collection of information about the company and the industry. 3) Design the audit programme depending on the evaluation of internal controls 4) Training to staff.
Audit of Public Trusts [Section 12A of the Income Tax Act]
1) Audit Programme: (a) Obtain resolution and a letter of appointment (b) Communicate with the PYs auditor (c) Obtain PY BS and list of books of accounts and records maintained by the trust (d) Obtain a certificate from the management regarding the system of accounting and the internal controls (e) Obtain a list of institutions/ activities run by the trust (f) Obtain a certified true copy of trust deed (g) Check the books of account and other records (h) Vouch the transactions of the trust. 2) Compliance with Accounting Principle: Ensure that all the assets have been verified and correctly valued, the liabilities have been properly recorded, all the investments of the trust are properly classified and valued. Also examine the recoverability of the outstanding dues to the trust. 3) Applicability of ASs: AS will not apply if all the activities of such organisations are not of commercial, industrial, or business in nature. 4) Annexure to Audit Report of Public Charitable Trust: The auditor should obtain from the trustees a certified list of persons specified u/s 13 (3). Audit report is to be given in form 10B.
Tax Audit Provisions under VAT Law

- 1) VAT Audit:** VAT is a tax on the value added to the commodity at each stage in the production and distribution chain. VAT is an indirect tax on consumption and it is collected at each stage of sale. It provides a credit set off for the input tax.
- 2) The role of the Tax Auditor under VAT:** (a) Whether, the turnover of sales/purchases is shown correctly in the returns (b) Whether, deductions claim by the tax payer from the turnover of sales are genuine and are supported by valid documents (c) Whether claim of the input tax credit has been properly made.
- 3) Steps required in preparation of Tax Audit under VAT:** (a) Knowledge of the client's business (b) Knowledge about the VAT law and allied laws (c) Obtaining a list of accounting records maintained by the auditee (d) Ascertaining the major accounting policies adopted by the auditee (e) Evaluation of internal control etc
- 4) Following provisions of VAT Law need to be understood in detail:** (a) Credit for input/supplies (and its accounting) (b) Credit in case of capital goods (c) Credit for goods lying in stock at inception of VAT Scheme (d) Utilizing of VAT credit for set off (e) VAT on sales (f) Valuation of inventories/capital goods.
- 5) Approach to Tax Audit under VAT:** The audit approach of the tax auditor under the VAT system will be more

or less similar to the approach which is adopted by the auditor while conducting the tax audit u/s 44AB of the Income-tax Act, 1961.

Audit Report under the VAT law: The format of the audit report is generally prescribed under the relevant VAT law.

Tax Audit u/s 44AB of Income Tax Act

Applicability of Tax Audit u/s 44AB

Applicability of Tax Audit u/s 44AB: (a) Turnover > Rs 1 crore (Business) (b) Gross receipt >25 lacs (Profession) (c) Covered u/s 44AE, 44BB or 44BBB, & claims that his income to be lower than the presumptive income deemed under these sections.

- 2) Following to be deducted from sale price: Discount allowed in the sales invoice (b) Special rebate allowed if it is in the nature of trade discount (c) Turnover discount (d) cash discount if it is allowed in cash memo/sales invoice.
- 3) Sale returns whether related to CY or PY & sale proceeds of fixed assets/property would not form part of turnover.

Qualification/dis-qualification of Tax Auditor: Almost same as per Co. Act.

Important points related to Tax Audit

- 1) A CA or CA firm, who is appointed as tax consultant of the assessee, can conduct tax audit u/s 44AB.
- 2) A CA cannot be the auditor of more than 60 concerns. .
- 3) The audit of the head office and branch offices of the assessee shall be regarded as one tax audit assignment.
- 4) A CA should not accept the tax audit of a person to whom he is indebted for more than Rs. 10000/-. The limit of Rs. 10000/- shall be the aggregate amount in respect of the proprietor and/or the partner/s of the firm of CA.
- 5) Management can remove tax auditor where there are valid grounds for such removal such as delay in AR & no possibility of getting the AR uploaded before the specified date. But cannot be removed on the ground that he has given an adverse AR. If there is any unjustified removal of tax auditors, the Ethical Standards Board constituted by the Institute can intervene in such cases. No other CA should accept the audit assignment if the removal of his predecessor is not on valid grounds.

Accounting Standards and the Income Tax Act

- 1) Section 145 (1):** Income has to be computed in accordance with either cash or mercantile system of accounting, as regularly employed by the assessee.
- 2) Section 145(2):** CG has the power to issue certain AS to be followed by assessee. Accordingly, the CG has notified two AS that are called AS (IT). These are to be followed by all the assessee following the mercantile system of accounting, if cash system need not be follow. These notified AS (IT) are: (a) Disclosure of accounting policies (b) Disclosure of prior period and extraordinary items, and changes in the accounting policies. There is no material difference between AS (IT)-1 and AS(IT)-2 notified by the CG and the corresponding A-1 and AS-5 of the ICAI respectively.
- 3) Section 145(3):** AO has the powers to reject the books of accounts and may make an assessment in the manner provided in Section 144.” Assessment U/s 144 can be made in following circumstances:
- (a) Where the AO is not satisfied about the correctness or completeness of the accounts of the assessee.
 - (b) Where the methods of accounting has not been regularly followed by the assessee.
 - (c) Where the AS notified u/s 145(2) have not been regularly followed by the assessee.

Revision of Tax Audit Report

- 1) Generally cannot be revised later.
- 2) Tax Audit Report has to be revised if, the accounts of assessee are revised in the following circumstances:
 - a) Revision of accounts of a company after it adoption in the AGM.
 - b) Change in law with retrospective effect.
 - c) Change in interpretation of law (CBDT Circular, Notifications, and judgements etc.)
- 4) It is to be clearly state in the AR that, it is a revised report & specify the reason for such revision with a reference to the earlier report.

Format of Form 3CA, 3CB & 3CD (Refer Chapter)

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- 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.
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ISBN 935196433-7

