Sample Chapter

A COMPLETE GUIDE FOR
ADVANCED AUDITING
(CA FINAL)

Applicable for CA Final Nov., 2015 Exams onwards

Short Notes for Quick Revision

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CA Sumit Aggarwal

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(CA FINAL)

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A Complete Guide For

ADVANCED AUDITING

(CA FINAL)

- With solved Question Papers for Last 34 Exams
- With Short Notes for Quick Revision

By

C.A. SUMIT AGGARWAL

Foreword by

C.A. AMARJIT CHOPRA

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Dedicated to

All CA Students

&

My Family

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 to Second Edition

Firstly, I would like to thank the reader for the response given to first edition. It gives me immense pleasure in presenting the second edition of the book "A Complete Guide for Advanced Auditing – CA Final".

The distinctive features of the second edition are as follows:

- Addition of One New Chapter "CARO 2015".
- Updation of Chapter 24 with (1) Example of Audit Engagement Letter as per SA 210; (2) Illustrative Format of Auditor's Report under the Companies Act, 2013.
- Updation of Chapter 8 "Audit Committee and Corporate Governance (Clause 49 of Listing agreement)".
- Incorporation of May, 2015 Question Paper.

I am thankful to my students and colleagues for their valuable suggestions while presenting this second edition of the book.

I also grateful to ***"Spiraa Publishing Inc."*** for their efforts in publishing the second edition of 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 for view. In case of any suggestion, please feel free in writing to me at **cacma.sumit@gmail.com**.

I look forward the views and suggestions from the readers which would help towards further improvement of the book.

Wishing every success to the readers.

CA Sumit Kumar Aggarwal

Preface to First Edition

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

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

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

Salient Features:

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

- ◊ Clause wise & Schedule wise (Chapter – Professional Ethics)
- ◊ Clause wise (Chapter – Audit under Fiscal Law (Form 3CD)

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

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

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

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

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

Wishing every success to the readers.

CA Sumit Kumar Aggarwal

Syllabus

(Applicable for May 2015 Exams & Onwards)
[As per ICAI Notification dated May 20 2014]

Paper 3: Advanced Auditing and Professional Ethics

(One Paper - Three hours - 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

(a) To gain expert knowledge of current auditing practices and procedures and apply them in auditing engagements.

(b) To develop ability to solve cases relating to audit engagements.

Contents:

1. Auditing Standards, Statements and Guidance Notes

Auditing and Assurance Standards (AASs) ; Statements and Guidance Notes on Auditing issued by the ICAI; Significant differences between Auditing and Assurance Standards and International Standards on Auditing.

2. Audit strategy, planning and programming

Planning the flow of audit work; audit strategy, framing programme and importance of supervision: review of audit notes and working papers; drafting of reports; principal's ultimate responsibility; extent of delegation; control over quality of audit work; reliance on the work of other auditor, internal auditor or an expert.

3. Risk Assessment and Internal Control

Evaluation of internal control procedures; techniques including questionnaire, flowchart; internal audit and external audit, coordination between the two.

4. Audit under Computerized Information System (CIS) environment

Special aspects of CIS Audit Environment, need for review of internal control especially procedure controls and facility controls. Approach to audit in CIS Environment, use of computers for internal and management audit purposes: audit tools, test packs, computerized audit programmes; Special Aspects in Audit of E-Commerce Transaction.

5. Special audit techniques

(a) Selective verification; statistical sampling: Special audit procedures; physical verification of assets, direct confirmation of debtors and creditors

(b) Analytical review procedures

(c) Risk-based auditing.

6. Audit of limited companies

Relevant Provisions under the Companies Act, 2013 relating to Audit and Auditors and Rules made there under; Audit of branches joint audits; Dividends and divisible profits-financial, legal, and policy considerations.

7. Rights, duties, and liabilities of auditors; third party liability.

8. Audit reports; Qualifications, notes on accounts, distinction between notes and qualifications, detailed observations by the statutory auditor to the management vis-a-vis obligations of reporting to the members.

9. Audit Committee and Corporate Governance.

10. **Provisions under the Companies Act, 2013 in respect of Accounts of Companies and Rules made there under** : Audit of Consolidated Financial Statements, Audit Reports and Certificates for Special Purpose engagements; Certificates under the Payment of Bonus Act, import/ export control authorities, etc.; Specific services to non-audit clients; Certificate on Corporate Governance.

11. Special features of audit of banks, insurance companies, co-operative societies and Non banking financial companies.

12. Audit under Fiscal Laws, viz., Direct and Indirect Tax Laws.

13. Cost audit.

14. Special audit assignments like audit of bank borrowers, audit of stock and commodity exchange intermediaries and depositories; inspection of special entities like banks, financial institutions, mutual funds, stock brokers.

15. Special features in audit of public sector companies. Directions of Comptroller and Auditor General of India to statutory auditors Concepts of propriety and efficiency audit.

16. **Internal audit, management and operational audit :** Nature and purpose, organization, audit programme, behavioral problems; Internal Audit Standards issued by the ICAI; Specific areas of management and operational audit involving review of internal control, purchasing operations, manufacturing operations, selling and distribution, personnel policies, systems and procedures. Aspects relating to concurrent audit.

17. Investigation and Due Diligence.

18. Concept of peer review.

19. Salient features of Sarbanes - Oxley Act, 2002 with special reference to reporting on internal control.

20. **Professional Ethics**

Code of Ethics with special reference to the relevant provisions of The Chartered Accountants Act, 1949 and the Regulations there under.

Note:

(I) The provisions of the Companies Act, 1956 which are still in force would form part of the syllabus till the time their corresponding or new provisions of the Companies Act, 2013 are enforced.

(II) If new legislations are enacted in place of the existing legislations, the syllabus would include the corresponding provisions of such new legislations with effect from a date notified by the Institute.

CA (Final) May 2015 Examination

Paper 3: Advanced Auditing and Professional Ethics

Question No. 1 compulsory. Attempt any five questions from the remaining six questions.

No.		Questions	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 statetements of TC & Co. have been prepared by management of an entity in acordance with the financial reporting provisions of 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 AS
	(c)	Write short note on Corporate Responsibility under Sarbanes and Oxley Act.	**4**	Chapter # 4B: Refer Point # 1 of Chapter # 4B
3	**(a)**	KG & 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: 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 ofNPAs, 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.
4	**(a)**	R and M is an audit firm having partners CA R, CA M and CA S. 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 "Disqualifications of Auditors [Section 141(3)] of Chapter 7C.
	(b)	s 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)
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 unda 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 account 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 point # 5.5 (Other Elements to be covered in Audit Report [Sec.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 44AB 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 of Chapter 7A
7		Write short notes/comment on any four of the following:	**16**	
	(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 13
	(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 Section 143 (3) of Co. Act, 2013 of Chapter # 7

STUDY PLAN – KEY TO EFFECTIVE LEARNING

While studying the subject of Auditing, students should also draw their knowledge from the other subjects (Accounting, Management Accounting, Company Law, Taxation and Other subjects) and adopt an integrated approach for the purpose as this is the subject which involves application of theoretical knowledge of other subjects.

For the purpose of its full coverage student should segregate the syllabus of this paper into seven parts for preparation.

Part 1:
- Auditing & Assurance Standard
- Guidance Note
- Accounting Standard

Part 2:
- Audit Strategy, Planning And Programming
- Risk Assessment, Internal Control & The Sarbane -Oxley Act Of 2002
- Audit Under Computerised Information System (CIS) Environment
- Special Audit Techniques

While doing preparation for this part, student may interlink it with Auditing Standards, specially the series of SA 300 – 499 i.e. Risk Assessment and Response to Assessed Risks and series of SA 500 – 599 Audit Evidence.

Part 3:

In this part, student should cover chapter related to Company Audit. For better understanding of this chapter, student must have good knowledge of the Companies Act, 2013 which is pre-requisite.
- Company Accounts
- Schedule III Of Companies Act, 2013
- Company Auditors
- Audit of Dividends
- Audit Committee and Corporate Governance (Clause 49 Of Listing Agreement)
- Audit of Consolidated Financial Statements
- Cost Audit
- Audit Report

While doing study of Audit Reports, student may interlink this with series of SA 700-799 i.e. Audit Conclusion and Reporting, and Statement on Reporting under The Companies Act, 2013. Students are also required to practice the drafting of qualifications. Student may also scan through the Annual Financial Statements of Companies to analyse the notes and qualifications, if any, incorporated by the Auditors in their Audit Report.

Part 4:
- Audits of Banks
- Audit of General Insurance Companies
- Audit of Co-operative Societies
- Audit of Non Banking Financial Companies

Part 5:

In part five, student should include following miscellaneous chapter namely:
- Audit Under Fiscal Laws (Tax Audit & Vat Audit)
- Audit of Public Sector Undertaking
- Special Audit Assignments
  - ◊ Audit of Member Of Stock Exchanges

- ◊ Audit of Mutual Funds
- ◊ Audit of Depositories
- ◊ Environmental Auditing
- ◊ Energy Audit
- ◊ Audit of Accounts of Non Corporate Entities (Bank Borrowers)

For the preparation of part five, deep knowledge of statutory requirements is a pre-requisite for validation of adherence to the business with applicable laws. For this student should follow a check-list approach ensuring completeness of compliance validations. Further, student should update yourself with latest notification, circulars etc. Student may also interlink the above part with guidance notes already covered in part one.

Part 6:

In part six, student should cover following chapters namely:

- Internal Audit, Management & Operational Audit
- Investigation and Due Diligence
- Liabilities of Auditor
- Peer Review

Part 7:

in the seventh part student may prepare ***Professional Ethics.*** Generally it has been observed that there is one question i.e. case studies based question of 16 marks in the examination paper.

General Approach to Preparation:

- As in all other subjects of CA course, to excel in Audit, proper preparation and planning is very much important to avoid failure. Further Audit is a paper which requires a practical approach towards actual Audit work.
- Student should in the first instance focus on studying Auditing concepts, procedures and techniques (Part 1 & Part 2). The knowledge being so derived may be related by the students to the practical work in the field of Auditing which they do as part of their Articles training.
- Students are advised not to count the total number of pages before preparing for the paper/chapter.
- While reading the chapters, student should try to highlight the important lines or make appropriate headings and sub-headings. It will help you a lot in the last few days of the exams to have a quick view.
- After reading each chapter student should try to solve the case studies. While answering the case study based question, answer should be split in to two parts, first one is facts of the case and second one is the relevant concept and finally give your own conclusion. In this manner, the case study and application oriented theory questions can be answered.
- It is also advisable to mention applicable Engagement Quality Control Standards or Accounting Standards or Sections in audit paper wherever required. Answers should be crisp, precise and to the point to secure good marks.
- Student should also practice well the latest case laws and amendments. Do not add anything new near the exams.
- Audit is a subject which requires a lot of quick and logical application of mind to answer practical problems. Finally student should not forget to revise as revision is also very important to crack the examination.
- My personal view is that while studying audit paper student should consider yourself as an auditor and analyze and comment on the situation as an auditor. Be practical and think like a CA.

Some other important Points:

Exam strategy: At the time of taking exam student should try to attempt all the questions and start attempting the easy and short questions first and then devote time to the tough questions. Do not answer the questions in essay type presentation make precise points headings and sub-headings while writing the exam.

Preparation and Application of SA and AS in Audit: Special attention to SA and AS is required to be given. Along with good knowledge of SA and AS the technique to apply SA and AS in audit practical problems should also be clear to you all. It is also advisable to mention SA in audit paper wherever required just like sections. For example if some where going concern word is used in the context of Audit, you may mention the relevant SA/AS no. where "going concern" is defined and explain the same if you have time.

Answering Practical Questions: Practical questions play an important role in audit paper. These Practical questions mostly based on Accounting Standards and Standard of Auditing. Always remember good command over Accounting standards and Standard of Auditing and its application to practical questions are the real key to score in audit. Further Accounting Standards are also mandatory to prepare for Financial Reporting paper or Accounting paper. So give special attention to AS.

Timely revision: Another basic study point is to give ample emphasis to a good revision plan. There is nothing is this world which can substitute a good revision plan. To succeed revision is must. It is important to have good materials (notes) for last minutes revisions to secure maximum marks. Short notes have been given at the end of this book.

Good presentation of theory: Lack of good presentation especially in theory paper is one of the major drawbacks for most of the students. In theory subjects good presentation of theory is must along with mentioning case laws and sections etc. So I'd request you all to take note of the same.

Some Important Topics for Exams

- Standard of Auditing & Guidance Notes
- Accounting Standards
- Company Audit
- Audit Report
- Professional Ethics
- Peer Review

Happy Reading and Best Wishes!

How to prepare for Theory Subjects

Time may change, technology may change, methodology of teaching and training and many other aspects of CA curriculum may change but as far as human brain is concerned, it follows some basic fundamental principles for remembering and recalling the things that has been learnt by an individual. As per my observations, I noticed some terrible mistakes that are being done by many students which I feel should be avoided.

The basic mistake I observed in those students who have the habit of not revising and not trying to recapitulate the things that they have just learnt. For example, you study Audit for the full day and will feed your brain the whole day about Audit. Now, you need to analyse how much you are able to recollect, isn't it? Or else what is the use of reading for 12 hours if you are not able to recall even the simplest of the things being read by you.

I want to give a simple example here, if you are using computer regularly, you will easily correlate this example with what I want to convey about human brain. Take an example where you are working on a file lets say this file 'Study Plan – Key to Effective Learning' and you saved it on some folder in your computer. Let's say C:\Users\Administrator\Dropbox\ Study Plan – Key to Effective Learning. Now you want to access that file and refer to this file, let's say after 3-4 months. In this case, it might be possible that you may have forgotten where you have kept this particular file unless you have accessed the file for at least 2-3 times. When you access it often, it becomes well printed in your brain where you have kept this file.

Similar to above example, our brain is also such that it can stores whatever you want to store in it; however, the retrieval power differs from person to person. The timely retrieval of information and knowledge depends on how much recalling practice you have. I was reading somewhere about human brain capacity of storage. The article revealed that human brain can store videos of around 300 years. Now, imagine what the sizes of our CA books are as compared to capacity we have got. You will wonder that human brain may be capable to even store all the existing books on this earth, you never know.

Now, the crux of the matter I want to convey you is that retrievability power. Retrievability power is our capacity to recall the stored data and knowledge as per our wish, on the day and time we want it.

Now let us analyse what our brain does when we are writing our exams? Our brain encounters a question and the answer is based on the vast amount of knowledge stored in our brain. Just like Google/Yahoo, our brain starts searching for the answer from the existing database and information bank inside itself. The more practice we have for recalling, the easier it becomes to reproduce it when required. Just stuffing the books in the storage (brain) does not help.

I want readers to do to practice retrieval of data and information from brain. I want them to practice those things which actually matters in exams, the things that they actually do in exams. It will be much beneficial for you if you practice what you are really going to do in exams. For theory subjects, what you are going to do in exams is to face a question and retrieve relevant section or text/point from your brain in order to present your answer. It requires practice to do this in smooth manner. Retrieval practice is most important part of your preparation. Just evaluate, how much time you are dedicating for recalling and how much time you are spending in dumping the data and information in your brain. Make your own choice and chose your own results.

To put it in a summary, you are going to retrieve your knowledge based on the questions you face in exams. So, how can you imagine doing it directly in examination hall without practicing the same, without trying to get hang of the recall process and recall practice.

Below mentioned are some simple steps which everyone should follow in order to remember more and more. (What I mean by remembering is the power of retrievability and the power to recall the things when required).

Step 1: Read and Recall every hour: Take any theory subject you want to prepare, read it for an hour or so and then ask yourself what you can recall from last one hour reading. Initially it will take more time to recall but as you practice this method, it will become easier. So, don't worry and keep trying. No effort goes waste; every try of recollecting makes your brain stronger with each passing moment.

Note: Please note that those people who doesn't have any practice of this method will find it frustrating because they have never asked themselves these questions about how much they can recall. I personally have felt this frustration because I couldn't recall even the smallest of the matter in the beginning, but gradually, it became very easy with each passing day. If there is a will, there is a way. So keep trying and trying.

Step 2: Note down important points in your own words: Try to jot down these points on a page in your own words. This practice is required because what we do in exam is to write something in our own language and express. This practice will be very very useful for effective writing in exams. It's also required for efficient brain and hand synchronization while writing. Our brain can think much faster than our writing speed, so we tend to skip a word or sentences while writing. You may have experienced this while re-reading your own answers. I am sure all must have experienced this some time in their student life.

Note: Please note that jotting down points after each hour may not be feasible because of time constraints, hence, points should be noted only when you come across some important parts of your chapter or after the full reading of each chapter.

Step 3: Repeat the process of Recalling and its importance: Every hour or after two hours, repeat the process of recalling. This will make your brain super active while reading. The neurons and cells of your brain that are employed for recalling process become more and more efficient with each passing hour(s) and with each additional practice. If you keep on asking your brain what it has remembered, it will certainly understand that whatever being read is important and it will apply all its possible energy in storing and retrieving.

Table Showing Importance of Chapter on the Basis of Marks Allotment in Past Examinations

No.	Chapter	N10	M11	N11	M12	N12	M13	N13	M14	N14	M15	Total	Avg.
1	Auditing & Assurance Standard and Guidence Note	17	32	11	32	29	20	27	19	50	24	**269**	**26.9**
2	Accounting Standards	20	4	16	5	5	15	14	5	9	6	**99**	**9.9**
3	Audit Strategy, Planning and Programming	0	8	8	0	0	0	0	0	0	6	**22**	**2.2**
4	Risk Assessment, Internal Control & The Sarbane -Oxley Act Of 2002	5	0	9	0	0	8	4	[illegible]	4	10	**44**	**4.4**
5	Audit under Computerised Information System (CIS) Enviroment	8	4	5	6	8	4	[illegible]	4	4	0	**47**	**4.7**
6	Company Audit	12	16	13	8	24	16	[illegible]	18	8	20	**138**	**13.8**
7	Audit Committee and Corporate Governance	0	0	0	4	0	0	8	4	0	0	**16**	**1.6**
8	Audit of Consolidated Financial Statements	0	0	0	0	4	4	9	6	0	6	**29**	**2.9**
9	Cost Audit	4	0	0	4	0	0	4	0	4	0	**16**	**1.6**
10	Audits of Banks	4	8	5	10		8	4	10	0	4	**53**	**5.3**
11	Audit of General Insurance Companies	4	4	4	4	0	5	4	6	6	4	**41**	**4.1**
12	Audit of Co-Operative Societies	6	4	0	0	0	4	4	0	4	0	**22**	**2.2**
13	Audit of Non Banking Financial Companies (NBFC)	0	[illegible]	0	0	6	0	0	4	0	4	**14**	**1.4**
14	Audit under Fiscal Laws (Tax Audit & Vat Audit)	5	4	15	6	4	4	4	0	4	4	**50**	**5.0**
15	Audit of Public Sector Undertaking	0	4	4	0	8	0	0	6	0	0	**22**	**2.2**
16	Special Audit Assignments	4	4	9	8	8	4	4	0	4	0	**45**	**4.5**
17	Internal Audit, Management & Operational Audit	10	4	0	4	0	4	4	3	0	4	**33**	**3.3**
18	Investigation and Due Diligence	5	4	0	8	8	4	4	4	0	4	**41**	**4.1**
19	Liabilities of Auditor	0	0	0	0	0	0	4	4	0	0	**8**	**8.0**
20	Peer Review	0	0	4	4	0	4	4	3	0	4	**23**	**2.3**
21	Professional Ethics	16	16	16	16	16	16	16	16	23	20	**164**	**16.4**

Contents at a Glance

List of Abbreviations

A/c	Accounts	GTD	Good till Days/Date Order
AAS	Auditing & Assurance Standard	HC	Historical Cost
AFS	Audited Financial Statement	I.Act	Insurance Act
AGM	Annual General Meeting	IC	Insurance Company
AO	Assessing Officer	IFI	Interim Financial Information
AOA	Article of Association	IOC	Immediate or Cancel Order
AON	All or None order	IR	Inherent Risk
AOP	Association of Person	IT	Income Tax
AP	Accounting Principle	LLP	Limited Lialibility Partnership
AR	Audit Report	MD	Managing Director
ARP	Analytical Review Procedures	MF	Minimum fill order
AS	Accounting Standard	MOA	Memorandum of Association
B&P	Business & Profession	MR	Management Representation
BS	Balance Sheet	MRL	Management Representation Letter
BM	Board Meeting	MSCOS	Multi State Cooperative Societies Act
BOD	Board of Directors	MWCB	Market Wide Circuit Breakers
BOLT	BSE on Line Trading System	NA	Not Applicable
BSE	Bombay Stock Exchange	NEAT	National Exch. for Automated Trading system
C&AG	Comptroller and Auditor General of India	NFRA	National Financial Reporting Authority
CAAT	Computer Assisted Audit Technique	NI	Necessary Information
CEO	Chief Executive Officer	NSE	National Stock Exchange
CF	Circuit Filters	NTE	Nature, Timing & Extent
CFO	Chief Financial Officer	OLRT	On Line Real Time
CFS	Consolidate Financial Statement	OM	Other Matter Paragraph
CG	Central Government	OP	Outstanding Premium
CIS	Computer Information System	OPC	One Person Company
CLB	Company Law Board	OR	Ordinary Resolution
CN	Contract Notes	OS	Other Source
Co	Company	PM	Practice Manual
COP	Certificate of Practice	PR	Peer Review
CoR	Certificate of Registration	PRB	Peer Review Board
CR	Control Risk	PU	Practice Unit
CSR	Corporate Social Responsibility	PY	Previous Year
CY	Current Year	QC	Qualitiy Control
DQ	Disclosed Quantity Order	R&P	Receipts & Payments
DR	Detection Risk	ROC	Reigstrar of Companies
DRR	Debenture Redemption Reserve	RSS	Rolling Settlement System
DTA	Deferred Tax Assets	SFS	Summary Financial Statement
DTL	Deferred Tax Liabilities	SG	State Government
EOM	Emphasis of Matter Paragraph	SLM	Straight Line Method
FV	Fair Value	SM	Solvancy Margin
FA	Fixed Assets	SOA	Statement of Accounts
FRF	Financial Reporting Framework	SPF	Special Purpose Framwork
FRS	Financial Reporting Standard	SR	Special Resolution
FS	Financial Statements	STT	Security Transaction Tax
FY	Financial Year	TB	Trial Balance
GC	Government Company	TCWG	Those Charged with Governance
GIC	General Insurance Companies	WDV	Written Down Value
GM	General Meeting	w.e.f.	With Effect from
GMCS	General Management & Communication Skills	WR	Written Representation
GOI	Government of India	w.r.t.	With Respect to
GTC	Good till Cancelled Order	WTD	Whole time Director

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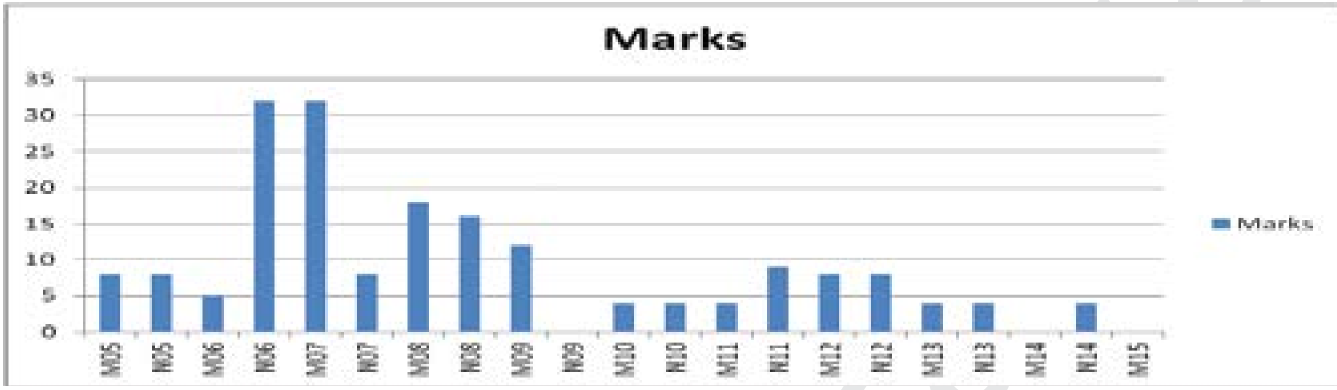
18 SPECIAL AUDIT ASSIGNMENTS



18A AUDIT OF MEMBER OF STOCK EXCHANGES

1. **Introduction:** Business at a stock exchange can only be transacted by a member of the stock exchange. A member of NSE cannot transact business at BSE unless he is a member of BSE also. The members of stock exchanges are also called stock or share brokers. The members enter into transactions either on their own behalf or on account of their clients, including sub-brokers. There are several ways of placing an order with a member. It could be either directly or indirectly through a sub-broker. Each stock exchange has its own SEBI approved rules and regulations regarding the admission of members.

2. **Trading on BSE /NSE:** Online Trading System used for trading on NSE is called NEAT System i.e. National Exchange for Automated Trading system & on BSE, it is called BOLT system i.e. BSE on line trading System.

3. **Types of Market under NEAT (NSE) [N06]:**
   - **Normal Market:** All orders which are of the regular lot size or multiple thereof are traded in Normal Market.
   - **Odd Lot Market:** An order is called, an odd lot order if the order size is less than regular lot size, such orders have different settlement periods v/s normal orders.
   - **Spot Market:** Spot orders are similar to the normal market orders except that spot orders have different settlement period vis-à-vis normal orders.
   - **Auction Market:** Stock exchange on behalf of their trading members initiates auctions for completing the settlement process. In this auction session, offers are invited from the other members to deliver the shares sold by originally selling member, since delivery has to be made to the buying member. In case no shares are received in auction, the sale transaction is closed-out at a close-out price, determined by higher of the following:
     - ◊ Highest price recorded in the scrip from the settlement in which the transaction took place up to a day prior to the auction.

       OR
     - ◊ 20% above the closing price on a day prior to the auction.

     In this case, the auction price/close-out price and difference between sale price, if positive is payable by the seller who failed to deliver the scripts. In case, auction /close out price is less than sale price, the difference is not given to the seller but is credited to Investor Protection Fund.

4. **Types of Transaction:**
   - **Intra Days Trading:** Generally called speculative transaction. In this case transaction is squared off every day & lot size is one share.
   - **Delivery Based Transaction:** If transaction is not squared off during the days, because he has purchased

the share & not able to sale in the same day, then clients are bound to take delivery of these shares. In case trader has made short sale & not able to square off this transaction on the same day, then trader has to provide delivery of these share. If he don't have these share, then he has to buy these securities in auction market through stock exchange to square off this transaction.

- **Future/option Transaction:** Where trader buy/sell securities at spot date at pre-specified price of future date. Lot size is generally 100/500/1000 share, varies from securities to securities & determined by stock exchange time to time. Every day loss/profit is work out based on closing price of trading day. If there is loss, margin is to be deposited, called mark to market margin. Finally transaction will be square off at pre-specified future date.

5. **Type of Margin [N98 M99 M05 M10 M11 M12 M13]:** Due to wide fluctuation in prices of securities over a period of time, the exchange levies margin on its members. This certain deposits are to be kept with exchange by its members. This mechanism is adopted in order to restrict excessive speculations and safeguard the interest of the investors. Members are required to collect margins from their clients and deposit it with the clearing house of exchange. There are three types of margins which are as follows:

- **Volatility Margin:** The volatility margin is levied to curb excessive volatility in the securities. It is also used to prevent building up of excessive outstanding positions. It is levied on the net outstanding positions of the member, in each security, based on the respective margin rates.

  Computation Price variations on account of calls, bonuses, rights, mergers, amalgamations and schemes of arrangements are adjusted for determining volatile securities and adjustments in prices is made for the purpose of computation of volatility, when securities are traded ex-benefits.

  Application Securities that attract volatility margin and the applicable margin rates are announced on the last day of the trading cycle and are applicable from the first day of the succeeding trading cycle.
- **Mark to Market Margin (MTM):** It is the notional loss, which a member or his client would incur, if the net cumulative outstanding positions in all securities were closed out at the closing price of the relevant trading day, which is different from the price at which the transaction had been entered into. For each security, it is worked out by multiplying the difference between the closing price and the price at which the trade was executed by the cumulative buy and sell open position. The aggregate amount computed across all securities is MTM margin payable by a member. The mark-to-market margin is payable with reference to net position at client's level.
- **Gross Exposure Margin:** It is the percentage of net cumulative outstanding position (purchase and sales) that the member is required to keep with the exchange at all times. This margin is calculated on continue basis & to be keep with stock exchange in advance. Gross exposure is calculated on all securities while volatility margin is calculated on any specific security.
- **Special Margin:** where price manipulation is suspected.
- **Adhoc Margin:** where it is felt that the margin cover vis-à-vis the exposure of the member is inadequate or a member has a concentrated position in some securities or has common clients along with other members

6. **Order Matching Rules:** As & when orders are received by the system, they are first numbered; time stamped and then scans for a potential match. In stock market, the best buy order at any point of time is matched with best sell order at that time. Trading system try to find for the seller the best possible buying price and the best possible selling price for the buyer. Order that match with the other orders are called 'active' order while those, which do not match, are called 'passive' order. If a match is not found, then the orders are stored in the books as per price/time priority. Price priority means that if two orders are entered into the system, the order having the best price gets the higher priority. Time priority means if two orders having the same price are entered, the order that is entered first gets the higher priority.

7. **Order Conditions [M99 M02]:**

7.1 Time Related Conditions:

- **Day Order:** is valid only for the day on which it is entered. It gets automatically cancelled if not matched by the end of the day.
- **Good Till Cancelled Order (GTC):** remain in the system until it is cancelled by the trading member. The maximum no of days for which a GTC is valid is notified by the concerned stock exchange

- **Good till Days/Date Order (GTD):** In such order the trading member specifies the days/date, up to which the order shall remain valid.
- **Immediate or Cancel Order (IOC) / Hit or Take Orders:** IOC allows a member to buy or sell a security as soon as the order is released in to the system. If it not matched at the same moment, it gets cancelled immediately. If it is partially matched, remaining quantity is automatically cancelled.

7.2 Price Related Conditions:

- **Limit Price Order:** where the trader specifies his offer price is called a limit price order.
- **Market Price Order:** An order to buy and sell securities at the best market price at the time of placing the order.
- **Stop Loss Price Order:** Stop loss price orders get activated when the market price reaches or crosses a threshold price specified in the order.

7.3 Quantity Related Conditions:

- **Disclosed Quantity Order (DQ):** A DQ order allows a trading member to disclose only part of the quantities to be disclosed. For example in a buy order for 500 units only 50 units (10%) will be disclosed. When these are purchased, the buy order for the next 100 units are disclosed
- **Minimum Fill Order (MF):** allow the members to specify the minimum quantities by which an order should be filled
- **All or None Order: (AON):** allow member to impose a condition that either the entire order should be matched or the order should not be executed.

8. Order Book: As and when orders are received by the system, they are first numbered, time stamped and then scanned for a potential match. If match is not found, then the orders are stored in the different books as per price/time priority. Thus, for order matching, top priority is given to the price. If many orders are entered at the same price, then priority is given to the order which was entered earlier.

9. Types of Order Books:

- **Regular Lot Book:** contains only regular lot orders
- **Stop-loss Book:** Stop loss orders are stored in this book till the trigger price is reached or surpassed. When the trigger price is reached or surpassed, the order is released in the regular lot book. A sell order in a stop loss book gets triggered when the last traded prices in the normal market reaches or fall below the trigger price of the order, while buy order triggered when price reaches or exceeds the trigger price of the order.
- **Auction Book:** contains orders that are entered for all auction sales.
- **Spot Book:** All order of Spot market is stored in this book.
- **Odd Lot Book:** contains all orders with lot size lesser than the marketable lot.

10. Settlement System at Stock Exchange: All over the world there are two types of system in stock exchanges:

10.1 Accounting Period System: Now it is not operational in India

10.2 Rolling Settlement System [RSS] [M00 M04 M08]: is one in which trades outstanding at the end of the day have to be settled (i.e. Payment/delivery to be made in case of purchase/sale of securities) within "X" business days from the transaction date. At present T+2 RSS applicable. In T+2 RSS, trade outstanding at end of the day is to be settled within 2 business day from transaction date. For Example, in T+2, if transactions are entered into on Monday, their pay in and payout take place on Wednesday. Trades on each single day settled separately from trades done earlier or subsequent trade days.

Netting of trades is done only for the day and not for multiple days. It adopt VAR (Value at Risk) based margining approach. If member fails to deliver shares sold, the exchange conducts an auction session on T+2 to meet the short fall due for non-delivery of shares.

11. Circuit Filters [CF] [N07 N08 N10 N12] : CF are imposed Individual Securities-wise.CF are the price bands that set the upper and lower limit within which, a stock can fluctuate on any day. SEBI has directed the exchanges to apply CF on security traded in Rolling Settlement if price fluctuates more than 20% of the closing price of security on the previous day in any direction. This CF may be 2/5/10 or 20% based upon category of share. It is calculated with respect to closing price of previous trading day. Example: if closing price of share is Rs 10, the price band in case of 20% CF is Rs 8/- (lower freeze) and Rs. 12/- (upper freeze) on next trading day. Thus CF restricts extreme price movement and resists price manipulation.

12. Market Wide Circuit Breakers (MWCB) [N14]: Market wide circuit breakers do the same job for the entire market what circuit filters do for individual security. MWCB has been introduced to control excessive market movements in BSE Sensex and Nifty. MWCB are imposed market wide. It is imposed on three stages of index movement i.e. 10%, 15% and 20%. These breakers provide the time to participants to reacts to the movement by way of the trading halt.

Time of Movement	**Duration of Trading halt**	
	Movement in Index is 10%	**Movement in Index is 15 %**
Before 1 P.M.	1 hour	2 hours
After 1 P.M. but before 2.30 P.M.	1/2 hour	1 hour
On or after 2.30 P.M.	No Trading halt	For entire remaining period of the day
If Movement in the Index is 20% the trading shall halt for remaining period of the day.		

These percentages are not calculated on day to day basis rather they are fixed for a quarter. These are fixed in absolute points of index variation on the basis of the closing of index on the last trading day of previous quarter and are reported in advance to the market participants at the beginning of the relevant quarter.

13. Short Sell: The seller sells the shares even if he doesn't own them. These are speculative order. In this case, the trader anticipates a decline in the price of shares. However, it is risky as he has to square off the transaction in same day, if he is not able to square off, then trader has to provide delivery of these shares. If he doesn't have share, then he has to buy these securities in auction market through stock exchange to square off this transaction.

14. Depositories in India: Depository is an organisation where securities of a shareholder are held in the form of electronic accounts, in the same way as bank holds money. The depository holds electronic custody of securities and also arranges for transfer of ownership of securities on settlement dates. A depository can't act as depository unless it obtains a certificate of commencement of business from SEBI.

In India National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL) are two depositories & they providing depository services to investors and clearing member through Depository Participants. They do not charge the investors clearing member directly but charge their DPs, who are free to have their own charge structure for their clients.

14.1. Depositories and Dematerialization: NSDL and CDSL keep record of ownership of securities electronically in book entry form. T/F of ownership of securities is done by simple a/c transfer. Advantage of dematerialization are given below:

- Liquidity of scripts (immediate t/f and register)
- Receive bonus and right as direct credit t A/c
- Much lower risk of bad deliveries
- Saving of Stamp duty
- Saving of courier charges
- No physical certificates (no risk of getting them misplaced)
- Reduction in brokerage

14.2. De-mat A/c: Every member has to maintain two De-mat A/c. One De-mat account is used to hold its own securities, known as "Beneficiary A/c". The other one is meant for trades executed on behalf of clients, known as 'Pool A/c'. The securities to be sold are transferred to the Pool account from where these are transferred to clearing house on the relevant pay in day. The Securities received in pool a/c must have been transferred to client's De-mat A/c within 48 hours. There should be valid reasons with authorization from client for holding a particular security in pool a/c for longer period. Securities lying in a pool account must have not been used to settle member's own trade obligations.

15. Clearing and Settlement Mechanism: When a trade has been executed, the shares and money should be transferred to the respective parties on settlement date. When an investor enters into a transaction with a broker, shares or funds, as the case may be, are delivered to the broker. In turn, the broker delivers these on settlement day to the settlement agent.

15.1 Settlement of Securities:

- Settlement of Securities is done through clearing house.
- Securities pay-in obligations of members are down-loaded by the clearing agency from online System.
- The members make available the required securities in their pool accounts with Depository participants by the prescribed pay-in time for securities.
- The depository runs an electronic file to transfer the securities from the member pool account maintain with DP to the DP account of the clearing agency.
- Same way, the securities are transfer on the pay-out day by the depository from the DP account of the clearing agency to the DP account of members.

15.2 Settlement of Funds:

- Select banks have been empanelled by clearing agency for electronic transfer of funds.
- Members are required to maintain a/c with any of these banks.
- The members are informed electronically of their pay-in obligation of funds.
- The members make available required funds in their a/c with clearing banks by prescribed pay-in day.
- The clearing agency forward funds obligation file to clearing bank which, in turn, debit the member's a/c with clearing banks and credit it own a/c.
- Same ways, the funds are transfer on the pay-out day by the clearing banks from the a/c of the clearing agency to the a/c of members.

16. Maintance of Accounts by Member of Stock Exchange: The members of the Exchange are required to maintain the books of accounts and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992. These books of accounts includes the following:

- Clients Ledger & General Ledger, Journal
- Cash Book Bank Pass Book
- Sauda Book, Members contract books
- Duplicate of contract notes issued to clients
- Written consent of clients for contracts entered into as principals
- Document register, Margin deposit book
- Copies of agreements with sub-brokers, accounts of sub-brokers
- If A member holding membership of many stock exchanges or different segments of same exchange (derivatives/capital market segment), then he has to maintain separate records and documents with respect to each exchange or each segment.

17. Audit of Accounts: in exercise of the powers vested in the Central Government under Rule 12 of the Securities Contracts (Regulation) Rules, 1957, all active member of stock exchanges are required to be audited theirs accounts by chartered accountants in practice. Any member who has conduced business in stock exchange ever for a single day in the year, will be called active member. Subsequent to the corporatisation of the Members of Stock Exchanges, statutory audit is now required under the Companies Act, 1956 (Now 2013).

18. Considerations by Auditor w.r.t. some important books/accounts:

18.1 Sauda Book/Daily Transaction List [N04]: It is the basic record maintained by all the member of Stock Exchange. It contains detail of all transactions entered by them on daily basis. It contains information on Securities traded; Rate of Securities bought and sold, Quantity of securities bought and sold, time of transaction, number of transaction, name of the clients etc. It contains detail of transaction entered by the member's for

- own business on the exchange
- on behalf of his clients
- business with his clients on a principal to principal basis
- business with the members of other stock exchange
- business on behalf of his clients with the member of other stock exchanges
- Spot transaction

18.2 Contract Notes (CN) [N03 N05 M07 N11]: CN is a document through which a contractual obligation is established between a member and a client. It is issued by each member to their clients for transaction done during the day. While issuing CN, following should be ensured:

- It should be pre-printed and issued within 24 hours of the execution of transactions. It should bear SEBI Reg. No. of member and PAN of Clients if required.
- CN are serially numbered.
- Should be in the format prescribed by the relevant exchange.
- Brokerage, Service Tax and Security transaction Tax shown separately and brokerage should be within specified limits prescribed by the exchange.
- Appropriate stamps should be affixed on the contract note. Duplicate copies of CN are being maintained by the members.
- Ordering time is reflected on CN along with the time of execution of order.
- It should be signed by the member/authorized signatory.
- All clauses specified by the Exchange have been printed on the reverse of the contract notes.
- Consent of the client should be taken for any trade done by the broker while acting as a principal.

The auditor should:

- Evaluate the internal control procedures instituted by the stock broker for proper Maintance and issuance of contract notes.
- Verify that all the transaction done by a member are recorded in the sauda book.
- Contract notes are issued for all the business conduct on behalf of the clients.
- Also cross verify the trades executed with the bills raised.

18.3 Margin Deposit Book: It record the margin deposited by the member with the clearing house of the relevant stock exchange. The Auditor should:-

- Check, whether margin has been in accordance with SEBI guidelines or Stock Exchange
- Cross Check, that it is as per the margin statement downloaded from the stock exchange
- Check, whether margins have been properly calculated, collected from clients and paid to the clearing house
- Check, any exemption from deposit of margin has been correctly checked and claimed.

19. Security Transaction Tax (STT) [M08]: In the union budget for 2004-05, the govt. has introduced STT to be levied on all transactions done on stock exchanges. As per the provision of the Finance Bill, the stock exchanges have entrusted with the responsibility of levy, collection and remittance of the STT on all transactions from the date of notification by the govt. of India.

SEBI vide its circular no. MRD/DOP/Cir-28/2004 dated 23/08/04 directed that no stock exchange shall permit trading activities unless it implements necessary software and procedures for the levy, collection and remittance of STT.

20. Disclosure of Proprietary Trading by Broker to Client: With a view to increase the transparency in the dealings between the broker and the client, SEBI has directed that every broker shall disclose to his client, whether he does client based business or proprietary (personal) trading as well. The broker shall disclose this info to his existing clients with in a period of one month from the date of this circular. Member will also disclose this info to new clients while into the KYC Agreement. If Member at present does not trade on proprietary a/c but in future, want to do so, then he shall be required to disclose this info to his clients before caring out any proprietary trading.

21. Bought out Deals [N99]: Company may place its equity intended to be offered to the public with a sponsor member at a mutually agreed price through the concept of Bought out Deal. Thus after buying out the total equity, sponsor member would sell all the shares of the company to the public through “offer for sale”. It ensures faster availability of funds to the company for timely completion of its projects and also a listed status on a later date.

Sponsor member can be authorised members of Over the Counter Exchange of India (OTCEI) or merchant banker. They acquire shares in the “bought out arrangement” and make them free of issues responsibilities, thus sponsors act as an important intermediary in mobalisation of savings.

22. Securities and Exchange Board of India [SEBI]: SEBI’s main function is to regulate the business in securities market. SEBI, for the purposes of regulation of securities market, can issue directions to stock exchange, companies, stock brokers or to any other person. SEBI Act 1992 empowers SEBI to levy monetary fines and penalties on any person incurring a default under the Act in the following cases:

- Failure to furnish information as required by SEBI
- Failure to maintain books of accounts/returns
- Failure to issue contract notes, delivery of securities, payment to clients or charging excess brokerage
- Failure to enter agreement with clients
- Failure to disclose aggregate of shareholding in body corporate before acquiring further share and to make public announcement to acquire share at minimum price in case of takeovers
- Any person dealing, communicating, counseling on the basis of some price sensitive information
- Failure by a person sponsoring or carrying on any collective investment scheme, including mutual funds, without obtaining certificate of registration (COR), failure to comply with the terms and conditions of COR, failure to dispatch unit certificates, failure to refund application money within the period specified, failure to invest collected money in the manner and within the period specified.
- SEBI has also power to suspend or cancel the COR of a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary, who may be associated with securities market.

23. Auditor's Report: The auditor's report shall report on the following:

- Whether all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit have been obtained.
- Whether, In our opinion, proper books of account and records as specified in Rule 15 of the Securities Contracts (Regulation) Rules, 1957 have been kept so far as appears from our examination of such books.
- Whether, the stock broker has complied with the requirements of the stock exchange so far as they relate to maintenance of accounts and was regular in submitting the required accounting information to the stock exchange.
- Whether, the balance sheet and the profit and loss account referred to in this report are in agreement with the books of account.
- Whether, in our opinion and to the best of our information and according to the explanations given to us, the said balance sheet and the profit and loss account read together with the notes thereon give a true and fair view insofar as it relates to the balance sheet, of the state of affairs of M/s. ABC, and insofar as it relates to profit and loss account, of the profit of M/s. ABC for the year ended on that date."

The audit should be completed within 6 months of the date of closing of the books of account. In individual cases, an extension for a period not exceeding 3 months may be granted by the concerned Executive Director / Secretary of the Stock Exchange if he is satisfied that adequate reasons exist for granting such an extension.

It may be noted that in cases where the member is a company registered under the Companies Act, 1956 the reporting consideration that apply to other companies shall also apply to the member company. For example the audit would have to necessarily make the assertions given in sub-section (2) and (3) of section 227 of the Companies Act, 1956.

24. Internal Audit for Stock Brokers/Trading Members/Clearing Members: SEBI vide its Circular dated 21.10.2008, has now been decided that stock brokers/trading members/clearing members shall carry out complete internal audit on a half yearly basis by chartered accountants, company secretaries or cost and management accountants who are in practice and who do not have any conflict of interest.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Types of market under NEAT (National Exchange Automated Trading)".	N06 PM	4	3
2	Write short notes on "Mark to Market Margins (MTM)".	M10,M12 PM	4	5
3	Write short notes on "Volatility Margin, its computation and its application".	M13 PM	4	5
4	Write short notes on "Volatility Margin".	M11 PM	4	5

5	Write short notes on "Margin" or Deposits with Stock Exchanges".	N98,M05 PM	4	5
6	Write short notes on "Limit Orders" in screen based trading in Stock Exchange".	M99	4	7
7	Write short notes on "Hit or take orders".	M02	4	
8	Write short notes on "Rolling Settlements".	M00 M04 PM	4	10.2
9	In the context of Audit of members of Stock Exchanges, explain what is Rolling Settlement?	M08	5	
10	Write short notes on "Circuit filters/Circuit breakers".	N07, N08 N10, N12 PM	4	11
11	Write short notes on "Maket Wide Circuit Breakers". [MWCB]	N14	4	12
12	Write short notes on "Sauda book".	N04 PM	4	18.1
13	Write short notes on "Contract notes in case of audit of member of Stock Exchange".	N03,N05, N11 PM	4	18.2
14	State the items contained in the SEBI's check list for auditors in respect of contract notes issued by a Stock Broker.	M07 PM	8	
15	Write short notes on "Securities Transaction Tax".	M08	4	19
16	Write short notes on "Bought out deal".	N99	4	21

18B AUDIT OF DEPOSITORIES

1. **Audit of Depositories:** The SEBI (Depositories and Participants) Regulations, 1996 empower SEBI to conduct inspection and audit. The regulation requires that depositories shall have adequate mechanisms for the purposes of reviewing monitoring and evaluating the depository's controls systems, procedures and safeguards.

2. **Records and Documents to be Maintained by Depositories:** Depositories are required to maintain the following records and documents, namely:
   - records of securities dematerialised and rematerialised;
   - the names of the transferor, transferee, and the dates of transfer of securities;
   - a register and an index of beneficial owners;
   - details of the holding of the securities of beneficial owners as at end of each year.
   - records of instructions received from and sent to participants, issuers, issuers' agents
   - and beneficial owners;
   - records of approval, notice, entry and cancellation or pledge or hypothecation, as the case may be;
   - details of participants;
   - details of securities declared to be eligible for dematerialisation in the depository; and
   - such other records as may be specified by the Board for carrying on the activities as a depository.

   Every depository shall intimate the Board the place where the records and documents are maintained. Subject to the provisions of any other law the depository shall preserve records and documents for a minimum period of 5 years.

   Where records are kept electronically by the depository, it shall ensure that the integrity of the automatic data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.

3. **Inspection of Depository by SEBI [N08]:** The SEBI has empowered to appoint one or more persons as inspecting officer to undertake inspection of the books of account, records, documents and infrastructure, systems and procedures, or to investigate the affairs of a depository, a participant, a beneficial owner, an issuer or its agent for any of the following purposes, namely:
   - To ensure that the books of account are being maintained in the manner specified in these regulations.
   - To ascertain whether, the provisions of the Act, the bye-laws, agreements and these regulations are being complied with.
   - To look into the complaints received from the depositories, participants, issuers, issuers' agents, beneficial owners or any other person.
   - To ascertain whether, the systems, procedures and safeguards being followed are adequate.
   - To suo motu ensure that, the affairs are being conducted in manners which are in the interest of the investors or the securities market.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Purpose of appointing Inspecting officer of a Depository".	N08 PM	4	3

18C AUDIT OF MUTUAL FUNDS

1. **Audit of Mutual Funds:** SEBI (Mutual Funds) Regulations, 1996 provide that every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company. The auditor shall be appointed by trustees. The auditor shall forward his report to the trustees and such report shall form part of the Annual Report of the mutual fund.

2. **Audit Report of Mutual Fund:** Audit report of Mutual Fund shall comprise the following:
   - Whether, he has obtained all information explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit;
   - Whether, the balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the Fund for the accounting period to which the Balance Sheet or, as the case may be, the Revenue Account relates;
   - Whether, the statement of account has been prepared in accordance with accounting policies and standards as specified in the Ninth Schedule.

3. **Inspection and Audit of Mutual Fund by SEBI:** The SEBI has a right to conduct inspection and audit the books of account as per Regulation. The SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the books of account, records, documents and infrastructure, systems and procedures or to investigate the affairs of a mutual fund, the trustees and asset Management Company for any of the following purposes, namely:
   - to ensure that the books of account are being maintained by the mutual fund, the trustees and asset management company in the manner specified in these regulations;
   - to ascertain whether the provisions of the Act and these regulations are being complied with by the mutual fund, the trustees and asset management company;
   - to ascertain whether the systems, procedures and safeguards followed by the mutual fund are adequate;
   - to ascertain whether the provisions of the Act or any rules or regulations made there under have been violated;
   - to investigate into the complaints received from the investors or any other person on any matter having a bearing on the activities of the mutual funds, trustees and asset management company;
   - to suo motu ensure that the affairs of the mutual fund, trustees or asset management company are being

conducted in a manner which is in the interest of the investors or the securities market.

The SEBI has also the power in addition to normal audit, to appoint an auditor to inspect or investigate, as the case may be, into the books of account or the affairs of the mutual fund, trustee or asset Management Company:

4. Requirement of Ninth Schedule Accounting Policies and Standards [Ninth Schedule]:

4.1 Investment: For the purposes of the financial statements, mutual funds shall mark all investments to market and carry investments in the balance sheet at market value. However, since the unrealised gain arising out of appreciation on investments cannot be distributed, provision has to be made for exclusion of this item when arriving at distributable income.

4.2 Dividend Income: Dividend income earned by a scheme should be recognised, not on the date the dividend is declared, but on the date the share is quoted on an ex-dividend basis. For investments which are not quoted on the stock exchange, dividend income must be recognised on the date of declaration.

4.3 Interest bearing Investments: In respect of all interest-bearing investments, income must be accrued on a day to day basis as it is earned. Therefore, when such investments are purchased, interest paid for the period from the last interest due date upto the date of purchase must not be treated as a cost of purchase but must be debited to Interest Recoverable Account. Similarly interest received at the time of sale for the period from the last interest due date upto the date of sale must not be treated as an addition to sale value but must be credited to Interest Recoverable Account.

4.4 Cost of Investment: In determining the holding cost of investments and the gains or loss on sale of investments, the "average cost" method must be followed.

4.5 Transactions for Purchase or Sale of Investments : Transactions for purchase or sale of investments should be recognised as of the trade date and not as of the settlement date, so that the effect of all investments traded during a financial year are recorded and reflected in the financial statements for that year. Where investment transactions take place outside the stock market, for example, acquisitions through private placement or purchases or sales through private treaty, the transaction should be recorded in the event of a purchase, as of the date on which the scheme obtains in enforceable obligation to pay the price or, in the event of a sale, when the scheme obtains an enforceable right to collect the proceeds of sale or an enforceable obligation to deliver the instruments sold.

4.6 Bonus Shares: Bonus shares to which the scheme become entitled should be recognised only when the original shares on which the bonus entitlement accrues are traded on the stock exchange on an ex-bonus basis. Similarly, rights entitlements should be recognised only when the original; shares on which the right entitlement accrues are traded on the stock exchange on an ex-rights basis.

4.7 Accrual of Income: Where income receivable on investments has accrued but has not been received for 12 months beyond due date, provision shall be made for income as accrued & no further accrual is made for such investment.

4.8 Purchase/Sale in case of an Open-ended Scheme: When in the case of an open-ended scheme units are sold, the difference between the sale price and the face value of the unit, if positive, should be credited to reserves and if negative be debited to reserves, the face value being credited to Capital Account. Similarly, when in respect of such a scheme, units are repurchased, the difference between the purchase price and face value of the unit, if positive should be debited to reserves and, if negative, should be credited to reserves, the face value being debited to the capital account.

4.9 Equalisation Account: In the case of an open-ended scheme, when units are sold and appropriate part of the sale proceeds should be credited to an Equalisation Account and when units are repurchased an appropriate amount should be debited to Equalisation Account. The net balance on this account should be credited or debited to the Revenue Account. The balance on the Equalisation Account debited or credited to the Revenue Account should not decrease or increase the net income of the fund but is only an adjustment to the distributable surplus. It should, therefore, be reflected in the Revenue Account only after the net income of the fund is determined.

4.10 Close-ended Scheme: In a close-ended scheme which provides to the unit holders the option for an early redemption or repurchase their own units, the par value of the unit has to be debited to Capital Account and the difference between the purchase price and the par value, if positive, should be credited to reserves and, if negative, should be debited to reserves. A proportionate part of the unamortised initial issue expenses should also be transferred to the reserves so that the balance carried forward on that account is proportional to the number of units remaining outstanding.

4.11 Cost of Investment: The cost of investments acquired or purchased should include brokerage, stamp charges and any charge customarily included in the broker's brought note. In respect of privately placed debt instruments any front-end discount offered should be reduced from the cost of the investment.

4.12 Underwriting Commission: Underwriting commission should be recognised as revenue only when there is no devolvement on the scheme. Where there is devolvement on the scheme, the full underwriting commission received and not merely the portion applicable to the devolvement should be reduced from the cost of the investment.

4.13 Unit Premium Reserve: W.e.f. March 15th, 2010, SEBI vide its Circular clarified that the Unit Premium Reserve, which is part of the sales price of units that is not attributable to realized gains, cannot be used to pay dividend. However, it is observed that some Mutual Funds are using Unit Premium Reserve for distribution of dividend. It is therefore reiterated that:

- When units of an open-ended scheme are sold, and sale price is higher than face value of the unit, part of sale proceeds that represents unrealised gains shall be credited to a separate account (Unit Premium Reserve) and shall be treated at par with unit capital and the same shall not be utilized for the determination of distributable surplus.
- When units of an open-ended scheme are sold, and sale price is less than face value of the unit, the difference between the sale price and face value shall be debited to distributable reserves and the dividend can be declared only when distributable reserves become positive after adjusting the amount debited to reserves as per par 2(a)(ix) of Eleventh Schedule of SEBI (Mutual Funds) Regulations.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Contents of Audit of Mutual Fund".	M07 PM	4	2

18D ENVIRONMENTAL AUDIT & ENERGY AUDIT

1. Environmental Auditing:

1.1 Introduction [N02 N12}: Environmental reporting deals with the disclosure by an entity of environmentally related data such as environmental risk, environmental policies, environmental performance etc. These reports may be provided along with annual reports, a stand-alone corporate environmental performance report or in any other form. The reports of such audits can be compliance based report or impact based reports. Environmental audit can be performed by external or internal experts (sometimes including internal auditors), at the discretion of the entity's management.

The objective of the Environmental Audit are to evaluate the efficiency of the utilisation of resources of man, machines and materials, and to identify the areas of environmental risks and liabilities and weakness(es) of management system and problems in compliance of the directives of the regulatory agencies and control the generation of pollutants and/or waste.

1.2 Environmental Impact Assessment (EIA) [N13]: In India, EIA is a pre-requisite to start an industry, which forecast the expected damage to the environment and means required to mitigate the damage. This is done considering the known spheres of activities on the existing environmental conditions but the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report, if it is noticed that the degradation to the environment caused on the establishment and running of the industry is much higher than what was predicted, the mitigatory measures suggested must also be furthered.

1.3 Main area to be covered in case of Environmental Audit of an Industrial Unit [N06]:

- **Layout and Design:** The factory layout should be designed to allow:
  - ◊ adequate provisions for installing pollution control devices.
  - ◊ provision for up-gradation of pollution control measures; and
  - ◊ the meeting of the requirements of the regulations framed by the Government.

  The auditor should identify:
  - ◊ the areas which require attention but not attended to by the industry to be pinpointed and
  - ◊ the future requirements of the environmental measures required in commensuration with the proposed future course of working plan.
- **Management of Resources:** Management resources include air, water, land, energy, raw materials and human resources besides others. It should be used in such a manner to produce best output and minimum waste.
- **Pollution Control System:** An effective system of pollution control should be in existence.
- **Emergency Safety Arrangement:** Emergency plans should be reviewed periodically and other required safety amenities should be kept ready, particularly for industries like Gas, Chemical Industry etc.
- **Medical & Healthcare Facilities:** Adequate medical and health care facilities should be maintained for meeting regular health care and first aid requirements.
- **Industrial Hygiene:** Proper system should be established to eliminate industrial unhygienic state.
- **Occupational Health:** The requirement for safeguarding against occupational health hazards should be available for all the workers. As the occupational health hazards varies from industry to industry due to the difference in the nature of working atmosphere and the pollutants present in it, the concerned industry must pay proper weightage to those diseases which are prone to that particular type of industry.
- **Information Assimilation and Reporting System:** The information system should be strengthened, keeping in view, the authorities, responsibilities and subsequent delegations. A report of compliance of all statutory environmental laws along with other preventive and precautionary measures should be put to Board at regular intervals.
- **Environmental Impact Assessment (EIA) Methodology:** The (EIA) is usually are pre-requisites to start an industry. This is done considering the known spheres of activities on the existing environmental conditions.
- **Compliance to the Regulatory Mechanism:** Persons, who are directly working with the system, should be made aware of the latest statutory/regulatory requirements. They should be trained and instructed on regular basis, to avoid making the Board/owner vulnerable to prosecution and penalty.
- **Society Welfare:** The industry very often transforms the agrarian environment into an industrial environment. The people so displaced by industrialisation feel alienated and develop a feeling of facing the gaseous, dustful, clumsy state of surroundings. The audit should look into this aspect how the industry is making a balance between its own development and the society's concern.

1.4 Audit Format of Environment Statements [N03 M09]: The main aspects which may be covered in the probable format of "Environmental Statement" are given below:

- Name and address of the owner/occupier of the industry, operation or process.
- Date of last environmental audit report submitted.
- Consumption of water and other raw materials as input during current and previous year.
- Pollution generated in air and water along with the output and the types of pollutants and the deviation from standard.
- Generation of hazardous waste in CY and PY from processes or from pollution control facility.
- Quantity of solid waste generated during CY and PY year from process/es from pollution control facility and from recycling or reutilisation of waste, etc.
- The disposal practice for different type of waste.
- The practice sorted for conservation of natural resources.
- The additional investment proposal for environmental protection including abatement of pollution.

2. Energy Audit [M04 M07 N11]: Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. It is the first step of any energy management programmes. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:

- Quantification of energy costs and quantities.
- Correlation trends of production or activity to energy costs.
- Devise energy database formats to ensure the correct picture - by product, department, consumer, etc.
- Advise and check the compliance of the organisation for policy and regulation aspects.
- Highlight areas that need attention for detailed investigations.
- Conduct preliminary and detailed energy audit which includes:
  - ◊ Data collection and analysis.
  - ◊ Measurements, mass and energy balances.
  - ◊ Reviewing energy procurement practices.
  - ◊ Identification of energy efficiency projects and techno-economic evaluation.
  - ◊ Establishing an action plan and making recommendations.

While performing the aforesaid key functions, the energy auditor is required to carry out the following activities:

- Analysis of historical energy consumption and cost data.
- Preliminary energy audit, with the objectives to identify: (a) Major energy consuming equipment and processes, (b) Obvious inefficiencies and energy wastes, (c) Priority areas for further detailed investigation
- Detailed technical and economic analyses of energy efficiency measures, especially those involving large capital investment or long payback periods.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Environmental Audit".	N02,N12 PM	4	1.1
2	Write short notes on "Environment Impact Assessment".	N13 PM	4	1.2
3	Enumerate the main areas to be covered by the auditor in the case of environmental audit of an industrial unit.	N06 PM	8	1.3
4	Write short notes on "Probable format of Environmental Statements".	M09,N03 PM	4	1.4
5	State the functions of Energy Auditor.	N11,M04,M07 PM	5, 8,8	2

18E AUDIT OF ACCOUNTS OF NON CORPORATE ENTITIES (BANK BORROWERS)

1. **Audit of Accounts of Non-Corporate Entities (Bank Borrowers):** The Reserve Bank of India (RBI), keeping in view the need for bringing discipline in the matter of maintenance of accounts by non-corporate entities, have recently issued a circular dated 12th April, 1985 to all Banks recommending audit of accounts of all non-corporate borrowers enjoying working capital limits of Rs 10 lacs (now raised to Rs 25 lacs) and above from the banking system. For the purpose of computing the above limit of Rs 25 lacs, the term borrowing will include borrowing of the following types:
   - Packing credit facilities
   - Cash credit facilities
   - Loans-secured and unsecured
   - Overdraft
   - Deferred payment facilities
   - Guarantees: (a)Performance guarantees (b) Financial guarantees Bill Discounting Facilities

- Any other credit facilities (other than loans, guarantees, letter of credit etc.).

It is necessary for the non-corporate entity enjoying such credit facility to submit the audited statements and audit report to the concerned bank as early as possible but in any case not later than 6 months from the close of the accounting year.

2. Audit Procedure:

- Auditor has to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require. This Report is special purpose report as it is to be given to lending bank.
- The auditor will have to keep in mind the concept of materiality depending upon the circumstances of each case.
- Section 227 of the Companies Act gives certain powers to the auditors to call for the books of account, information, documents, explanations, etc. and to have access to all books and records. In the case of audit of a non-corporate entity, it would be in the interest of the entity to furnish all the information and explanations and produce books of accounts and records required by the auditor. If, however, the entity refuses to produce any particular record or to give any specific information or explanation the auditor would be required to report the same and qualify his report.
- The non-corporate entity is free to choose any practicing Chartered Accountant to conduct this audit.
- The auditor should obtain the letter of engagement and list of books of account and other records maintained by the entity before undertaking the audit assignment.
- Non-corporate entities are, in certain cases; evidenced by documents/agreements, such as, partnership deed, deed of association, trust deed etc. It would be necessary for the auditor to check the compliance with the terms of documents, agreements, so far as they relate to accounts and audits and to report all material violations of such terms.
- The figures of the immediately preceding year should be given in a manner so as to enable meaningful comparison. If the accounts of such preceding year are not audited, the fact should be indicated by way of a note and also reported by the auditor.
- The accounts should be prepared in conformity with the generally accepted accounting principles followed consistently. Any deviation, if material, either from the accepted principles or from the policy/treatment followed in the preceding year should be clearly brought out in the notes and/or the Auditors' Report.
- The overall consideration should be that the financial statements so prepared should give a true and fair view of the working of the entity. Moreover, these statements should also assist the lending bankers in their evaluation of the loan proposals and in ensuring strict financial discipline, coupled with uniformity, in the existing as well as prospective customers.

3. Special Audit Report [M12]:

3.1 A lending bank may, in special cases, require the non-corporate entity to obtain a special report from the auditor. Such a report can be called by a lending bank if it finds that it is necessary to have more information about the working of the entity. In such a case the report will have to be given by the auditor on a quarterly basis. The special audit report which is to be given on a quarterly basis in the specified form is in addition to the normal audit report which is to be given by the auditor on a yearly basis. In the quarterly special audit report, the auditor will have to give information relating to the operating data for each quarter. This information will have to be classified in the following manner:

- Actual production;
- Actual production as a percentage of rated capacity;
- Sales;
- Cost of goods sold/cost of production;
- Gross margin;
- Interest on bank borrowing; and
- Interest on others

3.2 The age-wise classification of raw materials and finished goods is also to be given. For this purpose age-wise classification is to be made in the following manner in respect of raw materials and finished goods separately:

- Inventory for more than 1 year;
- Between 6 months and 1 year;
- Between 3 months and 6 months; and

- Below 3 months.

3.3 Similar information about the work-in-progress should also be given. The basis of valuation of raw material and finished goods should be given. For this purpose the following information is to be given:

- The manner of determination of cost (i.e. components of cost)
- The method of valuing stock i.e. FIFO, weighted average cost, etc.

It is also necessary to state if there is any discrepancy between the quantity and value of the stock as furnished to the bank and as appearing in the books. The reasons for such discrepancy should be given in the audit report.

3.4 Age-wise classification of bills receivable and other receivables with reference to the, bills due from domestic parties and bills in respect of exports should be given. The age-wise classification is to be done on the same basis as the classification for raw materials and finished goods as stated above.

3.5 **Information in respect of the following items is also to be given:**

- Balances at the end of each month of the quarter for major categories of stock, receivables and bills receivables;
- Tax assessments and payments made during the quarter;
- Actual disbursement of capital expenditure during the quarter;
- Outstanding contracts on capital account at the end of the quarter giving the details about the names of parties and amounts outstanding;
- The contingent liability which may or may not materialize during the financial year succeeding the relevant quarter;
- Investment made during the quarter and the income from such investments including profit on sale of investments;
- Loans given during the quarter;
- Loans raised during the quarter from banks and from others. Separate figures to be given; (ix) Overdue statutory liability at the end of the quarter;
- Amounts due but not paid at the end of the quarter in respect of (a) loans from banks, (b) public deposits, and (c) other loans; and
- Figures of cash losses during the last 2 years to be stated on the basis of the annual accounts. If such accounts were not audited this fact should be stated.

3.6 The funds obtained from the lending banks have to be utilised for the purpose for which they are given by the bank. If the auditor finds that these funds have been diverted for the purposes other than those for which they were given by the bank the auditor will have to give the details of the diversion for such other purposes. In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give information about the following ratios:

- Current ratio
- Acid test ratio
- Raw materials-turnover ratio
- Finished goods-turnover ratio
- Receivables-turnover ratio
- Return on investment
- Interest cover ratio
- Net margin ratio
- Capital turnover ratio
- Debt equity ratio
- Operating cash flow.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Write short notes on "Matter to be reported in respect of inventory in the case of a special audit of a non-corporate borrower of a Bank.	M12 PM	4	3.1 & 3.2 & 3.3

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