

MOCK TEST PAPER -1

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/ HINTS

1. (a) **Inability to Continue as a Going Concern:** As per SA 570 on “Going Concern”, it is the responsibility of the auditor to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity’s ability to continue as a going concern. The auditor shall evaluate management’s assessment of the entity’s ability to continue as a going concern. In evaluating management’s assessment, the auditor shall consider whether management’s assessment includes all relevant information of which the auditor is aware as a result of the audit.

In the instant case, S N Projects Limited has incurred massive loss during the year 2015-16 as the financial institutions have stopped financing additional working capital to the company because of a complaint which was lodged against the company by government for involvement in some irregularity relating to allotment of coal blocks. There were delays in salary and other payments. Besides this, certain key managerial personnel, GM Finance and certain other employees have also left the company. The company, in addition, has no sound action plan to mitigate these situations.

Thus, there are clear indications that there is danger to entity’s ability to continue in future. Considering the fact that there is no sound plan of action to mitigate these factors, the going concern assumption does not seem appropriate.

Therefore, the auditor should ask the management for its adequate disclosure in the financial statement and include the same in his report. However, if the management fails to make adequate disclosure, the auditor should express Express a qualified opinion or adverse opinion

- (b) **Risk Assessment:** The auditor in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, should make an assessment of inherent and control risk for material financial statement assertions.

In a CIS environment the risk of a Material financial statement ascertain being erroneously stated could arise from the deficiencies in the following case as-

- (i) Program Development and maintenance.
- (ii) System software support.

- (iii) Operations including processing of data.
- (iv) Physical CIS security.
- (v) Control over access to specialized utility program.

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

(c) Positive External Confirmation: As per SA 505, "External Confirmation", factors to be considered when designing confirmation requests include:

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.
- (v) The method of communication (for example, in paper form, or by electronic or other medium).
- (vi) Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- (vii) The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

(d) Basis for the Auditor's Opinion on the Summary Financial Statements: As per SA 810, "Engagement to Report on Summary Financial Statements", the auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

- (i) Evaluate whether the summary financial statements adequately disclose their summarised nature and identify the audited financial statements.

- (ii) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:
 - (1) From whom or where the audited financial statements are available; or
 - (2) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.
 - (iii) Evaluate whether the summary financial statements adequately disclose the applied criteria.
 - (iv) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.
 - (v) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
 - (vi) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
 - (vii) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements.
2. (a) **Sharing of Audit Fees with non-member:** As per Clause (2) of Part I of First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services to time in or outside India.

In the instant case, CA Ciya, a practicing Chartered Accountant gave 60% of the audit fees received by her to Mr. Suhas, who was not a Chartered Accountant, under the nomenclature of office allowance. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

Therefore, CA Ciya will be held guilty of professional misconduct under clause (2) of Part I of First Schedule of Chartered Accountants Act, 1949.

- (b) **Disrepute to the Profession:** As per Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or to the Institute as a result of his action whether or not related to his professional work.

Accordingly, a Chartered Accountant is also expected to maintain the highest standards and integrity even in his personal affairs and any deviation from these standards calls for disciplinary action.

In the given case, CA Raj, a Chartered Accountant in practice approached Manager of a Nationalised Bank for a loan and offered for filing Income tax Returns without any fees. This approach of CA Raj brings disrepute to the profession of a Chartered Accountant.

Hence, CA Raj will be held guilty of other misconduct under Clause (2) of Part IV of the First Schedule of the Chartered Accountants Act, 1949.

- (c) **Advertisement:** As per Clause (7) of Part I of First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than "Chartered Accountant" on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

Here there is no prohibition for printing names on the personal letter heads in which a member holding certificate of practice is a partner.

In the given case, CA Naman mentioned the names and addresses of all the 4 firms in which he is a partner on the personal letter heads. Therefore, CA Naman will not be held guilty of any professional misconduct in pursuant to Clause (7) of Part I of First Schedule of the Chartered Accountants Act, 1949.

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

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, it was held, under a case, that he was guilty of professional misconduct under Clause (7).

In the given case, CA. Dev has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements.

Therefore, CA. Dev will be held guilty of professional misconduct under Clause (7) of Part I of the Second Schedule of the Chartered Accountants Act, 1949.

3. (a) Auditing Standards of the Public Company Accounting Oversight Board (PCAOB) has the following key requirements:

- (i) The design of controls-relevant assertions related to all significant accounts and disclosures in the financial statements;
- (ii) Information about how significant transactions are initiated, authorized, supported, processed, and reported;
- (iii) Enough information about the flow of transactions to identify where material misstatements due to error or fraud could occur;
- (iv) Controls designed to prevent or detect fraud, including who performs the controls and the regulated segregation of duties;
- (v) Controls over the period-end financial reporting process;
- (vi) Controls over safeguarding of assets;
- (vii) The results of management's testing and evaluation.

(b) Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of Modest Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

- (i) No single person should have complete control over any important aspect of

the business operation. Every employee's action should come under the review of another person.

- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
 - (iii) Every member of the staff should be encouraged to go on leave at least once a year.
 - (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
 - (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
 - (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
 - (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
 - (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
 - (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
 - (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
- (c) **Formulation of Audit Strategy:** While formulating the audit strategy for a company, following factors may be considered -

General Factors:

- (i) The engagement objectives.
- (ii) The results of the business review, including major developments in the client's business and industry, significant operating results and financial arrangements.
- (iii) Preliminary judgements as to materiality.
- (iv) Identified inherent risks. The team should also consider the risk of fraud and, in particular, any evidence of a high level of risk to the firm. They should take into account the results of procedures for the acceptance and continuation of clients.
- (v) The degree to which the team should carry out further assessment of controls

as a means of reducing substantive tests.

- (vi) The broad nature, extent and timing of substantive tests, or changes to the previous year's strategy for substantive testing.
- (vii) Main points relating to planning and controlling the audit or comments on the adequacy of the existing arrangements.

Specific Factors for Online Shopping:

The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

- (i) The classes of transactions in the entity's operations that are significant to the financial statements;
- (ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
- (iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
- (v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

4. (a) (i) **Non-cash Transactions with Relative of Director:** As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report "whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with".

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

In the instant case, JKL Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is an arrangement by which JKL Ltd. is in process to acquire assets for consideration other than cash. In the above situation the

provisions of section 192 of Companies Act, 2013 have been complied with.

However, the reporting requirements under this clause are given in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

In the given situation, JKL Ltd. has entered into non-cash transactions with Mr. Rahul, son of director which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below.

According to the information and explanations given to us, the Company has entered into non-cash transactions with Mr. Rahul, son of one of the directors during the year, for the acquisition of assets, which in our opinion is covered under the provisions of Section 192 of the Companies Act, 2013.

- (ii) **Title deeds of Immovable Property in the name of Director:** As per Clause (i)(c) of Paragraph 3 of the CARO, 2016, the auditor is required to report on whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

The auditor should verify the title deeds available and reconcile the same with the fixed assets register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the fixed assets register and the details available in the title deeds. This may be due to various reasons which needs to be examined.

In the given case, STP Limited has its factory building, appearing as fixed assets in its financial statements in the name of director. Thus, the auditor shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2016.

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

A In case of land:-

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

B In case of Buildings:-

- total number of cases,
- gross block & net block, (as at Balance Sheet date) and
- remarks, if any.

(b) (i) Compliance Requirements for Code of Conduct as per Listing Order Disclosure Requirement (LODR) Regulations:

- (1) The Board shall lay down a code of conduct for all Board members and senior management of the listed entity.
- (2) All Board members and senior management personnel shall affirm compliance with the code on an annual basis.
- (3) The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.
- (4) The code of conduct shall be posted on the website of the company.
- (5) The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

The term “senior management” shall mean personnel of the listed entity who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

(ii) Role of Auditor: The auditor should ascertain-

- (1) whether the Board of Directors of the company has laid down a Code of Conduct for all Board members and senior personnel of the company and obtain a copy of the same.
- (2) He should also verify whether all Board members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on company's website.

5. (a) Statutory Liquidity Ratio (SLR) Requirements: The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a financial year not being Fridays. The resultant report is to be sent to the top management of the bank and to the Reserve Bank. The report of the statutory auditors in relation to compliance with SLR requirements has to cover two aspects-

- (i) correctness of the compilation of DTL (Demand and Time Liabilities) position; and
- (ii) maintenance of liquid assets.

Audit Approach and Procedure:

- (i) Obtain an understanding of the relevant circulars of the RBI, particularly regarding composition of items of DTL.
- (ii) Require the branch auditors to send their weekly trial balance as on Friday and these are consolidated at the head office. Based on this consolidation, the DTL position is determined for every reporting Friday. The statutory central auditor should request the branch auditors to verify the correctness of the trial balances relevant to the dates selected by him. The branch auditors should also be specifically requested to examine the cash balance at the branch on the selected dates.
- (iii) Examine, on a test basis, the consolidations regarding DTL position prepared by the bank with reference to the related returns received from branches. The auditor should examine whether the valuation of securities done by the bank is in accordance with the guidelines prescribed by the RBI.
- (iv) While examining the computation of DTL, specifically examine that the following items have been excluded from liabilities-
 - (a) Part amounts of recoveries from the borrowers in respect of debts considered bad and doubtful of recovery.
 - (b) Amounts received in Indian currency against import bills and held in sundry deposits pending receipts of final rates.
 - (c) Un-adjusted deposits/balances lying in link branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
 - (d) Margins held and kept in sundry deposits for funded facilities-
- (v) Similarly, specifically examine that the following items have been included in liabilities-
 - (a) Net credit balance in branch adjustment accounts including these relating to foreign branches.
 - (b) Interest on deposit as at the end of the firm half year reversed in the beginning of the next half-year.
 - (c) Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'

- (d) The reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized carefully to analyze and ascertain if any inwards remittances are received on behalf of the customers / constituents of the bank and have remained unaccounted and / or any other debit (inward) entries have remained unaccounted and are pertaining to any liabilities for the bank.
 - (vi) Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches.
 - (vii) It may be noted that, even though interest accrues on a daily basis, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL.
 - (viii) The auditor at the central level should apply the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in his report.
 - (viii) While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he has relied on the returns received from the unaudited branches in forming his opinion. Recently, there has been introduction of Automated Data Flow (ADF) for CRR & SLR reporting and the auditors should develop necessary audit procedures around this.
- (b) **Reporting under CARO, 2016 for Registration under section 45-IA of the RBI Act, 1934:** As per Clause (xvi) of paragraph 3 of the CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

Audit Procedures and Reporting-

- (a) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
- (b) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- (c) Whether the company has net owned funds as required for the registration as NBFC.
- (d) Whether the company has obtained the registration as NBFC, if not, the

reasons should be sought from the management and documented.

(e) The auditor should report incorporating the following:-

- (i) Whether the registration is required under section 45-IA of the RBI Act, 1934.
- (ii) If so, whether it has obtained the registration.
- (iii) If the registration not obtained, reasons thereof.

(c) Reporting for Adjustment to be made to the Profits or Loss for complying with ICDSs: Clause 13(d) of Form No. 3CD of the tax audit report requires the tax auditor to state whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2) of the Income Tax Act, 1961.

Further, the tax auditor is also required to report under Clause 13(e), if answer to Clause 13(d) above is in the affirmative i.e. the auditor is required to give details of such adjustments as follows:

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Liabilities and Assets			
	Contingent and Contingent Assets			
	Total			

Furthermore, Clause 13(f) also requires the tax auditor for disclosure of the following as per ICDS:

(i)	ICDS I-Accounting Policies
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(ii)	ICDS II-Valuation of Inventories
(iii)	ICDS III-Construction Contracts
(iv)	ICDS IV-Revenue Recognition
(v)	ICDS V-Tangible Fixed Assets
(vi)	ICDS VII-Governments Grants
(vii)	ICDS IX Borrowing Costs
(viii)	ICDS X-Provisions, Contingent Liabilities and Contingent Assets”.

6. (a) **Reporting of Cost Records under CARO, 2016:** The auditor is required to report as per clause (vi) to Paragraph 3 of the CARO, 2016, “Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.”

Audit Procedures and Reporting-

The Order requires the auditor to report whether cost accounts and records have been made and maintained. The word “made” applies in respect of cost accounts (or cost statements) and the word “maintained” applies in respect of cost records relating to materials, labour, overheads, etc. The auditor has to report under the clause irrespective of whether a cost audit has been ordered by the central government.

The auditor should obtain a written representation from the management stating:

- (a) whether cost records are required to be maintained for any product(s) or services of the company under section 148 of the Act, and the Companies (Cost Records and Audit) Rules, 2014; and
- (b) whether cost accounts and records are being made and maintained regularly.

The auditor should also obtain a list of books/records made and maintained in this regard. The Order does not require a detailed examination of such records. The auditor should, therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should, of course, make such reference to the records as is necessary for the purposes of his audit.

It is necessary that the extent of the examination made by the auditor is clearly brought out in his report. The following wording is, therefore, suggested:

“We have broadly reviewed the books of account maintained by the company pursuant to the Rules made by the Central Government for the maintenance of cost records under section 148 of the Act, and are of the opinion that prima facie, the prescribed accounts and records have been made and maintained.”

Where the auditor finds that the records have not been written or are not prima facie complete, it will be necessary for the auditor to make a suitable comment in his report.

- (b) **Major areas to examine in course of Due Diligence Review:** 'Due Diligence' is a term that is often heard in the corporate world these days in relation to corporate restructuring. The purpose of due diligence is to assist the purchaser or the investor in finding out all he can, reasonably about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the view point of extraordinary items, analysis of significant deviations, etc.

However, in order to investigate **hidden liabilities**, the auditor should pay his attention to the following areas:

- ◆ The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
- ◆ The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
- ◆ The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
- ◆ Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
- ◆ Tax liabilities under direct and indirect taxes.
- ◆ Long pending sales tax assessments.
- ◆ Pending final assessments of customs duty where provisional assessment only has been completed.
- ◆ Agreement to buy back shares sold at a stated price.
- ◆ Future lease liabilities.
- ◆ Environmental problems/claims/third party claims.

- ◆ Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
 - ◆ Huge labour claims under negotiation when the labour wage agreement has already expired.
 - ◆ Contingent liabilities not shown in books.
- (c) (i) **Direct Assistance from Internal Auditor:** As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- ◆ Assessing the risks of material misstatement;
- ◆ Evaluating the sufficiency of tests performed;
- ◆ Evaluating the appropriateness of management's use of the going concern assumption;
- ◆ Evaluating significant accounting estimates; and
- ◆ Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. K cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

- (ii) **Direct Assistance from Internal Auditor in case of External Confirmation Procedures:** SA 610 "Using the Work of Internal Auditor", provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, "External Confirmation" the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

7. (a) **Mark to Market Margin (MTM):** MTM margin is the notional loss, which a stock 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, this 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 (for buy position the close price being lower than actual trade price and for sell position the close price being higher than actual trade price). 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.
- (b) **Advantages of Cost Audit to Government:** Cost auditor's approach is to ensure that the cost accounting plan is in consonance with the objectives set by the organisation and the system of accounting is geared towards the attainment of the objectives. A cost accounting system designed to exercise control over cost may be different from the one if the objective is to fix price. Accordingly, over a period of time particularly in view of administered pricing system the cost accounting becomes quite important. Some of the specific advantages which can be reaped by the Government are:
- (i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.
 - (ii) Cost audit helps in the fixation of selling prices of essential commodities and thus undue profiteering is checked.
 - (iii) Cost audit enables the government to focus its attention on inefficient units.
 - (iv) Cost audit enables the government to decide in favour of giving protection to certain industries.
 - (v) Cost audit facilitates settlement of trade disputes brought to the government.
 - (vi) Cost audit and consequent management action can create a healthy competition among the various units in an industry. This imposes an automatic check on inflation.
- (c) **Audit of a Co-operative Society:** Special features to be borne in mind in general while conducting the audit of a Co-operative Society are as follows-
- (i) Examination of overdue debts.
 - (ii) Special treatment of overdue interest in the determination of profit.
 - (iii) Certification of bad debts before being written off.
 - (iv) Valuation of Assets and Liabilities.
 - (v) Adherence to co-operative Principles.
 - (vi) Observations of the Provisions of the Act and Rules.

- (vii) Verification of members' Register and examination of their pass books.
 - (viii) Special report to the registrar on fraud, mismanagement and personal profiteering.
 - (ix) Audit classification of society based on the audit findings.
 - (x) Discussion of draft audit report with the managing committee.
- (d) Technical, Professional and Ethical Standards as per Statement on Peer Review:** As per the Statement on Peer Review, Technical, Professional and Ethical Standards means-
- (i) Accounting Standards issued by ICAI and /or prescribed and notified by the Central Government of India;
 - (ii) Standards issued by the Institute of Chartered Accountants of India including
 - (a) Engagement standards
 - (b) Statements
 - (c) Guidance notes
 - (d) Standards on Internal Audit
 - (e) Statements on Quality Control
 - (f) Notifications/ Directions/ Announcements/ Guidelines/ Pronouncements/ Professional standards issued from time to time by the Council or any of its committees.
 - (iii) Framework for the Preparation and presentation of financial statements, framework of statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and framework for assurance engagements;
 - (iv) Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being Reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.
- (e) Environmental Audit:** Environmental reporting deals with the disclosure by an entity of environmentally related data, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities or environmental performance to those who have an interest in such information as an aid to enabling/enriching their relationship with the reporting entity via either the annual report; a stand-alone corporate environmental performance report; or some other medium (e.g. staff newsletter, video, CD ROM, internet site). The reports that are generated after such

audits can be either compliance-based reporting or impact-based performance reporting.

Environmental audit deals with verification of information contained in such reports with a view to expressing an opinion thereon. Environmental audit can be performed by external agencies or internal experts (including internal auditors). In practice, environmental audit is not done by a single agency but by various agencies who are experts in the field. Since the subject matter of environmental audit involves multi-disciplinary knowledge and skill, it is preferable to form a team of persons drawn from different disciplines who may assist the chartered accountant in performing the task in an effective manner, generally environmental audits are not required by any statute but are sometimes done at the request of the management to address issues like compliance with environmental laws and regulations, etc.