Advanced auditing and Professional ethics answer key

1a)

As per new para 46A(1) of AS 11 "The Effects of Changes in Foreign Exchange Rates" inserted by Ministry of Corporate Affairs by way of notification, the exchange differences arising on reporting of long- term foreign currency monetary items in so far as they relate to the acquisition of a depreciable capital asset in respect of accounting periods commencing on or after the 1st April, 2011. Such exchange differences can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, it can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods.

Thus, X Ltd. has the choice to avail this option. However, the company should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.

1b)

When the Parent's Auditor is not the Auditor of all its Components: In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of **SA 600 "Using the Work of Another Auditor".**

As per SA 706, When the parent's auditor decides that he will make reference to the audit of the other auditors, the auditor's report on consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating aggregate rupee amounts or percentages of total assets and total revenues and cash flows of subsidiary(s) included in consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidated adjustments.

However, reference in the report of the auditor of consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

1c)

As per SRS 4410 "Compilation Engagements", the engagement partner shall take responsibility for-

(i) The overall quality of each compilation engagement to which that partner is assigned; and

(ii) The engagement being performed in accordance with the firm's quality control policies and procedures, by:

(1) Following appropriate procedures regarding the acceptance and continuance of client relationships and engagements;

(2) Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the compilation engagement;

(3) Being alert for indications of non-compliance by members of the engagement team with relevant ethical requirements, and determining the appropriate action if matters come to the engagement partner's attention indicating that members of the engagement team have not complied with relevant ethical requirements;

(4) Directing, supervising and performing the engagement in compliance with professional standards and applicable legal and regulatory requirements; and

(5) Taking responsibility for appropriate engagement documentation being maintained.

1d)

Quality Control Issues on an engagement: Several quality control issues are raised in the scenario:

Engagement Partner: An engagement partner is usually appointed to each audit engagement undertaken by the firm, to take responsibility for the engagement on behalf of the firm. Assigning the audit to an experienced audit manager is not sufficient.

The lack of an audit engagement partner also means that several of the requirements of SA 220 on "Quality Control for an Audit of Financial Statement", about ensuring that engagements in relation to independence and directing, supervising and reviewing the audit are not in place.

Conflicting Views: In this scenario the audit manager and senior have conflicting views about the valuation of inventory. This does not appear to have been handled well, with the manager refusing to discuss the issue with the senior.

SA 220 on "Quality Control for an Audit of Financial Statement", requires that the audit engagement partner takes responsibility for settling disputes in accordance with the firm's policy in respect of resolution of difference of opinion required by SQC 1" Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements". In this case, the lack of engagement partner may have contributed to this failure to resolve the disputes. In any event, at best, the failure to resolve the difference of opinion is a breach of the firm's policy under SQC 1. At worst, it indicates that the firm does not have a suitable policy concerning such disputes required by SQC.1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".

2a)

Sharing Fees with an Articled Clerk: As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949, a Chartered Accountant in practice shall be 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 from time to time in or outside India.

In view of the above, the objections of the Institute of Chartered Accountants of India, as given in the case, are correct and reply of Mr. X, stating that he is paying 1 % profits of his firm over and above the stipend to help the articled clerk as the position of the articled clerk is weak is not tenable.

Hence, Mr. X is guilty of professional misconduct in terms of Clause (2) of Part I of First Schedule to the Chartered Accountants Act 1949.

2b)

Evaluating Inherent Risk: To assess inherent risk, the auditor would use professional judgment to evaluate numerous factors, having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which might have taken place since his last assessment.

Inherent audit risk at the level of Account Balance and Class of Transactions is:

(i) Quality of the accounting system.

(ii) Financial statements are likely to be susceptible to misstatement, for example, accounts which required adjustment in the prior period or which involve a high degree of estimation.

(iii) The complexity of underlying transactions and other events which might require using the work of an expert.

(iv) The degree of judgement involved in determining account balances.

(v) Susceptibility of assets to loss or misappropriation, for example, assets which are highly desirable and movable such as cash.

(vi) The completion of unusual and complex transactions, particularly at or near period end.

(vii) Transactions not subjected to ordinary processing.

2c)

Mandatory Review Areas of the Audit Committee: The Audit Committee shall mandatorily review the following information as per Clause 49 of the Listing Agreement-

(i) Management discussion and analysis of financial condition and results of operations;

(ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

(iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;

(iv) Internal audit reports relating to internal control weaknesses; and

(v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

2d)

Behavioural Aspects Encountered in Management Audit: Financial auditors deal mainly with figures. Management auditors deal mainly with people. There are many causes for behavioural problems arising in the review function of management audit. Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex. The operating people may be speaking a language and using terms that are foreign to the auditor's experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below:

(1) **Staff / Line conflict**: Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.

(2) **Control**: The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. It breeds antagonism. The causes are under:

   (i) Fear of criticism stemming from adverse audit findings.

   (ii) Fear of change in day to day working habits because of changes resulting from audit recommendations.

   (iii) Punitive action by superior prompted by reported deficiencies.

   (iv) Insensitive audit practices.

   (v) Hostile audit style.

Solution to behavioural problems: The following steps may be taken to overcome the aforesaid problems-

(i) To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.

(ii) To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.

(iii) To demonstrate the review will be with minimum interference with regular operation.

(iv) The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released.

It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.

Finally, it needs hardly any emphasis that there should be right management culture, enlightened auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.

3a)

Bringing Disrepute to the Profession: A Chartered Accountant is expected to maintain the highest standard of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work would expose him to disciplinary action.

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct".

As per Clause (2) of Part IV of the 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 the Institute as a result of his action whether or not related to his professional work.

The question whether a particular act or omission constitutes "other misconduct" should be based on fact and circumstances of each case.

Under Negotiable Instruments Act 1881, where any cheque drawn by a person for the discharge of any liability is returned by the bank unpaid, either for insufficiency of funds or the cheque amount exceeds the arrangements made by the drawer of the cheque, the drawer of such cheque shall be deemed to have committed an offence.

In the given case the cheque was dishonoured with the remark "refer to drawer". However, such dishonour need not necessarily be only due to insufficiency of funds.

If it is proved that the cheques were dishonoured due to insufficiency of funds, the CA would be held guilty of "other misconduct".

3b)

Reporting under CARO, 2016 for Registration under 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-

(i) 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.

(ii) 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.

(iii) Whether the company has net owned funds as required for the registration as NBFC.

(iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.

3c)

Treatment of Employee Benefits Expenses: The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said scheme encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(i) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(ii) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(iii) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

4a)

Liability of Auditor: "It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of M/s Cloud Ltd. Therefore, he started investigation of books of accounts audited and signed by Mr. Old, a practicing Chartered Accountant. While going through the books, he found that M/s Cloud Ltd. Used to maintain two sets of Books of Accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. Old had negligently performed his duties.

Mr. Old, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only.

In this situation, as Mr. Old, performed the auditing with due skill and diligence; and, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

4b)

Factors to be Considered While Planning the Performance Audit: While planning a performance audit of Sugar Industry, the auditors should take care of certain factors which are listed below-

(i) to consider significance and the needs of potential users of the audit report.

(ii) to obtain an understanding of the program to be audited.

(iii) to consider legal and regulatory requirements.

(iv) to consider management controls.

(v) to identify criteria needed to evaluate matters subject to audit.

(vi) to identify significant findings and recommendations from previous audits that could affect the current audit objectives. Auditors should determine if management has corrected the conditions causing those findings and implemented those recommendations.

(vii) to identify potential sources of data that could be used as audit evidence and consider the validity and reliability of these data, including data collected by the audited entity, data generated by the auditors, or data provided by third parties.

(viii) to consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.

(ix) to provide sufficient staff and other resources to do the audit.

(x) to prepare a written audit plan.

4c)

Minimum Audit Fee: Prescribed minimum audit fee is recommendatory, not mandatory in nature. Therefore, acceptance of audit assignment by M/s PQR, a firm of Chartered Accountants having 5 partners of ABC Pvt. Ltd. for audit fees of ₹ 2,500 is not violation of any provisions.

Therefore M/s PQR will not be held liable for guilty of misconduct.

5a)

Importance of KYC Requirements for a Chartered Accountant's Practice: The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI recommended such norms to be observed by the members of the profession who are in practice. These Know Your Client (KYC) Norms are also important in order to ensure a healthy growth of the profession and an equitable flow of professional work among the members.

The self-regulatory measures are recommendatory. However, considering the spirit underlying these measures, it is expected that every Chartered Accountant carrying out attest function is encouraged to follow them and implementation of these measures would go a long way in ensuring equitable flow of work among the members and would also further enhance the prestige of the profession in the society.

5b)

Reversal of Income: If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).

5c)

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.

5d)

Branch Audit: As per section 143(8) of the Companies Act, 2013, if a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

In the given situation, A Ltd. is a Chennai based company, having total turnover of ₹ 10 Crore. The company is having a branch office at an area which is recently affected by flood.

Therefore, the company has to get its branch audited. In case no branch audit has been carried out, company's auditor is required to mention this fact in the audit report and deal appropriately. Thus, no reference of above branch in statutory auditor's report is not correct.

6a)

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.

6b)

The provisions relating to tax audit under section 44AB of the Income Tax Act, 1961 applies to every person carrying on business, if his total sales, turnover or gross receipts in business exceed the prescribed limit of ₹ 1 crore and to a person carrying on a profession, if his gross receipts from profession exceed the prescribed limit of ₹ 50 lakhs (w.e.f. A.Y. 2017-18) in any previous year. However, the term "sales", "turnover" or "gross receipts" are not defined in the Act, and therefore the meaning of the aforesaid terms has to be considered for the applicability of the section.

Some of the points for merit consideration in this regard as discussed in the Guidance Note issued by the Institute are given below-

(i) Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.

(ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. Therefore, should not be deducted from the turnover.

(iii) Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. As per trade practice, it is in the nature of trade discount and should be deducted from the figure.

(iv) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.

(v) Price of goods returned should be deducted from the turnover even if the returns are from the sales made in the earlier year/s.

(vi) Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However, if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof will form part of turnover.

In the given case, Concession Ltd. is engaged in manufacturing business. Therefore, the tax audit would be applicable if the turnover exceeds ₹ 1 crore during the financial year 2017-18. The calculation of effective turnover for the prescribed limit purpose, in accordance with abovementioned conditions, is given below:

Recorded turnover during the year			₹ 1,13,00,000
Less:	(i)	Discount allowed in the Sales Invoice	(₹ 8,20,000)
	(ii)	Trade discount	(₹ 2,90,000)
	(iii)	Sales Return	(₹ 1,60,000)
Effective turnover			₹ 1,00,30,000

Conclusion: The effective turnover of Concession Ltd. is rupees one crore and thirty thousand only which is over and above the prescribed limit for tax audit under section 44AB of the Income Tax Act, 1961. Thus, the provisions related to tax audit are applicable to the company and is therefore liable for tax audit

6c)

As per **SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

(i) The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.

(ii) How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed, in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.

(iii) The estimation making process adopted by the management including-

(1) The method, including where applicable the model, used in making the accounting estimates

(2) Relevant controls

(3) Whether management has used an expert?

(4) The assumption underlying the accounting estimates

(5) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and

(6) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

6d)

Specific Risk to an Entity's Internal Control: As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to an entity's Internal Control. They are–

(i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both.

(ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.

(iii) The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.

(iv) Unauthorised changes to data in Master files.

(v) Unauthorised changes to systems or programs.

(vi) Failure to make necessary changes to systems or programs.

(vii) In appropriate manual intervention.

(viii) Potential loss of data or inability to access data as required.

7a)

The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

7b)

Considerations for the Effectiveness of a System of Internal Check: The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check-

(i) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.

(ii) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, 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 in a year so that frauds successfully concealed by such a person can be detected in his absence.

(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

7c)

Consolidation of Financial Statement: AS 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when-

(i) Control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future or

(ii) Subsidiary operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In this case, R Ltd's intention is to dispose off the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, however for the compliance of provisions related to consolidation of financial statements given under Section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, R Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.

7d)

Flow-Chart Technique for Evaluation of Internal Control: This technique can be resorted to for evaluation of the Internal Control System. It is a graphic presentation of internal controls in the organisation and is normally drawn up to show the controls in each section or sub-section.

As distinct from a narrative form, it provides the most concise and comprehensive way for reviewing the internal controls and the evaluator's findings. In a flow chart narratives, are reduced to the minimum and by that process, it can successfully bring the whole control structure, specially the essential parts thereof, in a condensed but wholly meaningful manner. Every details relevant from the control point of view and the details about how an operation is performed can be included in the flow-chart.

Essentially, a flow chart is a diagram full with lines and symbols and if judicious use of them can be made, it is probably an effective way of presenting the state of internal controls in the client's organisation. A properly drawn up flow chart can provide a neat visual picture of the whole activities of the section or department involving flow of documents and activities. However, in drawing the flow chart, the auditor has to take few precautions, e.g., flow-charts should not be lengthy and cumbersome, should be neat, should portray the flow completely with final disposal of papers and there should be proper use of symbols and lines. The auditor will be able to visually correlate the functions and the related controls and assess the adequacy and effectiveness thereof much quickly than a possibly in any other method. More specifically it can show –

(i) at what point a document is raised internally or received from external sources;

(ii) the number of copies in which a document is raised or received;

(iii) the intermediate stages set sequentially through which the document and the activity pass;

(iv) distribution of the documents to various sections, department or operations;

(v) checking authorisation and matching at relevant stages;

(vi) filing of the documents; and

(vii) final disposal by sending out or destruction.

A flow chart is normally a horizontal one in which documents and activities are shown to flow horizontally from section to section and concerned sections are shown as the vertical column needs. These can be sales, purchase, wages, production etc.

Purchases can be linked with sundry creditors and payments, sales with sundry debtors and collections. By this process, a flow chart will become self contained, complete and meaningful for evaluation of internal controls. Generally, a questionnaire is also enclosed with a flow chart, incorporating questions, the answers to which are to be looked into from the flow chart.

7e)

Categories of Non-Banking Financial Company: In terms of the Section 45-I(f) read with Section 45-I (c)of the RBI Act, 1934, as amended in 1997, NBFC is one whose principal business is that of receiving deposits or that of a financial institution, such as lending, investment in securities, hire purchase finance or equipment leasing. Consequent upon to RBI Circular December 6, 2006, companies financing real/physical assets for productive/ economic activity will be classified as Asset Finance Company (AFC) as per the specified criteria. The remaining companies would be continued to be classified as loan/investment companies. In the proposed structure the following categories of NBFCs will emerge-

Currently, NBFCs registered with RBI are being classified as:

- **Asset Finance Company (AFC) -** The main activity of an AFC is financing of physical assets supporting productive / economic activity. These may be in the areas such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments and general purpose industrial machines.
- **Investment Company (IC)** which mainly deal in acquisition of shares and securities of other companies. A core investment company would be a company which acquires shares and securities of Group companies.
- **Loan Company (LC) -** Loan companies primarily provide finance (whether by making loans or advances or otherwise for any activity), other than its own activity.
- **Infrastructure Finance Companies -** This category of NBFCs deploys a minimum of three-fourths of their total assets in infrastructure loans. The net owned funds of this category of NBFCs are more than ₹ 300 crores and they should have a minimum credit rating of 'A' or equivalent and the Capital to Risk-Weighted Assets Ratio (CRAR) is 15% (with a minimum Tier I Capital of 10%).
- **Core Investment Company (CIC) -** These are NBFCs which carry on the business of acquisition of shares and securities in group companies and satisfies four conditions stated in the regulatory framework for Core Investment Companies issued by RBI.
- **Infrastructure Debt Fund - Non-Banking Financial Company (IDF-NBFC) -** Infrastructure Debt Funds (IDFs) are funds set up to facilitate the flow of long-term debt into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust based IDF would normally be a Mutual Fund (MF) while a company based IDF would normally be a NBFC.
- **Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) -** An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956 {now section 8 of the Companies Act, 2013}) that fulfils certain conditions.