## Version 6.0

- Including updated content & questions from ICAI Study Material-2022
- Topics covered -

PSU, NBFC, Peer Review & Quality Review, Investigation, Due Diligence & Forensic Audit, Internal, Management & Operational Audit, Liabilities of Auditors, Automated Environment, Audit under Fiscal Laws (Tax Audit, Public Trust Audit), Audit of Banks & Insurance Company, Audit Planning, Strategy & Execution, Risk Assessment & Internal Control

- Covers 300 + Questions
- Includes questions of Past Exam, MTPs, & RTPs upto Dec 2021
- Designed to assist integrated case study based MCQ solving
- Refer separate Drone Chart for Code of Ethics, Company Audit & SA's

# -CA FINAL —

Ab! Ab! Ab! Hoga Sabse of COMING



# SPECIAL AUDITS CAFINAL DRONE AUDIT © CHARTS

Full Topic Summarised - Enough for Exams - Scientifically Designed & Beautifically Crafted

These are not just summary charts but covers all concepts in pictorial charts for easy understanding and quick last day revision.

Relevant for CA Final New & Old Course

CA. Sarthak Niraj Jain

All India CA Ranker

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#### CA FINAL - SPECIAL AUDIT - DRONE CHARTS









































# **300+ Questions Covered**

Dear Students,

Special Audit Drone Chart 6.0 in your hand is the output of a dream which we were not just imagining, but living day and night. Finally it has come to life. Thanks to the inspiration given by you!

Every word, concept, connection in the book has been crafted with utmost care. It has been rechecked and subject to rigorous quality reviews and we trust that you will absolutely love this publication of FAST as you have loved the FR Brahmastra, Ind-AS and Audit Full course, Drone Charts, Question Banks and so many more. Now we are confident that 100% of Audit can be well covered and revised just in a day before the exams. Surely Ab Audit Hoga Sabse Scoring.

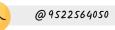
Best of Luck











first attempt success tutorials

(Special thanks to Naeem Shaikh)



# F.A.5 . AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU) DRONE CHARTS







#### INTRODUCTION

#### **Categories for organisation of PSUs:**

**Government Companies** and government controlled companies, set up under the Companies Act, 2013.

**Departmentally managed** undertakings which form part of Government activities for e.g. Indian Railways, Postal Services, Security Printing Press, Canteen Store Department etc.

#### **Corporations**

set up under of the legisla-

## ture for e.g. LIC,

the specific Acts UTI etc.

#### COMPTROLLER AND **AUDITOR GENERAL** (C&AG)



Comptroller and Auditor General (C&AG) of

India, Indian audit and accounts department.

#### Article 148

- Appointment of C&AG by the President.
- Special procedure for removal of C&AG, only on the ground of proven misbehaviours or incapacity.

#### Article 149

- Perform such duties and exercise such powers in relation to accounts of the Union & States and of any other authority or body as may be prescribed.
- The C&AG (Duties, Powers and Condition of Service) Act, 1971 defines these.

#### Article 150

On the advice of the C&AG, President to prescribe such form in which accounts of the Union and States shall be kept.

#### Article 151

**Audit reports** of the C&AG relating to the accounts of the Central / State Govt. should be submitted to the President /Governor of the state who shall cause

#### II. TERM OF C&AG

C&AG shall hold office for a term of 6 years or up to the age of 65 years whichever is earlier.

#### III. C & AG Role in functioning of financial committees of Parliament **and State Legislature**

- (i) Reports of CAG form the basis of Committees' working, i.e. committees examine the issues raised by C&AG Reports.
- ii) Committees requires the assistance of **C&AG** for scrutinising the notes which the Ministries submit to the Committees in so far as to check the **correctness of** submissions to the Committees and facts and figures in their draft reports.
- iii) Reports of the Financial Committees are being submitted to the Parliament/State Legislature with their observations and recommendations.
- v) The C&AG assists various committees in suggesting the recommendations.

All the Union and State Government departments and offices including the **Indian** Railways and Posts and Telecommunications.

Non-commercial

or the States.

autonomous bodies and

controlled by the Union

authorities owned or

**ORGANISATIONS SUBJECT TO C&AG AUDIT** 

Authorities and bodies substantially **financed** from Union or State

revenues. i.e. NGO

**Public commercial** enterprises controlled by the Union and State governments, i.e.

**Government Companies** and Corporations.

authorised.

iii. That **re-appropriations** have

AUDIT OF GOVERNMENT **COMPANIES** (COMMERCIAL AUDIT)

The auditors of these companies are **Chartered** Accountants,

appointed by the

**C&AG**, who gives the auditors directions in the manner in which the audit should be conducted by them.

(Section 139(5), (7), (8) (ii) and Section 143(5), (6), (7) of Companies Act, 2013 are relevant)

**AUDIT BOARD SETUP IN COMMERCIAL AUDIT** (FOR COMPREHENSIVE **AUDITS)** 

- Audit Boards conduct comprehensive audit of PSUs
- Works under the **supervision and control** of the Comptroller and Auditor General
- Associate experts with them
- It's results are incorporated in **C&AG reports**

**SPECIALISED** COMMITTEES

Parliament and State Legislature have, for scrutiny of Annual Accounts & Audit Reports constituted specialised committees to which these audit reports and annual accounts automatically stand referred.

# PAC

**Public Accounts Committee** (Financial/Expenditure **Control-Government** 

- Department) satisfies itself i. That the **moneys were**
- disbursed legally for purpose to which they were applied. ii. Suggest alternative policies.
- ii. That the **expenditure was**
- been made in accordance with the provisions made (i.e. distribution of funds).

#### EC

**Estimates Committee examine** estimates to: -

- i. Report economics, improvements, efficiency, to be effected in
- underlying estimates made.
- iii. Examine whether the money is well laid out within the limit.
- iv. **Suggest the form** in which the estimates shall be presented to parliament.

### CPU/COPU

**Committee on Public** undertakings (Financial Control PSUs): -

- i. Examine reports and accounts.
- ii. Examine reports of C&AG.
- iii. Examine efficiency of public
- undertakings. iv. Other functions alloted by the
- Speaker.

them to be laid before parliament/state legislature.

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Q.3. The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees. In view of above, you are required to list down any four role. (MTP-N-18)- Hint: See point '2' (III)





# AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU)

(iii)





**OBJECTIVE AND SCOPE OF PUBLIC ENTERPRISES AUDIT** 

#### I. OBJECTIVE

Audit of PSU not constrained to Financial and **Compliance Audit** it also covers **its performance** 

**Propriety Audit:** Examine expenditure to be in **best interest** of the entity

C

**Comprehensive Audit:** whether the undertakings here fulfill its objectives, Whether value-for-money spent or Whether the targets have been achieved



Organisations decision to be taken by Competent Authority using all information available

Helping government to improve efficiency and effectiveness

**Highlighting issues** of efficient and economic operations

Fiscal and management accountability a. Fiscal Accountability: Audit of sanctions, provisions of funds, compliance and propriety (Audit of provision of funds, sanctions, compliances, propriety)

b. Management Accountability: Efficiency cum performance audit

#### **II. SCOPE OF AUDIT** OF PSU

The C&AG's (Duties, **Power and Conditions** of Services) Act, 1971 specifies the entities that come under audit purview of C&AG at the Union and State level, however, the scope and extent of audit is determined by the C&AG itself.

Scope and extent of audit of PSU extends to

(i) Financial audit

(ii) Compliance Audit

(iii) Comprehensive audit

(iv) Propriety Audit and

(v) Performance audit and on the facts.

#### **Auditor**

The role of auditor is fulfilled by **Supreme** Audit Institution(SAI), and its personnel delegated with duty of conducting audits.

#### **Responsible Parties**

Generally auditable entities and TCWG of the auditable entities would be the responsible parties.

The responsible parties may be responsible / **for -** the subject matter information, for managing the subject matter or for addressing recommendations.

#### **Intended Users**

Intended users are the individuals, organisations or classes **thereof** for whom the auditor prepares the audit report.

(A)

**THREE PARTIES** 

**SUBJECT MATTER, CRITERIA** 

BASIC ELEMENTS OF PSU AUDITS

AND SUBJECT MATTER **INFORMATION** 

ⅡⅡ

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**(B)** 

#### **Subject Matter**

This refer to the **information**, condition or activity that is measured or evaluated

against certain criteria.

Criteria

These are **benchmarks** used to evaluate the subject matter.

#### **Subject Matter Information**

These refers to the outcome of evaluating or measuring the subject matter against the

#### **Direct Reporting Engagements**

In Direct Reporting Engagements it is the auditor who measures or evaluates the subject matter against the criteria. e.g.performance audits and

**TYPES OF ENGAGEMENT** 

(C)

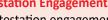
(ii)

#### **Attestation Engagements**

In attestation engagements, the responsible party **measures** the subject matter against the criteria and presents the subject matter information, on which the auditor gathers sufficient and appropriate audit evidence(SAAE) to provide a reasonable basis



compliance audit.



for expressing a conclusion e.g. Financial Audits.







# F.A. .5 1 AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU)





#### **PRINCIPLES OF PSU**

#### IT CONSISTS THE GENERAL STANDARDS THAT APPLY TO SAI INDIA'S PERSONNEL AS AUDITORS AND FUNDAMENTAL TO PSU AUDITS

#### **GENERAL PRINCIPLES**

- (a) Ethics & Independence
- (b) Professional Judgement, Due Care and Skepticism
- (c) Quality Control
- (d) Audit Team Management & Skill
- (e) Audit Risk
- (f) Materiality
- (g) Documentation
- (h) Communication

#### PRINCIPLES RELATING TO AUDIT PROCESS

#### **PLANNING THE AUDIT**

- Establish the terms of the Audit.
- Obtain understanding of the Entity.
- Conduct risk assessment of problem analysis.
- Identify risks of fraud.
- Develop an audit plan.

#### **CONDUCTING THE AUDIT**

- Perform the planned audit procedures to obtain audit evidence.
- Evaluate audit evidence and draw conclusions.

#### **REPORTING & FOLLOW-UP**

- Prepare a report based on the conclusions reached.
- Follow-up on reported matters as relevant.

#### STEPS INVOLVED IN THE AUDIT OF GOVT COMPANIES

- Appointment of Auditors u/s 139(5), **139(7), 143(5)** of the Companies Act;
  - Supplementary audit under section 143(6) (a) of Companies Act, 2013;
- **Comment upon** or **supplement** such audit report u/s **143(6)(b)**;
- **d** Test Audit u/s 143 (7) of the Companies Act. 2013.

(Discussed under Audit of Limited Companies)

#### SJ Update (Performance Audit- Refer 12C)

**Definition**: A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assesment of the performance of a government organization, program, activity or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

**Conducted by:** C&AG through subordinate offices of Indian Audit and Accounts Department (IAAD).

Guide to audit: Manual and auditing standards prescribed by C&AG.

**Audit Promotes:** Accountability by assisting TCWG and improving performance through an examination of

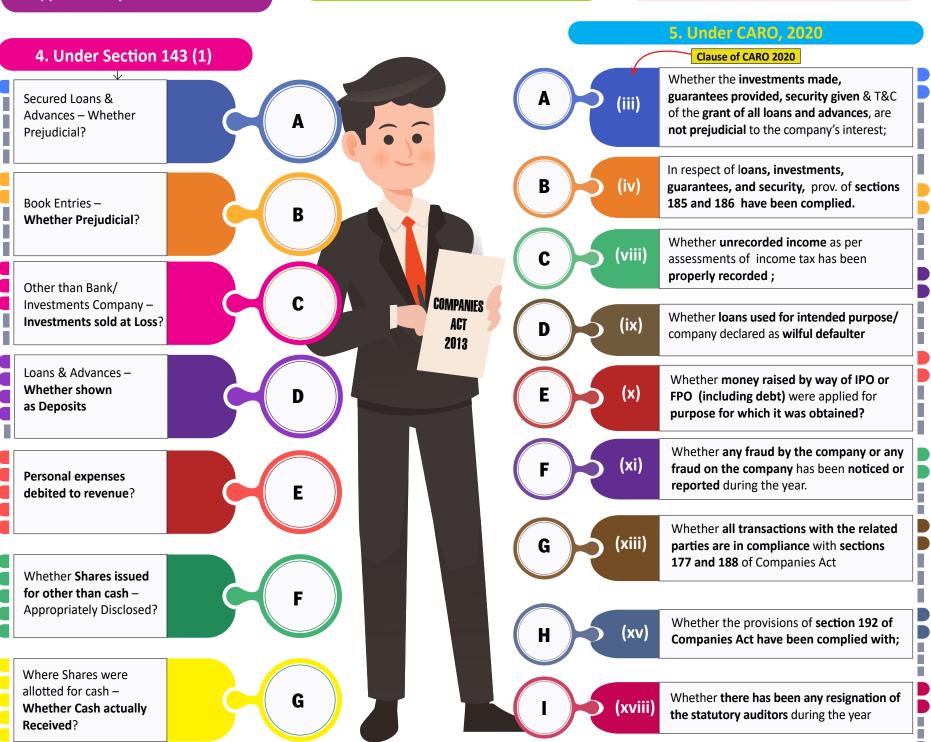
- decisions by the legislature or the executive are efficiently and effectively prepared and **implemented**; and
- b. tax payers or citizens have received value for money.

## **PROPRIETY ELEMENTS COMPANIES ACT, 2013**

1. Under Section 143 (6) & (7)-**Supplementary Audit & Test Audit** 

2. Section 148 : Cost Audit & Records

3. Sch III-Part II-Additional Information



Q.6 Briefly describe the various principles associated with audit of Public Sector enterprises.- Hint: See point '09'

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Q.11 Write short note on: Propriety Elements in CARO, 2020.- Hint: See point '11'

Q.7 Write short notes on the Role of C&AG in the Audit of a Government company (SM) - Hint: See point '10' Q.8 Write short note on areas of proprietary audit under section 143(1) of the Companies Act, 2013 (M-18-New)(N-12) (SM) Hint: See point '11'





# DRONE CHARTS AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU) F.A.5.7



**TYPES OF AUDIT CONDUCTED BY C&AG** 

#### **FINANCIAL AUDIT**

Financial audit is primarily conducted to (a) express an audit opinion on a set of financial statements, and(b) enhance user confidence, it includes-

- i. Examination and evaluation of **financial records**, to express opinion on set of FS whether as per applicable
- ii. Financial system and compliance with applicable statues & regulations.
- iii. Internal control and internal audit functions.

#### Performance Audit - Aspects to be looked into, to assess the efficiency

- In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of
- Auditing efficiency embraces aspects such as whether:
- **Sound procurement practices** are followed;
- ii. Resources are properly protected and
- iii. Human, financial and other resources are efficiently used;
- iv. Optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
- v. Public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
- vi. Efficient operating procedures are used; and
- vii. Objectives of public sector programmes are met cost-effectively



#### **COMPLIANCE AUDIT**

Compliance audit is an independent assesment of whether a given subject matter is in compliance with applicable criteia

#### It is concerned with -

- i) Regularity: Adherence of subject matter to formal criteria based on L&R and agreements applicable to entity
- ii) Propriety: Observing public officials following sound FM and ethical conduct.

#### Perspective of Compliance Audit -

Compliance auditing is generally conducted either-

other causes;

components:

- In relation with the audit of financial statements, or
- (ii) Separately as individual compliance audits, or
- (iii) In combination with performance auditing.

**Performance Audit - Auditing the Effectiveness** 

a. Assess whether the objectives of and the means provided (legal, finan-

cial, etc.) are proper, consistent, suitable or relevant to the policy;

e. Assess whether the programme complements, duplicates, overlaps or

f. Assess the effectiveness of the program and/or of individual program

g. Determine whether management has considered alternatives for carry-

h. Assess the adequacy of the management control system for measuring,

i. Assess compliance with laws and regulations applicable to the program;

monitoring and reporting a programme's effectiveness;

Identify ways of making programmes work more effectively

ing out the program that might yield desired results more effectively or

c. Assess and establish with evidence whether the observed direct or

**d. Identify factors** inhibiting satisfactory performance;

counteracts other related **programmes**;

Determine the extent to which a program achieves a desired results;

indirect social and economic impacts of a policy are due to the policy or to



#### PERFORMANCE AUDIT

**Definition** - Refer SJ Update Previous Page **Objectives** – To examine whether:

- i. Economy- Resources have been used economically and acquired in due time, in appropriate quantity and quality, at the **best price**
- ii. Efficiency it is assessment of Input Output Ratio (see point 'a' below)
- Effectiveness extent to which objectives are achieved (see point 'b' below)

#### Planning a Performance Audit-

- a. Understanding the entity/programme (see point 'c' below)
- b. Defining the objectives and scope
- c. Determining audit criteria (see point 'd' below)
- d. Deciding audit approach (see point 'e' below)
- e. Developing audit questions
- f. Assessing audit team skills whether outside expertise required?

the Entity

v. Past audits

vi. Media coverage

vii. Special focus groups

**Performance Audit -**

**Sources for Understanding** 

Documents of the entity

iv. Academic and special research

ii. Legislative documents

Policy documents

- g. Preparing audit design matrix (see point 'f' below)
- h. Establishing time table and resources
- i. **Intimation** of Audit programme

#### **COMPREHENSIVE AUDIT**

Efficiency-cum-performance audit locates the area of weakness and extravagance for managements. Areas covered - Refer SJ Update Next Page

#### Issues examined –

- a. Overall capital cost of the project.
- b. Accepted production.
- c. Planned rate of return been
- d. System of project formulation.
- e. Cost control measures are adequate.
- f. Purchase policies are adequate.
- g. Repairs & maintenance.
- h. Effective & economical.
- i. Poor or insufficient project planning.

**Refer SJ Update Next Page** 

#### **Performance Audit -Methods for Deciding Audit Approach**

- Analysis of procedures
- Case studies
- Surveys
- Analysis of results
- Quantitative analysis



- Use of existing data

# Performance Audit - Sources for Determining Audit Criteria

- Procedure manuals of the entity
- ii. Policies, standards, directives and guidelines
- iii. Criteria used by the same entity or other entities in similar activities or
- iv. Independent expert opinion and know how
- New or established scientific knowledge and other reliable information
- General management and subject matter literature and research papers

## **PROPRIETY AUDIT**

- E.L. Kohler has defined the term propriety as "that which meets the tests of public interest, commonly accepted customs, and standards of conduct and particularly as applied to professional performance, requirements of law, Govt. regulations and professional codes."
- It is concerned with **scrutiny of executive actions** and decisions bearing on financial and profit & loss situation of the company with special regard to public interest and commonly accepted customs and standards of conduct.
- Every officer has exercises the same vigilancein respect of expenditure incurred from public money.

#### Requirements –

- a. Expenditure is not prima-facie more than occasion demands
- b. Authority doesn't exercise its power for its own advantage
- c. Funds are not utilised for benefit of a particular person or group
- d. Apart from agreed remuneration no other benefit avenue is kept open for the management

#### Problems associated with the Propriety Audit

- The expression "propriety" is a **moral term** and can be understood by reference to the concept of morality
- The element of subjectivity has caused proper discharge of duty very delicate and demands
- The judgement of the auditor must be objective as otherwise it would dampen the initiative of MGT and others
- C&AG has developed the norms of propriety -C&AG has really tried to tackle in a practical way the complex problem of subjectivity

#### (f) Performance Audit - Specimen of Audit Design Matrix (ADM)

Audit	Audit	Audit	Evidence	Data Collection and Analysis Method
Objective	Questions	Criteria	(4)	(5)
(1)	(2)	(3)		

## **(13)**

#### **AUDIT REPORT OF C&AG**

- a. Introduction to government companies, deemed govenment companies & corporations.
- b. Comprehensive appraisal audit board.
- c. Company auditor reports comments on **the account** of the government companies.
- d. Significant results undertakings not taken up for appraisal by audit board.
- For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature.
- For other state /U.T. with legislature, there is a commercial chapter in the main audit report.
- The state audit reports contains both results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies notified by the statutory auditors etc.

#### AB AUDIT HOGA SABSE SCORING by CA. Sarthak Niraj Jain



Q 17

# F.A. . — AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU)

**ADDITIONAL QUESTIONS** 





#### SJ Update

(Comprehensive Audit- Refer 12D)

#### **Areas Covered:**

- 1. Investment decisions
- 2. project formulations
- 3. organisational effectiveness
- 4. capacity utilisation
- 5. management of equipment
- 6. plant and machinery
- 7. production performance
- 8. use of materials
- 9. productivity of labour
- 10. idle capacity, costs and prices
- 11. materials management
- 12. sales and credit control
- 13. budgetary and internal control systems, etc.

#### SJ Update (Comprehensive Audit- Refer 12D)

**Developing Audit programme** 

Based on study of objective, reason of setting up enterprise, its objectives, annual accounts, budget, BOD deliberations, other reports & papers these programmes identify areas requiring further:

- a) detailed analysis
- b) criteria (source of criteria is Bureau of public enterprises PSU guidance of General mgt. FM, Materials mgt., Production management, etc. + Technical/Industrial studies by internal/ external experts etc.)
- c) data required for analysis
- d) source of data
- e) **extent** of analysis including test checks

Comptroller & Auditor General of India were conducting supplementary audit U/s 143(6) of the Companies Act, 2013 made certain comments on the reported foreign exchange loss in the accounts of a Public sector company. The Board of Directors failed to reply to the comments of C&AG in their report. Comment. (N-11) Hint: See point '10' & The Board of Directors has contravened provisions of the Companies Act. They should give explanation on such comments.

The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India. What are the relevant sections of the Companies Act, 2013 and steps involved in auditor of Government Companies? (MTP N-18)(M-19) Hint: See point '10'

Write short notes on: Various Types of Audit conducted by CAG. Hint: See point '12'

> The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG. (M-19-Old)(Dec-21-New) Hint: See point '13'

The areas covered in comprehensive audit vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. You are required to list down some of the broad areas to be examined in comprehensive audit. (MTP-M-18) (RTP-M-19) Hint: See point '12-D'

XYZ & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of ABC Public undertaking. C&AG advised to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc. Discuss stating the issues examined in comprehensive audit. (RTP-M-20) Hint: See point '12-D'

The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness and extravagance for managements' information. Explain stating clearly the issues examined in comprehensive audit. (MTP-N-19) Hint: See point '12-D'

Sun Light Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.(MTP-Dec-21)(MTP-M-21) (SM)(MTP-N-20)(N-18-New) Hint: See point '12-D'

Briefly describe the problems associated with propriety audit. Hint: See point '12-E'-Problems associated with the Propriety Audit

Tee & Co., a firm of chartered accountants had been appointed by C & AG to conduct statutory audit of M/s Rare Airlines Limited, a Public-Sector Company. They would like to check certain mandatory propriety points as required u/s 143(1) of the Companies Act, 2013. List the areas of check to meet these requirements.(M-18-New)(MTP-M-19) Hint: See point '11'

"A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG. (SM)(RTP-M-20) (RTP-N-18) Hint: See point '12-C'

Write short note on; Issues addressed in Performance Audit of PSUs. (N-18-Old) Hint: See point '12-C'

ABG & Co., a Chartered Accountant firm has been appointed by C &AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry? (M-14) Hint: See point '12-C'

You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task? (SM)(MTP-Dec-21) Hint: See point '12-C'(d)

The Comptroller and Auditor General of India has appointed a chartered accountant firm to conduct the comprehensive audit of Metro Company Limited (a listed government company) which is handling the Metro project of the metropolitan city for the period ending 31-03-2020. The work to be conducted under Project A handled by the Metro Company Limited was of laying down railway line of 124 kilometres. [The chartered accountant firm reviewed the internal audit report and observed the shortcoming reported about the performance of Project A regarding the understatement of the Current liabilities and Capital work in progress by ₹ 84.68 crore.] Explain some of the matters to be undertaken by the chartered accountant firm while conducting the comprehensive audit of Metro Company Limited. (Jan-21-New) Hint: See point '12-D'

Q 24

Q 26

Q 27

Q 28

Q 29

Q 30

Q 31

CA FINAL AUDIT: AUDIT OF PUBLIC SECTOR UNDERTAKINGS (PSU)

Q 23

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# AUDIT OF NON-BANKING FINANCIAL COMPANY



## A. Back drop

#### 1 DEFINITION

**Section 45 I(f)** of Reserve Bank of India (Amendment) Act, 1997 defines a Non-Banking Financial Company as:

- A **financial institution** which is a company;
- A non banking institution which is a company with principal business of receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner:
- Such other non-banking institution or class of such institutions, as the Reserve Bank with the previous approval of the **Central Government** may **specify** by notification in the official Gazette.

For purpose of **RBI Directions** relating to acceptance of Public Deposits, Non-Banking Financial Company means only the non-banking institution which is a -"Loan Company, Investment Company, Hire Purchase Finance Company, Equipment Leasing Company and Mutual Benefit Financial Company".

#### **DEEMED NBFC**

Further, financial activity as **principal business** also happens when (as per last audited balance sheet)

- A company's financial assets constitute more than 50 % of the total assets (netted off by intangible assets) and
- Income from financial assets constitute more than **50 % of the gross income.** A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI. (Popularly Known as 50-50 test)

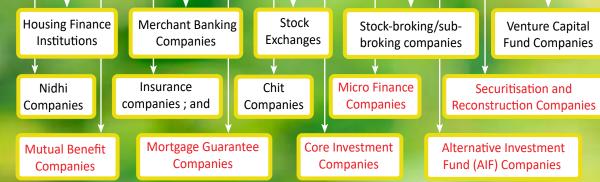
#### **REGISTRATION AND REGULATION OF NBFC**

Under section 45-IA of the RBI (amendment) Act, 1997, no Non-Banking Financial Company(NBFC) is allowed to commence or carry on the business of a Non-Banking Financial Institution without:

- . Obtaining a certificate of registration issued by the RBI.
- Having a net owned fund (NOF) of ₹ 25 lakhs (₹ 2 crore since April 1999) not exceeding ₹ 200 lakhs, as the RBI may, by notification in the official gazette, specify. (Upper limit in relation to net owned fund requirement for commencing NBFC business has been increased from ₹ 2 crores to ₹ 100 crores as per Finance Act. 2019). Presently notified limit is ₹ 2 crores only.

#### **3** EXEMPTION FROM THE REGISTRATION WITH RBI

Following NBFCs have been exempted from the requirement of registration under Section 45 -IA of the RBI Act, 1934 subject to certain conditions.



Note: - (i) Mortgage Guarantee Companies have been notified as NBFCs under Section 45 I(f)(iii) of the RBI Act, 1934(ii) Core Investment Companies with asset size of less than Rs. 100 crore, and those with asset size of Rs. 100 crore and above but not accessing public funds are exempted from registration with the RBI.

#### 4 CLASSIFICATION OF NBFC'S REGISTERED WITH RBI

#### **CLASSIFICATION OF NBFC'S REGISTERED WITH RBI**

NBFCs mandated to register under RBI categorized as follows:

- a) Deposit Acceptance: In terms deposit acceptance or otherwise into Deposit and Non-Deposit accepting NBFCs;
- b) Non deposit taking NBFCs: By their size into systemically important and non-systemically important (NBFC-NDSI and NBFC-ND); and c) by the kind of activities, they conduct.

The different types of NBFCs are as follows: by the kind of activity they conduct

(i) Investment and Credit Company (ICC) (ii) Infrastructure **Finance Company** (IFC)

(iii) Systematically Important (v) NBFC-MicroFinance **Core Investment Company** (CIC-ND-SI) (iv) Infrastructure Debt **Fund** Non- Banking

4.2 NON-BANKING FINANCIAL COMPANY - MICRO

**FINANCE INSTITUTION (NBFC-MFI)** 

NBFC-MFI is a non- deposit taking NBFC which has at least 85% of

be in the form of loan given to those who have annual income of ₹

1,00,000 in rural areas and ₹ 160,000 in urban or semi urban areas.

Such loans should not exceed ₹ 1,00,000 and its tenure should not

be less than 24 months. Further, the loan has to be given with-

out collateral. Loan repayment is done on weekly, fortnightly or

monthly installments at the choice of the borrower.

its assets in the form of microfinance. Such microfinance should

**Financial Company** 

(IDF-NBFC)

Institution (NBFC-MFI) (vi) NBFC Factors (NBFCFactors) (vi) NBFC- Non Operative **Financial Holding** Company (NOFHC)

own security and not any other category of NBFC (as defined by RBI in any of its master directions)

#### 4.3 INFRASTRUCTURE FINANCE COMPANY (IFC)

A company which has net owned funds of at least ₹ 300 Crore and has deployed 75% of its total assets in Infrastructure loans is called IFC provided it has credit rating of A or above and has a CRAR of 15%

**4.1 INVESTMENT CREDIT** 

**COMPANY (ICC)** 

Means any company which is a

financial institution carrying on

as its principal business as:

Providing finance -

whether by making loan or

advances or otherwise

• For any activity other than

• The acquisition of its

Asset finance

#### 4.4 INFRASTRUCTURE DEBT FUND (IDF-NBFC)

IDF-NBFC means a non-deposit taking Non Banking Financial Company that has:

- Net owned funds of ₹ 300 crore or more; and
- Which invests only in **Public Private Partnerships**(PPP) and post commencement operations date (COD) infrastructure projects which have completed at least one year of satisfactory commercial operation and becomes a party to a Tripartite Agreement.

#### 4.5 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, namely-

- i. it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
- ii. its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes **not less than 60% of its Total Assets**;
- iii. it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
- iv. it does not carry on any other financial activity referred to in section 45-I(c) and 45- I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans and investments in debt issuances of group companies or guarantees issued on behalf of group companies.

#### 4.6 SYSTEMICALLY IMPORTANT CORE INVESTMENT COMPANY (CIC-ND-SI)

Core Investment Companies (CIC) having total assets of not less than ₹ 100 crores either individually or in aggregate along with other CICs in the group and which raises or holds public funds are called as **Systemically Important Core Investment Companies** (CICs-ND-SI)

Q.4A ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures / securities issued by Government or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements:

(i)	Paid-up share capital	₹ 40.53 Cr.
(ii)	Non-Current Assets - Loans & Advances	₹ 55.90 Cr.
(iii)	Current Assets - Loans and advances	₹ 344.47 Cr.
(iv)	Total assets of the company	₹ 530 Cr.
(v)	Intangible assets	₹ 3 Cr.
(vi)	Profit for the Year	₹ 7.25 Cr.
(vii)	Income from interest and dividends	₹ 52 Cr.
(viii	) Gross income	₹ 102.57 Cr.
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Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise. (Dec-21-New) Hint: See point '1&2'

(Now Definition from point 4.1 to 4.8 removed from module)

AB AUDIT HOGA SABSE SCORING by CA. Sarthak Niraj Jain

CA FINAL AUDIT: AUDIT OF NON-BANKING FINANCIAL COMPANY

- Q.1 Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs. (SM)(N-05)(RTP-M-13) Hint: See point '1 & 4' Q.2 Write short note on Core Investment Companies. (M-15) - Hint: See point '4.5'
- Q.3 Write short note on: Infrastructure Finance Companies.- Hint: See point '4.3'



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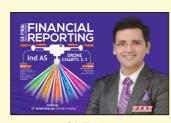
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