

Chapter 11 AUDIT REPORT
Compilation of Important ICAI question Answers

Question

What constitutes a 'true and fair' view, is the matter of an auditor's judgement in the particular circumstances of a case. In order to ensure 'true and fair' view, auditor has to review certain points. Mention any such 5 (five) points in brief. (5 Marks)

Answer

True and Fair View: To ensure true and fair view, an auditor has to see:

- (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
- (ii) no material asset is omitted;
- (iii) the charge, if any, on assets are disclosed; (iv) material liabilities should not be omitted;
- (v) the profit and loss account and balance sheet discloses all the matters required to be disclosed;
- (vi) accounting policies have been followed consistently; and
- (vii) all unusual, exceptional or non-recurring items have been disclosed separately.

Question 5

Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report? (5 Marks) (May 2018)

Answer

Emphasis of Matter paragraph: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- (ii) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- (iii) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Question 5

(a) "An auditor is required to make specific evaluations while forming an opinion in an audit report." State them. (Nov. 2018) (5 Marks)

Answer

(a) Specific Evaluations by the auditor: In particular, the auditor shall evaluate whether :

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Question 5

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When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited. **(Nov., 2019) (4 Marks)**

Answer

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstance.

1. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify auditor's report opinion on the current period's financial statements. In the basis for modification paragraph in the auditor's report the auditor shall either:
 - (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figure are material; or
 - (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified.

Question : How would an auditor determine Key Audit Matters as per SA - 701, "Communicating Key Audit Matters in the Independent Auditor's Report"? **(Nov. 2020) (3 Marks)**

Answer

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

- (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA315.
- (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (c) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above stated para were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

Question : What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section ? **(Jan. 2021) (4 Marks)**

Answer

An auditor should state in "Basis for Opinion" section of Auditor's Report as under: Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (iii) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.

(iv) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to

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provide a basis for the auditor's opinion.

Amendments an Auditor should make :

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (i) Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- (ii) Within this section, include a description of the matter giving rise to the modification.

Question: CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)?
(July 2021) (3 Marks)

Answer: Since the auditor, CA Guru, disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence of JPA Pvt Ltd, the auditor (CA Guru) shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements , and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised)

Question: M/s S & Associates are the Statutory Auditors of Real Ltd., a company engaged in the business of manufacturing of garments. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2020 -2021. CA K, the engagement partner, **wants to conclude that whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. What factors he should consider to reach that conclusion?**
(Dec.2021) (4 Marks)

Answer: Factors to be considered to form an opinion:

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (a) The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained
- (b) The auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in aggregate.
- (c) The evaluations required
 - (i) The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
 - (ii) This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Question: Draft signature section in audit report

Answer:

M/s ABC & Associates
Chartered Accountants
(Firm's Registration No.)
Signature
(Name of the Member Signing the Audit Report)
(Designation)
(Membership No. XXXXX)
UDIN: 20037320AAAAAH1111

Place of Signature

Date

Question

“The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgements.” Discuss stating clearly qualitative aspects of the entity’s accounting practices

Answer

Evaluations by the Auditor

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgements.

Qualitative Aspects of the Entity’s Accounting Practices

1. Management makes a number of judgements about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity’s accounting practices, the auditor may become aware of possible bias in management’s judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
 - (i) The selective correction of misstatements brought to management’s attention during the audit.
 Example ♦ Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
 - (ii) Possible management bias in the making of accounting estimates.
4. SA 540 addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates.
 They may, however, affect the auditor’s evaluation of whether the financial statements as a whole are free from material misstatement

Question

Discuss the factors affecting the decision of the auditor regarding which type of modified opinion is appropriate.

Answer

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor’s judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

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The following illustrates how the auditor's judgement about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification AND- auditor's Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Statements

1. Financial statements are materially misstated - Material but not Pervasive- Qualified opinion
2. Financial statements are materially misstated - Material and Pervasive- Adverse opinion
3. Inability to obtain sufficient appropriate audit evidence-Material but not Pervasive - Qualified opinion
4. Inability to obtain sufficient appropriate audit evidence-Material and Pervasive - Disclaimer of opinion

Question

Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report"

Answer

Objective of the Auditor- To Express Clearly an Appropriately modified Opinion As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Question

In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated.

Explain and analyse the indicators of lack of neutrality with examples, wherever required.

Answer

In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:

- (i) The selective correction of misstatements brought to management's attention during the audit.

Example

- Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
- The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgement and involvement of audit executives.

- (ii) Possible management bias in the making of accounting estimates.

Question: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also identify the entity whose financial statements have been audited. State other things that it identifies.

Answer

The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) Refer to the notes, including the summary of significant accounting policies; and

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- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

Question: State how unmodified opinion is written in report.

Answer: Unmodified Opinion: When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (a) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework]; or
 (b) In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework].

The phrases "present fairly, in all material respects," and "give a true and fair view" are regarded as being equivalent.

Question

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section.

Answer

Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
 (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
 (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
 (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Question

The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain

Answer

Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and

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- (b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Question

Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse.

Answer

Communicating key audit matters in the auditor's report is not:

- (i) A substitute for disclosures in the financial statements that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters

Question

Distinguish between an adverse opinion and a qualified opinion. Also draft an opinion paragraph for both types of opinion.

Answer

An auditor shall express an adverse opinion, when the auditor having obtained sufficient and appropriate audit evidence, concludes that misstatements, individually or in aggregate are both material and pervasive.

Whereas, when the auditor, having obtained sufficient and appropriate audit evidence, concludes that misstatements are material but not pervasive, shall express a qualified opinion.

SA705 – "Modifications To The Opinion In The Independent Auditor's Report" deals with the form and content of both types of report. The following are the draft of the opinion paragraphs of the reports.

- (a) Adverse Opinion

We have audited the accompanying consolidated financial statements of ABC Company Limited (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group"), its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2021, the consolidated statement of profit and Loss, (consolidated statement of changes in equity) and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the "consolidated financial statements"). In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2021, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

- (b) Qualified Opinion

We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 2021, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)) . In our opinion and to the best of our information

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and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31st, 2021 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Question

The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements. (2 Marks) (May 2018)

Answer

Incorrect: Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.

Question

An auditor should issue disclaimer of opinion when there is difference of opinion between him and the management on a particular point. (Nov. 2018) (2 Marks)

Answer

Incorrect: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
In case of difference of opinion, either the auditor will issue qualified report or adverse report and not disclaimer of opinion.

Question

Where the firm is appointed as an auditor of the entity the audit report is signed only in the name of audit firm.

(May 2019) (2 Marks)

Answer

Incorrect: Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India along-with registration number for the firm.

Question

The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of the auditor's report. (July 2021) (2 Marks)

Answer

Incorrect: The description of the auditor's responsibilities for the audit of the financial statement shall be always shown as below -

Within the body of the auditor's report

Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or

By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

Question

Communicating Key Audit Matters is a substitute for the auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with SA 705. (Jan. 2021) (2 Marks)

Answer

Incorrect: Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised).