

**Chapter 3 Documentation and Audit Evidence (including SA  
230,500,501,505,510,550,560,570,580) Compilation of Important ICAI  
Question Answers**

Question : Discuss the following:

(a) Name the assertions for the following audit procedures:

- (i) Year end inventory verification.
- (ii) Depreciation has been properly charged on all assets.
- (iii) The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- (iv) All liabilities are properly recorded in the financial statements.
- (v) Related party transactions are shown properly.

(5 Marks) (May 2018)

Answer

- (i) Year end inventory verification: Existence Assertion.
- (ii) Depreciation has been properly charged on all assets: Valuation Assertion.
- (iii) Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
- (iv) All liabilities are properly recorded in the financial statements: Completeness.
- (v) Related party transactions are shown properly: Presentation & Disclosure.

**Question:** M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach?  
(Nov. 2018) (5 Marks)

**Answer:** Initial audit engagement is an engagement in which either :

- (i) The financial statements for the prior period were **not audited**; or
- (ii) The financial statements for the prior period were audited **by a predecessor auditor**.

From the above, it is quite clear that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.

**Audit Procedures regarding Opening Balances as per SA 510;** The auditor shall **read the most recent financial statements, if any, and the predecessor auditor's report thereon**, if any, for information relevant to opening balances, including disclosures.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- (a) Determining whether the prior period's closing balances have been **correctly brought forward** to the current period or, when appropriate, any adjustments have been **disclosed as prior period items** in the current year's Statement of Profit and Loss;
- (b) Determining whether the opening balances reflect the application of **appropriate accounting policies**; and
- (c) Performing one or more of the following:
  - (i) Where the prior year financial statements were audited, perusing the **copies of the audited financial statements** including the other relevant documents relating to the prior period financial statements;
  - (ii) Evaluating whether audit **procedures performed in the current period provide evidence** relevant to the opening balances; or
  - (iii) Performing **specific** audit procedures to obtain evidence regarding the opening balances.

**Question :** Briefly mention the matters that are relevant in planning attendance at physical inventory counting.

(Nov. 2018) (5 Marks)

**Answer:** Matters relevant in planning attendance at physical inventory counting include, for example:

- (i) Nature of inventory.
- (ii) Stages of completion of work in progress.
- (iii) The risks of material misstatement related to inventory. (iv) The nature of the internal control related to inventory.

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- (v) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (vi) The timing of physical inventory counting.
- (vii) Whether the entity maintains a perpetual inventory system.
- (viii) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (ix) Whether the assistance of an auditor's expert is needed.

**Question :** "P India" Ltd. is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case. **(May 2019) (4 Marks)**

**Answer:** The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including :

- (i) **Inquiry of management** and, where applicable, others within the entity, including in - house legal counsel;
- (ii) Reviewing **minutes of meetings** of those charged with governance and **correspondence** between the entity and its external **legal counsel**; and
- (iii) Reviewing **legal expense accounts**.

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, **seek direct communication with the entity's external legal counsel**.

**Question 3 AUDIT DOCUMENTATION SUMMARY or**

"Completion Memorandum" is helpful as part of the audit documentation. Explain. **(May 2019) (3 Marks)**

"Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain.

**Answer: Completion Memorandum or Audit Documentation Summary.**

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

- (i) the significant matters identified during the audit.
- (ii) how they were addressed.

Such a summary may **facilitate effective and efficient review and inspection** of the audit documentation, particularly for large and **complex audits**. Further, the preparation of such a summary may assist auditor's consideration of the **significant matters**. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

**Question :** While conducting the audit of Amrit Ltd. the auditor A of ABC and Associates, Chartered Accountants observes that there are a large number of trade receivables standing in the books of account as on 31st March. The auditor wanted to send confirmation request to a few large trade receivables but the **management refused the auditor to send confirmation request**. How would the auditor proceed **(Nov. 2020) (4 Marks)**

**Answer:** In the given case of Amrit Ltd, the auditor wanted to send confirmation request to a few large trade receivables but the management did not want the auditor to send confirmation request.

**SA 505** on external confirmations states if the management refuses to allow the auditor to send a confirmation request , the auditor shall-

1. Inquire as to management's **reasons for the refusal** and seek audit evidence as to their validity and reasonableness.
2. Evaluate the implications of management's refusal on the auditor's **assessment of the relevant risks** of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
3. Perform **alternative audit procedures** designed to obtain relevant and reliable evidences.
4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is **unreasonable**, or the auditor is **unable** to obtain relevant and reliable audit evidences from alternative audit procedures, the auditor shall **communicate** with those charged with governance in accordance with SA 260.

The auditor shall also determine the implication for the audit and the **auditor's opinion in accordance with SA 705**.

**Question :** Explain the objectives of the auditor regarding written representations. **(Jan. 2021)** (3 Marks)

**Answer:** The objectives of the auditor regarding written representation:

**(i) To obtain written representations**

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for completeness of the information provided to the auditor;

**(ii) To support other evidence**

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

**(iii) To respond appropriately**

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

**Question:** Management's assessment of the entity's ability to continue as a going concern involves making a judgement about inherently uncertain future outcomes of events or conditions. What are relevant factors to that judgement? **(Jan. 2021)** (4 Marks)

**Answer:**

Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions.

The following factors are relevant to that judgment:

1. The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.
2. The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
3. Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

**Question :** Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples. **(July 2021)** (4 Marks)

**Answer:** The **documentation of the audit plan** is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

Example

*The following things should form part of auditor's documentation:*

A summary of discussions with the entity's key decision makers.

Documentation of audit committee pre-approval of services, where required.

Audit documentation access letters.

Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.

Auditor's report on the entity's financial statements.

Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

**Question :** The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the auditor's risk assessment? **(July 2021)** (4 Marks)

**Answer: SA 560** "Subsequent Events" requires the auditor shall perform audit procedures designed to obtain sufficient

appropriate audit evidence that *all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.*

The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment which shall include the following:

- (a) Obtaining an **understanding of any procedures management has established** to ensure that subsequent events are identified.
- (b) **Inquiring of management** and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (c) Reading **minutes**, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been **held after the date of the financial statements** and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (d) Reading the entity's **latest subsequent interim** financial statements, if any.

**Question :** CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. **(July 2021) (4 Marks)**

**Answer:** SA 505 states that Negative confirmation is a request that the confirming party respond directly to the auditor **only if the confirming party disagrees** with the information provided in the request. Negative information provide **less persuasive audit evidence than positive confirmations**. Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- (a) The auditor has assessed the **risk of material misstatement as low** and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (b) The population of items subject to negative confirmation procedures comprises a **large number of small, homogeneous, account balances, transactions or conditions**;
- (c) A very **low exception rate** is expected; and
- (d) The auditor is **not** aware of circumstances or conditions that would cause recipients of negative confirmation requests **to disregard** such requests.

**Question :** CA K is re-appointed as the auditor of B Ltd. He wants to re-confirm certain matters and has asked the management to give written representations for the same. Under what circumstances can an auditor ask the management to reconfirm its acknowledgement and understanding of responsibilities in written representation? **(Dec.2021) (4 Marks)**

**Answer:** Other Written Representation: Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

The written representations draw on the agreed acknowledgement and understanding of management of its responsibilities by requesting confirmation that it has fulfilled them. The auditor, CA K of B Ltd, may also ask management of B Ltd to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

- (i) Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- (ii) The terms of the audit engagement were prepared in a previous year;
- (iii) There is any indication that management misunderstands those responsibilities; or
- (iv) Changes in circumstances make it appropriate to do so.

**Question :** CA K audited the books of accounts of E Ltd. for the financial year 2020-2021. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor and its reliability. (Dec.2021) (3 Marks)

**Answer:** Audit Procedure:

**Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.** Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

In view of above, it can be concluded that CA K used Inspection as an audit procedure.

**Question:** In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control. comment.

**Answer:** Using Audit Evidence Obtained in Previous Audits

the auditor shall consider the following:

- (a) The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- (b) The risks arising from the characteristics of the control, including whether it is manual or automated;
- (c) The effectiveness of general IT-controls;
- (d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;
- (e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- (f) The risks of material misstatement and the extent of reliance on the control.

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit.

**Question:** Define audit documentation. Also give some examples.

**Answer:** Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as “working papers” or “work papers” are also sometimes used.)

Audit documentation may be recorded on paper or on electronic or other media.

Example : Audit Documentation include:

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning significant matters.

**Question :** Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity’s financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation.

**Answer:** Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity’s financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Written representations are requested from those responsible for the preparation and presentation of the financial statements.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management’s responsibilities, or about specific assertions.

**The objectives of the auditor regarding written representation (SA 580)**

The objectives of the auditor are:

- To obtain written representations**  
To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- To support other evidence**  
To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations.
- To respond appropriately**  
To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

**Question:** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report. Explain the auditor’s obligation in the above situation.

**Answer: SA 560 states that** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall:

- (a) Discuss the matter with management and, where appropriate, those charged with governance.
- (b) Determine whether the financial statements need amendment and If so,
- (c) Inquire how management intends to address the matter in the financial statements.

**Question:** The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.

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**Answer:** Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, **the nature of related party relationships and transactions** may, in some circumstances, give rise to **higher risks** of material misstatement of the financial statements than transactions with unrelated parties.

**Example**

1. Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding **increase in the complexity of related party transactions**.

2. Information systems may be **ineffective** at identifying or summarising transactions and outstanding balances between an entity and its related parties.

3. **Related party transactions may not be conducted under normal market terms and** conditions; for example, some related party transactions may be conducted with no exchange of consideration.

**Question :** When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.

**Answer:** When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- (a) Determining the information to be confirmed or requested;
- (b) Selecting the appropriate confirming party;
- (c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- (d) Sending the requests, including follow-up requests when applicable, to the confirming party.

**Question:** “Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal”. Discuss.

**OR**

The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of AB Industries Ltd. The auditor requests management to provide Banker’s certificate in support of Fixed deposits whereas management provides only written representation on the matter. Analyse how would you deal as an auditor

**Answer: As per SA 580**

**Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own** about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does **not affect the nature or extent of other audit evidence** that the auditor obtains about the fulfillment of management’s responsibilities, or about specific assertions. WR is not a substitute for obtaining other evidences, rather it is an additional evidence.

Applying the above to the given problem, the auditor would further request the management to provide him with the Banker’s certificate in support of fixed deposits held by the company

**Question:**

Most of the auditor’s work in forming the auditor’s opinion consists of obtaining and evaluating audit evidence. Explain

**Answer:**

**Audit evidence is necessary to support the auditor’s opinion and report.**

It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, **the entity’s accounting records are an important source of audit evidence**. Also, information that may be used as audit evidence may have been prepared using the **work of a management’s expert**. Audit evidence comprises both information that supports and corroborates management’s assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management’s refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

Most of the auditor’s work in forming the auditor’s opinion consists of obtaining and evaluating audit evidence.

**Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-**

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performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

As explained in SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated.

**Question:** Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. Analyse and explain.

**Answer:** Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

1. This requirement reflects the facts that:
  - (i) the auditor’s assessment of risk is judgemental and so may not identify all risks of material misstatement; and
  - (ii) there are inherent limitations to internal control, including management override.
2. Depending on the circumstances, the auditor may determine that:
 

Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor’s assessment of risk is supported by audit evidence from tests of controls.

Only tests of details are appropriate.

A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.
3. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, “Analytical Procedures” establishes requirements and provides guidance on the application of analytical procedures during an audit.
4. The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.
5. Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory.
6. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

**Question:** M/s ANS & Associates has been appointed as the statutory auditors of MNO Ltd. The company has been suffering losses due to the emergence of highly successful competitor, thereby leading to negative networth. Also, the sales head, key management personnel, of the company left the company due to health issues. When CA Amar, the engagement partner discussed the scenario with the management of the company, he did not get any satisfactory reply from the management. What is the responsibility of M/s ANS & Associates with regard to SA 570?

**Answer:** As per SA 570, one of the objectives of the auditor regarding going concern is to obtain sufficient and appropriate audit evidence regarding the same and to conclude on the appropriateness of the management’s use of the going concern basis of accounting in the preparation of the financial statements. Further it also contains the list of events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern which are:



Financial indicator- Negative net worth

Operating indicator- Loss of key management and emergence of highly successful competitor.

In the present case, MNO Ltd. has negative networth on account of emergence of highly successful competitor and the sales head of the company has also left the company.

Also, CA Amar did not get any satisfactory reply when he discussed the going concern matter with the management.

Thus, from the above facts, it appears that MNO Ltd. is not going concern.

If the management of MNO Ltd. has used the going concern basis of accounting, the auditor should first ask the management to adjust the financial statements.

If the management of MNO Ltd. does not agree with the same, CA Amar shall consider the impact on his audit report. He shall express modified opinion as per SA 705.

**Question;** M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2020-21-. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the ***objective of the engagement partner in terms of SA 510?***

**Answer:** As per SA 510, “**Initial Engagement- Opening balances**” the objective of the auditor with respect to the opening balances is to obtain sufficient and appropriate audit evidence about whether:

- (a) Opening balances **contain misstatements** that materially affect the current period’s financial statements; and
- (b) **Appropriate accounting policies** reflected in the opening balances have been **consistently** applied in the current period’s financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

**Question:** What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor’s judgement as to the sufficiency of audit evidence.

**Answer:** Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Following are the factors affecting the auditor’s judgement as to the sufficiency of audit evidence:

- (a) **Materiality:** It may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
- (b) **Risk of material misstatement:** It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level :

Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity’s internal control.

Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

- (c) **Size of a population:** It refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

**QUESTION: The form, content and extent of audit documentation depend on factors. Comment.**

**ANSWER: The form, content and extent of audit documentation depend on factors such as:**

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified
6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
7. The audit methodology and tools used.

**QUESTION:** While auditing the books of accounts of Very Careful Limited for the financial year 2020-21, a team member of the auditors of Very Careful Limited was of the view that with regard to audit of the company, no relation exists between **Audit File and Audit Documentation**. Explain the relationship between Audit File and Audit Documentation.

**Answer:** Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. The auditor **shall assemble the audit documentation in an audit file** and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

**QUESTION:** short note on: **Assembly of the Final Audit File**

**Answer:** The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

- ◆ SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
  - ◆ An appropriate time limit within which to complete the assembly of the final audit file is ordinarily **not more than 60 days** after the date of the auditor's one or more folders or other storage media in physical or electronic form, containing the record that comprise the audit documentation for a specific engagement
- The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- ◆ **Changes may, however, be made to the audit documentation during the final assembly process**, if they are administrative in nature. Examples of such changes include:
    - Deleting or discarding superseded documentation.
    - Sorting, collating and cross-referencing working papers.
    - Signing off on completion checklists relating to the file assembly process.
    - Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
  - ◆ After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
  - ◆ SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than **seven years from the date of the auditor's report**, or, if later, the date of the group auditor's report.

**Question:** The auditor of Fresh and Well Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor. Explain what relationship exists between Audit Evidence and Opinion of Auditor.

**Answer: There exists a very important relationship between Audit Evidence and opinion of the Auditor.** While conducting an audit of a company, the auditor obtains audit evidence and with the help of that audit evidence obtained, the auditor forms an audit opinion on the financial statements of that company. Explaining this further, audit evidence includes:-

**(1) Information contained in the accounting records:**

Accounting records include • the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; • invoices; • contracts; Audit evidence is Information used by the auditor in

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arriving at the conclusions on which the auditor's opinion is based It includes both information contained in the accounting records underlying the financial statements and other information • the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and • records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

- (2) **Other information** that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements: Other information which the auditor may use as audit evidence includes, for example • minutes of the meetings, • written confirmations from trade receivables and trade payables, • manuals containing details of internal control etc. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

Question: Explain what are the **Audit Procedures to Obtain Audit Evidence**

Answer: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

- (a) Risk assessment procedures; and
- (b) Further audit procedures, which comprise:
  - (i) Test of controls, when required by the SAs or when the auditor has chosen to do so; and
  - (ii) Substantive procedures, including tests of details and substantive analytical procedures

**Risk assessment procedures:**

Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

**Further Audit Procedures**

Further Audit Procedures comprise of:

- (i) Tests of controls, when required by the SAs or when the auditor has chosen to do so; and
- (ii) Substantive procedures, including tests of details and substantive analytical procedures.

**Test of controls**

Test of controls may be defined as an audit procedure designed to **evaluate the operating effectiveness of controls** in preventing, or detecting and correcting, material misstatements at the assertion level.

**Substantive Procedures**

Substantive procedure may be defined as an **audit procedure designed to detect material misstatements** at the assertion level.

Substantive procedures comprise:

- (i) Tests of details (of classes of transactions, account balances, and disclosures), and
- (ii) Substantive analytical procedures

**Audit procedures to obtain audit evidence can include:**

- (i) Inspection
- (ii) Observation
- (iii) External Confirmation
- (iv) Recalculation
- (v) Reperformance
- (vi) Analytical Procedures
- (vii) Inquiry

Question: Write a short note on Inquiry

Answer:

- Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.
- Inquiry is used extensively throughout the audit in addition to other audit procedures.
- Inquiries may range from formal written inquiries to informal oral inquiries.
- Evaluating responses to inquiries is an integral part of the inquiry process.
- Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.

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- Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls.
- In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

**Question: State examples of external confirmation.**

Answer:

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.
- Inventories held by third parties at bonded warehouses for processing consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

Question: State the Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures

Answer: These factors include:

- The **confirming party's knowledge** of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The **ability or willingness** of the intended confirming party to respond – For example, the confirming party:
  - may not accept responsibility for responding to a confirmation request;
  - may consider responding too costly or time consuming;
  - may have concerns about the potential legal liability resulting from responding;
  - may account for transactions in different currencies; or
  - may operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- The **objectivity of the intended confirming party** – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

**QUESTION: What are Substantive Procedures Related to the Financial Statement Closing Process?**

Answer: The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

- Agreeing or reconciling** the financial statements with the underlying accounting records; and
- Examining material **journal entries and other adjustments** made during the course of preparing the financial statements.

The nature, and also the extent, of the auditor's examination of journal entries and other adjustments depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement

**QUESTION: EXPLAIN ASSERTIONS RELATING TO TRANSACTIONS, BALANCES AND DISCLOSURES.**

Answer:

(a) **Assertions about classes of transactions and events for the period under audit:**

- Occurrence – transactions and events that have been recorded have occurred and pertain to the entity.
- Completeness – all transactions and events that should have been recorded have been recorded.
- Accuracy – amounts and other data relating to recorded transactions and events have been recorded appropriately.
- Cut-off – transactions and events have been recorded in the correct accounting period.
- Classification – transactions and events have been recorded in the proper accounts.

(b) **Assertions about account balances at the period end:**

- Existence – assets, liabilities, and equity interests exist.
- Rights and obligations – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

- (iii) Completeness – all assets, liabilities and equity interests that should have been recorded have been recorded.
- (iv) Valuation and allocation – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

**(c) Assertions about presentation and disclosure:**

- (i) Occurrence and rights and obligations – disclosed events, transactions, and other matters have occurred and pertain to the entity.
- (ii) Completeness – all disclosures that should have been included in the financial statements have been included.
- (iii) Classification and understandability – financial information is appropriately presented and described, and disclosures are clearly expressed.
- (iv) Accuracy and valuation – financial and other information are disclosed fairly and at appropriate amounts.

Question: **Information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the generalisations about the reliability of audit evidence may be useful.** Comment.

Answer. **RELIABILITY OF AUDIT EVIDENCE:**

- ◆ The reliability of audit evidence is increased when it is obtained **from independent sources** outside the entity.
- ◆ The reliability of audit evidence that is generated internally is increased when the related **controls, including those over its preparation and maintenance, imposed by the entity are effective.**
- ◆ Audit evidence obtained **directly by the auditor** (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- ◆ Audit evidence in **documentary form**, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- ◆ Audit evidence provided by **original documents** is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Question: How shall auditor proceed as per SA 500 when information to be used as audit evidence has been prepared using the **work of a management's expert**

Answer: When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

- (a) Evaluate the **competence, capabilities and objectivity** of that expert;
- (b) Obtain an **understanding** of the **work** of that expert; and
- (c) Evaluate the **appropriateness** of that expert's work as audit evidence for the **relevant assertion.**

Question: If management does not provide one or more of the requested written representations, the auditor shall deal accordingly as per SA 580. Comment.

**ANSWER: Requested Written Representations Not Provided**

If management does not provide one or more of the requested written representations, the auditor shall:

- (a) **Discuss the matter** with management;
- (b) **Re-evaluate the integrity** of management and evaluate the **effect** that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the **possible effect on the opinion** in the auditor's report in accordance with SA 705.

Question: If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general.

Answer: **Doubt as to the Reliability of Written Representations** : SA 580 "Written Representation" deals with the situation when auditor has doubt over reliability of written representation.

- In particular, if written representations are **inconsistent with other audit evidence**, the auditor shall perform audit procedures to attempt to resolve the matter.
- If the matter remains **unresolved**, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general.
- If the auditor **concludes that the written representations are not reliable**, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with **SA 705**.

Question: **When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory** . comment

Answer: As per SA 501, When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- (a) **Attendance at physical inventory counting**, unless impracticable, to:
- Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
  - Observe the performance of management's count procedures;
  - Inspect the inventory; and
  - Perform test counts.
- (b) Performing audit procedures over the entity's **final inventory records** to determine whether they accurately reflect actual inventory count results.

**Attendance at Physical Inventory Counting Attendance at Physical Inventory Counting Involves:**

- Inspecting** the inventory to ascertain its existence and evaluate its condition, and **performing test counts**;
- Observing** compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
- Obtaining audit evidence as to the reliability of **management's count procedures**.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

Question: Paramount Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of Paramount Exports Ltd. Considers that inventory held with job workers is material to the financial statements. Required Suggest the audit procedures in the given case.

Answer:

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (b) Perform inspection or other audit procedures appropriate in the circumstances.

Question: the Auditor is unable to Attend Physical Inventory Counting due to **Unforeseen Circumstances**. **Comment**.

Answer: If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.

Question: **Attendance at Physical Inventory Counting Is Impracticable**. **Comment**

Answer:

- If attendance at physical inventory counting is impracticable, the auditor shall perform **alternative audit procedures to obtain sufficient appropriate audit evidence** regarding the existence and condition of inventory.
- If it is not possible to do so, the auditor shall modify the opinion in the auditor's report as per SA 705.

- In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor.
- The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable.
- Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.
- In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.
- In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 requires the auditor to **modify the opinion** in the auditor's report as a result of the scope limitation.

**QUESTION:** Pride India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to **identify litigation and claims** resulting to risk of material misstatements. Suggest the auditor with reference to SAs.

**ANSWER:** As per SA 501, The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (c) Reviewing legal expense accounts.

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.

Further if:

- (a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705. Written Representations The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

**Question write a short note on Auditors duties regarding Segment information as per SA 501**

**Answer:** The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

- (a) Obtaining an understanding of the methods used by management in determining segment information. Further,
  - (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
  - (ii) Where appropriate, testing the application of such methods; and
- (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.

**Understanding of the Methods Used by Management** Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- ◆ Sales, transfers and charges between segments, and elimination of intersegment amounts.

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- ◆ Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- ◆ The allocation of assets and costs among segments.
- ◆ Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies .

Question: **The design of a confirmation request** may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. State factors to consider.

Answer: Factors to consider when designing confirmation requests include:

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

Question: Define related parties as per SA 550.

Answer: SA 550- "Related Parties", deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

**Definition of Related Party:**

A party that is either:

**(i) A related party as defined in the applicable financial reporting framework; or**

**(ii) Where the applicable financial reporting framework establishes minimal or no related party requirements:**

- (a) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity
- (b) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
- (c) Another entity that is under common control with the reporting entity through having:
  - Common controlling ownership;
  - Owners who are close family members; or
  - Common key management.

However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

**Question: How can an auditor verify the existence of related party relationships and transactions?**

Answer: During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g, Prospectuses.



**Question: What constitutes a ‘true and fair’ view is a matter of an auditor’s judgement in the particular circumstances of a case. Comment.**

**Answer:** In more specific terms, 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: With what SA 570 deals with?**

**Answer:** SA 570 (Revised) on “Going concern” deals with :

- (I) The auditor’s responsibilities in the audit of financial statements relating to going concern and
- (II) The implications for the auditor’s report.

The auditor’s responsibilities in the audit of financial statements relating to going concern: It is important to note that SA 701 deals with the auditor’s responsibility to communicate key audit matters in the auditor’s report. SA 701 acknowledges that, when SA 701 applies, matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern is, by its nature, a key audit matter.

**Question: What are the Objectives of the auditor regarding going concern?**

**Answer:** The objectives of the auditor are:

- (a) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management’s use of the going concern basis of accounting in the preparation of the financial statements;
- (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern; and
- (c) To report in accordance with this SA.

**Question:** When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity’s ability to continue as a going concern. **Comment.**

**Answer:** When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity’s ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity’s ability to continue as a going concern, and:

- (a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern and, if so, management’s plans to address them; or
- (b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern.

**Question: State the Events or Conditions That May Cast Significant Doubt on the Entity’s Ability to Continue as a Going Concern**

**Answer:** The following are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern(SA 570)

**Financial**

- ◆ Net liability or net current liability position.
- ◆ Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive

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reliance on short-term borrowings to finance long-term assets.

- ◆ Indications of withdrawal of financial support by creditors.
- ◆ Negative operating cash flows indicated by historical or prospective financial statements.
- ◆ Adverse key financial ratios.

**Operating**

- ◆ Management intentions to liquidate the entity or to cease operations.
- ◆ Loss of key management without replacement.
- ◆ Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- ◆ Labor difficulties.
  - ◆ Shortages of important supplies.
  - ◆ Emergence of a highly successful competitor.

**Other**

- ◆ Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.
- ◆ Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- ◆ Changes in law or regulation or government policy expected to adversely affect the entity.
- ◆ Uninsured or underinsured catastrophes when they occur.

**Question: Additional Audit Procedures When Events or Conditions Are Identified that cast doubt on Going concern assumption.**

Answer: If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, including

consideration of mitigating factors. These procedures shall include:

- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
- (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (e) Requesting written representations from management regarding their future action plans and the feasibility of these plans.

Audit procedures that are relevant to the requirement as stated above may include the following:

- ◆ Analyzing and discussing cash flow, profit and other relevant forecasts with management.
- ◆ Analyzing and discussing the entity's latest available interim financial statements.
- ◆ Reading the terms of debentures and loan agreements and determining whether any have been breached.
- ◆ Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- ◆ Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- ◆ Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- ◆ Evaluating the entity's plans to deal with unfilled customer orders.
- ◆ Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.

- ◆ Confirming the existence, terms and adequacy of borrowing facilities.
- ◆ Obtaining and reviewing reports of regulatory actions.
- ◆ Determining the adequacy of support for any planned disposals of assets.

Question: ***How does auditor report when Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists.***

Answer: As per SA 570 on Going Concern, the identification of a material uncertainty is a matter that is important to users' understanding of the financial statements.

The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

(1) **Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements** If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

(2) **Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements** If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

- (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
- (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

**Question 1**

- (c) The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.

**(2 Marks) (May 2018)**

**Answer**

- (c) Incorrect: SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

**Question 1**

- (j) Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit.

**(2 Marks) (May 2018)**

**Answer**

- (j) Incorrect: SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

**Question 1**

- (c) An auditor is not concerned with consistency of accounting policies relating to opening balances.

**(Nov. 2018) (2 Marks)**

**Answer**

- (c) Incorrect: In conducting an initial audit engagement, one of the objectives of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

<p><b>Question 1</b></p> <p>(d) Audit evidence obtained from external confirmation is always reliable. <b>(Nov. 2018) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(d) Incorrect: The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.</p>
<p><b>Question 1</b></p> <p>(G) Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information provided in the request. <b>(May 2019) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(G) Incorrect –In Positive confirmation request confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information whereas Negative confirmation request is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.</p>
<p><b>Question 1</b></p> <p>(c) All entities that are under common control by a state (i.e., national, regional or local government) are considered related party. <b>(Nov., 2019) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(c) Incorrect: Entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.</p>
<p><b>Question 1</b></p> <p>(g) The auditor's substantive procedure at the assertion level means substantive analytical procedures only. <b>(Nov., 2019) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(g) Incorrect: The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.</p>
<p><b>Question 1</b></p> <p>(h) External confirmation procedures are restricted to the items of addressing assertions associated with account balances &amp; their elements only. <b>(Nov. 2020) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(h) Incorrect: External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmation need not be restricted to account balances only.</p>
<p><b>Question 1</b></p> <p>(g) Sufficiency is the measure of the quantity of audit evidence. <b>(Jan. 2021) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(g) Correct: Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required).</p>

<p><b>Question 1</b></p> <p>(c) Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. <b>(July 2021) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(c) Incorrect: Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur. Thus its not by Auditor rather by Management. Auditor tests these assertions.</p>
<p><b>Question 1</b></p> <p>(g) In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater. <b>(July 2021) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(g) Correct: In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:  Management may be unaware of the existence of all related party relationships.  Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.</p>
<p><b>Question 1</b></p> <p>(c) When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management. <b>(Dec.2021) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(c) Incorrect: When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:</p> <p>(a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.</p> <p>(b) Perform inspection or other audit procedures appropriate in the circumstances.</p>
<p><b>Question 1</b></p> <p>(d) While auditing the books of accounts of ABC Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection". <b>(Dec.2021) (2 Marks)</b></p> <p><b>Answer</b></p> <p>(d) Incorrect: The audit procedure used by the auditor of ABC Ltd. is known as "observation".  Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.</p>