AUDITING AND ETHICS

100 IMPORTANT QUESTIONS

Q-1 Explain the concept of **"reasonable assurance"** as an objective of an audit, and differentiate it from **"absolute assurance."** How does the auditor's objective of obtaining reasonable assurance shape the audit process?

Ans:

Audit Objective (SA-200):

The auditor seeks reasonable assurance for financial statements' freedom from material misstatements (fraud or error), enabling an opinion on compliance with the applicable financial reporting framework.

The auditor is required to report on the financial statements and communicate findings as mandated by the Standards on Auditing (SAs).

An analysis of above brings out following points clearly: -

1. Reasonable Assurance: The auditor's goal is to attain reasonable assurance regarding the absence of material misstatements (fraud or error) in financial statements. This assurance, though high, is distinct from absolute certainty.

2. Misstatements: Financial statement misstatements, stemming from fraud or error, prompt the auditor to seek reasonable assurance for their absence, considering their impact on the entire financial picture.

3. Opinion Expression: Attaining reasonable assurance allows the auditor to express an opinion on the financial statements' preparation in accordance with the applicable financial reporting framework.

4. Reporting: The auditor conveys the opinion, based on audit findings, through a written report in adherence to Standards on Auditing.

Q-2 Is audit always legally **mandatory** for all entities? Provide examples of situations where audit is legally required and situations where entities may voluntarily choose to undergo an audit.

Ans:

It is not necessary that audit is always legally mandatory. There are entities like companies who are compulsorily required to get their accounts audited under law. Even non-corporate entities may be compulsorily requiring audit of their accounts under tax laws. For example, in India, every person is required to get accounts audited if turnover crosses certain threshold limit under income tax law.

It is also possible that some entities like schools may be required to get their accounts audited for the purpose of obtaining grant or assistance from the Government.

Audit is not always mandatory. Many entities may get their accounts audited voluntarily because of benefits from the process of audit. Many such concerns have their internal rules requiring audit due to advantages flowing from an audit.

Q-3 Rahul is a shareholder in a company and is concerned about the reliability of the financial information provided by the management. He wonders why an audit is necessary and how it benefits him as a shareholder. Explain the **benefits of an audit** in the context of shareholders and other stakeholders.

Ans:

Audits play a crucial role in providing confidence and assurance to stakeholders, especially shareholders. Here are the key benefits:

1. Quality Information: Audited accounts ensure high-quality information, adhering to globally recognized Auditing Standards. This gives shareholders confidence in the reliability of the financial data they rely on.

2. Shareholder Protection: As shareholders may not be involved in day-to-day management, audits act as an independent check, safeguarding their interests by verifying the accuracy and reliability of financial statements prepared by the management.

3. Moral Check on Employees: The fear of being discovered by an audit serves as a moral check on employees, discouraging fraudulent activities.

4. Tax Determination: Government authorities use audited financial statements to determine tax liabilities, ensuring compliance with tax regulations.

5. Credit Decision Support: Lenders and bankers rely on audited financial statements to make informed credit decisions, assessing the financial health of the entity before lending.

6. Fraud Detection: Audits may uncover fraud or errors, contributing to a more transparent financial environment.

7. Control Review: Audits review the existence and operations of controls in an entity, helping identify and rectify deficiencies in the control systems.

In summary, audits not only enhance the reliability of financial information but also serve as a mechanism to protect shareholder interests and ensure the overall integrity of an organization.

Q-4 In a recent audit engagement, the auditor completed the examination and prepared the audit report. **To whom should the auditor submit the audit report**, and who are the likely recipients of the findings in the case of a company and a firm?

Ans:

In this case, the auditor should submit the audit report to the entity or individual who appointed them for the audit. If the audit was conducted for a company, the primary recipients would be the shareholders. They are the ones with a direct interest in the financial performance and integrity of the company. On the other hand, if the audit was carried out for a firm, the audit report would typically be submitted to the partners who engaged the auditor. Partners, being closely involved in the firm's operations, would be keenly interested in the audit findings and recommendations for maintaining financial transparency and accountability.

Q-5 ABC Ltd., a manufacturing company, has engaged a practitioner to conduct an assurance engagement on its sustainability practices. The company aims to provide confidence to its stakeholders about its commitment to environmental responsibility. Explain the **key elements** involved in this assurance engagement.

Ans:

Key elements assurance engagement:

1. Three-Party Relationship: In this assurance engagement, the three parties involved are the practitioner (assurance provider), ABC Ltd. (responsible party), and the stakeholders (intended users). The practitioner is tasked with providing assurance on ABC Ltd.'s sustainability practices.

2. Appropriate Subject Matter: The subject matter of the assurance engagement is ABC Ltd.'s sustainability practices. The practitioner will examine the company's initiatives, disclosures, and performance related to environmental responsibility.

3. Suitable Criteria: To evaluate ABC Ltd.'s sustainability practices, the practitioner will use suitable criteria. These criteria may include environmental standards, industry guidelines, and regulatory requirements relevant to sustainable business practices.

4. Sufficient Appropriate Evidence: The practitioner will gather sufficient and appropriate evidence during the assurance engagement. This may involve reviewing documentation of sustainability initiatives, interviewing responsible personnel, and verifying the company's adherence to environmental criteria. The evidence collected should be both in quantity (sufficient) and quality (appropriate).

5. Written Assurance Report: Upon completion of the assurance engagement, the practitioner will provide a written assurance report. This report will contain a conclusion expressing the degree of confidence stakeholders can have in ABC Ltd.'s sustainability practices. The report will be in an appropriate form, outlining the findings and the practitioner's opinion.

In brief, this assurance engagement aims to enhance stakeholders' confidence in ABC Ltd.'s commitment to environmental responsibility by evaluating its sustainability practices against established criteria and providing a formal opinion through a written assurance report.

Q-6 An audit does not provide absolute assurance. Discuss how **nature of audit procedures** itself is one of the reasons due to which audit cannot provide absolute assurance.

Ans:

Nature of Audit procedures

Auditors face practical and legal limitations in obtaining audit evidence. Practical limitations include the use of sampling instead of testing all transactions. Legal limitations arise when management withholds requested information; auditors can only report if information is not provided.

Dishonest management may engage in fraud, concealing it with sophisticated schemes and presenting fabricated documents. Auditors, lacking expertise in document authentication, may unknowingly accept invalid evidence based on unauthentic documents.

Related party transactions pose a challenge, as they may only exist on paper, escaping detection in audit procedures. The auditor's inability to authenticate documents and potential deceit by dishonest management highlight the complexities in obtaining reliable audit evidence.

Q-7 ABC Audit Firm is engaged to conduct an assurance engagement on the sustainability practices of XYZ Corporation.

(i) Explain the **different categories of standards** that ABC Audit Firm needs to consider in performing this assurance engagement.

(ii) Discuss **why adherence to these standards** is crucial for maintaining the quality of assurance services.

Ans:

(i) Categories of Standards:

1. Standards on Auditing (SAs): SAs apply in the audit of historical financial information, ensuring high-quality benchmarks are followed by auditors. Relevant to ABC Audit Firm when conducting an audit of XYZ Corporation's financial statements.

2. Standards on Review Engagements (SREs): SREs apply in the review of historical financial information, providing a limited level of assurance. Relevant when ABC Audit Firm performs a review, such as reviewing interim financial information of XYZ Corporation.

3. Standards on Assurance Engagements (SAEs): SAEs apply in assurance engagements other than audits and reviews, dealing with subject matters beyond historical financial information. Relevant if ABC Audit Firm engages in assurance services related to non-financial matters, like the examination of prospective financial information for XYZ Corporation.

4. Standards on Related Services (SRSs): SRSs apply in engagements to perform agreed-upon procedures, compilation engagements, and other related services. Relevant if ABC Audit Firm performs agreed-upon procedures or compilation engagements for XYZ Corporation.

5. Standards on Quality Control (SQCs): SQCs establish standards for a firm's system of quality control for audit, review, assurance, and related service engagements. Applicable to ABC Audit Firm to ensure compliance with professional standards, legal requirements, and the issuance of appropriate reports.

(ii) Importance of Adhering to Standards:

➔ Adherence to standards ensures that audit practices are at par with global benchmarks, maintaining consistency in audit approaches.

➔ Standards contribute to the improvement of financial reporting quality, aiding users in making informed decisions.

➔ Standards promote uniformity in audit practices, ensuring that financial statement audits are conducted consistently.

➔ Standards equip professional accountants, like ABC Audit Firm, with the necessary knowledge and skills to perform high-quality assurance services.

➔ Standards on Quality Control (SQC 1) ensure that firms establish systems to comply with professional standards and legal requirements, maintaining overall audit quality.

In conclusion, adherence to these standards is vital for ABC Audit Firm to provide reliable and high-quality assurance services to XYZ Corporation, covering a range of engagements and maintaining the integrity of the audit profession.

Q-8 Why is it **important for auditors** to construct an audit programme, and what **key considerations should auditors keep in mind** during the programme construction process?

Ans:

Importance of Audit Programme:

An audit programme holds significant importance in the audit process, especially for larger audits. It serves as a systematic plan that guides auditors through the examination and verification steps necessary to ensure the accuracy and reliability of financial statements.

The following key considerations are essential during the construction of an audit programme:

1. Importance of Scope and Limitation: Stay within the scope and limitation of the audit assignment. The programme should align with the specific objectives of the audit engagement, ensuring that all relevant areas are covered while acknowledging any limitations.

2. Written Documentation: Prepare a written audit programme detailing the procedures required for implementing the audit plan. A documented programme provides a clear roadmap for auditors and their assistants, fostering consistency, accountability, and effective communication throughout the audit.

3. Evidence and Satisfaction: Determine the evidence reasonably available and identify the best evidence for deriving satisfaction. Auditors must carefully select procedures that yield sufficient and appropriate audit evidence, ensuring the reliability of their conclusions about the financial statements.

4. Useful Procedures: Apply only those steps and procedures useful in accomplishing the verification purpose in the specific situation. The programme should focus on relevant procedures tailored to the client's circumstances, avoiding unnecessary steps that do not contribute to the audit objectives.

5. Audit Objectives and Details: Include audit objectives for each area and provide sufficient details as instructions for assistants. Clearly defined objectives and instructions help in controlling the proper execution of audit work, maintaining consistency across the audit team.

6. Error Possibilities: Consider all possibilities of error. Anticipating potential errors allows auditors to design procedures that effectively detect and address inaccuracies in financial reporting.

7. Coordinated Procedures: Coordinate procedures for related items. Ensuring coordination helps in avoiding redundancy, optimizing efficiency, and addressing interrelationships between different audit steps.

Q-9 Imagine you are tasked with conducting an audit of the financial processes of a medium-sized manufacturing company. The company has been experiencing financial challenges, and there are concerns about the accuracy and reliability of its financial reporting. **Develop an audit program outlining the key steps and procedures you would include to thoroughly assess the company's financial processes.**

Ans:

Constructing an audit programme

The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit.

However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

Further, the auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.

For the purpose of programme construction, the following points should be kept in mind:

(1) Stay within the scope and limitation of the assignment.

(2) Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.

(3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.

(4) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.

(5) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.

(6) Consider all possibilities of error.

(7) Co-ordinate the procedures to be applied to related items.

Q-10 An audit program plays a crucial role in the auditing process, providing a structured framework for auditors to plan, perform, and document their work. Let's discuss the **advantages and disadvantages** of an audit program

Ans:

Advantages of an Audit Programme:

(a) Clear Instructions: An audit programme provides the assistant with clear and comprehensive instructions for conducting the audit work.

(c) Assistance Selection: Easier selection of assistants based on capability when the work is logically planned and defined.

(d) Systematic Approach: Helps avoid the risk of oversight or neglecting certain books and records, promoting a systematic audit process.

(f) Progress Control: Enables the principal to monitor audit progress through examination of initiated audit programmes for completed work.

(g) Guidance for Future Audits: Serves as a guide for audits in subsequent years, ensuring consistency and continuity.

(h) Evidence in Case of Negligence: Acts as evidence in defending against charges of negligence, demonstrating the exercise of reasonable skill and care.

Disadvantages of an Audit Programme:

(a) Mechanical Work: Risk of the audit becoming mechanical, with specific parts of the programme executed without a full understanding of their role in the overall audit.

(b) Rigidity and Inflexibility: Programmes may become rigid, not adapting to changes in business operations or internal control, leading to potential inefficiencies.

(c) Defensive Use by Inefficient Assistants: Inefficient assistants may use the programme as a defense for deficiencies in their work, claiming lack of instruction.

(d) Initiative Suppression: A rigid programme may stifle the initiative of efficient and enterprising assistants.

Q-11 Imagine an auditor assigned to a company fails to document the audit strategy and audit plan. **What potential consequences could arise from this failure**, both in terms of audit effectiveness and professional responsibility?

Ans:

The auditor must document:

(a) Overall audit strategy

(b) Audit plan

(c) Any significant changes, along with reasons

Documentation includes the overall audit strategy, capturing key decisions for planning and team communication. The audit plan documents the nature, timing, and extent of procedures in response to risks, ensuring thorough planning, review, and approval. Noteworthy changes are recorded with explanations, reflecting adjustments and ensuring a clear understanding of the strategy and plan, demonstrating appropriate responses to audit changes.

In summary, the consequences of not documenting the audit strategy and plan include compromised audit effectiveness, increased risk of errors or omissions, and potential ethical and legal implications for the auditor.

Q-12 How does the **relationship between audit strategy and audit plan** contribute to the effective and efficient execution of an audit, and why is it important for these two components to be closely inter-related throughout the audit process?

Ans:

The audit strategy is like a big picture plan for the audit, determining its scope, timing, and direction. On the other hand, the audit plan is a more detailed guide, specifying the nature, timing, and extent of audit procedures to be performed. While the audit strategy sets the tone, the audit plan explains how to implement it effectively.

Think of the audit strategy as deciding where to go and why, while the audit plan is the step-by-step roadmap to get there. These two are closely connected because changes in one (strategy) can impact the other (plan), and they work together to achieve audit objectives efficiently.

In summary, the strategy is the overall approach, and the plan is the detailed execution of that approach.

Q-13 XYZ Corporation manufactures complex electronic components for the automotive industry. During the annual financial audit, the auditors **identified key components of the risk of material misstatement.**

Ans:

a) Inherent Risk: Explain how inherent risk is defined in the context of the audit and how it relates to the susceptibility of an assertion about a class of transactions, account balance, or disclosure to a material misstatement. Provide examples of factors that might contribute to higher inherent risk for certain assertions, and discuss why inherent risk is considered before the consideration of any related controls.

b) Control Risk: Define control risk and describe its relationship with the efficiency of internal control in an entity. Elaborate on how control risk is assessed, including the factors that auditors consider when determining whether internal controls are effective in preventing, detecting, and correcting material misstatements.

c) Detection Risk: Discuss the concept of detection risk as defined in SA-200 and explain the role of auditors in influencing detection risk. Highlight the auditor's ability to reduce detection risk and maintain audit risk at an acceptably low level.

Q-14 Explain the **testing internal controls** in the audit process and describe the **different types of tests of controls.**

Ans:

Purpose of Testing Internal Controls: Testing internal controls is a crucial step in the audit process to assess the effectiveness of an entity's accounting and internal control systems. The primary objectives are to evaluate the design and operation of internal controls, reduce control risk, and gather audit evidence about the reliability of financial statement assertions.

Types of Tests of Controls:

1. Inspection of Documents: To verify that internal controls have operated properly.

2. Inquiries and Observations: To gather evidence about internal controls without an audit trail.

3. Re-performance: Independent execution of procedures originally performed by the entity.

4. Testing Computerized Applications: Assessing internal control effectiveness in specific computerized applications.

Q-15 How can auditors leverage data analytics, specifically Computer Assisted Auditing Techniques (CAATs), to **enhance the audit process and ensure the accuracy of financial information**?

Ans:

In the modern digital landscape, auditors can harness the power of data analytics, employing Computer Assisted Auditing Techniques (CAATs) to streamline the audit process and ensure the precision of financial information. CAATs encompass a variety of tools and techniques such as spreadsheets, IDEA, and ACL, enabling auditors to tap into vast electronic data sets.

Through the application of data analytics, auditors can check the completeness of data used in test controls or substantive audit tests, facilitate the selection of audit samples using methods like random or systematic sampling, and even reconstruct trial balances from transaction data for a comprehensive re-computation of balances.

Additionally, auditors can perform tasks like re-evaluating mathematical calculations (e.g., depreciation, bank interest), analysing journal entries, conducting fraud investigations, and assessing the impact of control deficiencies. This integration of data analytics into the audit process not only enhances efficiency but also empowers auditors to obtain meaningful insights from the massive volumes of electronic data present in IT systems, contributing to the overall effectiveness of the auditing function.

Q-16 XYZ Ltd. is a publicly traded company, and John, the auditor from ABC Audit Firm, is conducting the annual audit. During the planning phase, John considers materiality and audit risk. Sarah, the CFO of XYZ Ltd., provides him with the financial statements for the year. John identifies potential risks of material misstatement and plans the audit procedures accordingly. In the course of the audit, he discovers certain uncorrected misstatements. Discuss the **interplay between materiality and audit risk** in this scenario, and how John should address the identified misstatements

Ans:

John, the ABC Audit Firm auditor for XYZ Ltd., relies on materiality throughout the audit:

1. Risk Assessment: Identifies and assesses risks of material misstatement, including fraud or error, during planning.

2. Audit Procedures: Determines the nature, timing, and extent of audit procedures based on materiality and audit risks, focusing on high-risk areas.

3. Uncorrected Misstatements: Evaluates the impact of uncorrected misstatements on financial statements, communicating material findings to management.

4. Addressing Misstatements: Discusses material misstatements with XYZ Ltd.'s CFO, assessing the need for adjustments and considering implications on the overall audit opinion.

In conclusion, materiality and audit risk guide John in ensuring a reliable audit opinion on the fairness of XYZ Ltd.'s financial statements.

Q-17 What are the **key components and activities involved in risk assessment procedures** during an audit.

Ans:

Risk assessment procedures are fundamental for identifying and evaluating risks of material misstatement in financial statements. They include:

1. Inquiries of Management and Others within the Entity: Obtain information from management and other relevant personnel. Seek perspectives from individuals throughout the organization. Focus on those with different levels of authority for a comprehensive view.

2. Analytical Procedures: Use financial and non-financial data for risk assessment. Identify unknown aspects of the entity and assess material misstatement risks. Analyse relationships, such as sales versus square footage or volume of goods sold. Detect unusual transactions, events, or trends that may indicate fraud risks.

3. Observation and Inspection: Support inquiries of management and others through direct observation. Provide additional insights into the entity and its operating environment.

Q-18 Examine the repercussions of information technology (IT) risks on a technology-dependent company, outlining specific examples of potential impacts on operations, finance, and reputation. Suggest concise strategies to mitigate these risks.

Ans:

Impact of IT related risks

The above risks have to be mitigated. If not mitigated, such risks, could have an impact on audit in different ways discussed as under: -

Impact on substantive checking

Inability to address above discussed risks may lead to non-reliance of data obtained from systems. In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy. It could lead to increased substantive checking i.e., detailed checking.

Impact on controls

It can lead to non-reliance on automated controls, system calculations and accounting procedures built into applications. It may result in additional audit work.

Impact on reporting

Due to regulatory requirements in respect of internal financial controls (discussed in subsequent paras) in case of companies, it may lead to modification of auditor's report in some instances.

Q-19 What are some **key benefits for the auditor in evaluating the internal control system** during an audit, and how do these benefits contribute to the overall assurance in the auditing process?

Ans:

Evaluation of internal control system

The auditor must review the internal control system to ensure it adequately records all essential accounting information. This assessment provides the necessary assurance for the accuracy of accounting data.

Benefits of Evaluation of Internal Control to the Auditor

1. Identify if errors or fraud are likely in everyday business operations.

2. Determine if the internal control system is both adequate and operating as planned.

3. Assess the effectiveness of the internal auditing department.

4. Examine administrative controls, such as worker recruitment, which may impact the audit (e.g., weak controls could lead to false entries in wage sheets).

5. Ensure controls effectively safeguard assets.

6. Evaluate how well management records transactions accurately.

7. Gauge the reliability of management reports, records, and certificates.

8. Determine the necessary extent and depth of examination in different accounting areas.

9. Tailor audit techniques and procedures based on the specific circumstances.

10. Identify areas with weak or excessive controls.

11. Provide valuable suggestions for improving the overall control system.

Q-20 As the lead auditor for a manufacturing company undergoing changes in financial reporting systems and key personnel, **how do you plan to strategically use audit evidence obtained in previous audits to enhance the efficiency and effectiveness of the current audit**? Consider factors like changes in systems, personnel turnover, and the need for adaptation in your approach.

Ans:

In deciding if it's okay to use past audit evidence about how well controls are working and when to retest them, auditors should consider:

(a) Checking if other parts of the internal control, like the control environment, how the entity monitors controls, and its risk assessment process, are effective.

(b) Looking at risks tied to the control itself, such as whether it's manual or automated.

(c) Assessing how well general IT controls are working.

(d) Evaluating the effectiveness of the control and how the entity applies it, including any issues found in previous audits and if there have been personnel changes impacting the control.

(e) Checking if a lack of change in a control might be risky given new circumstances.

(f) Considering the risks of mistakes in financial statements and how much they rely on the control.

If the auditor plans to use evidence from a prior audit about how well specific controls are operating, they need to make sure it's still relevant by confirming if there have been any significant changes to those controls since the last audit.

Q-21 What is the primary objective of the auditor according to SA 315, and what specific steps does the auditor need to follow in order to **identify and assess the risks of material misstatement** at both the financial statement and assertion levels?

Ans:

In SA 315, the auditor aims to identify and evaluate the risks of material misstatement at both the financial statement and assertion levels, attributable to fraud or error. This understanding of the entity and its environment, encompassing internal controls, forms the basis for crafting responses to minimize material misstatement risks.

(i) The auditor's task is to identify and assess risks at:

1. Financial statement level

2. Assertion level for transactions, balances, and disclosures, guiding further audit procedures.

(ii) For this purpose, the auditor must:

1. Identify risks by grasping the entity and its environment, including relevant controls. This involves considering transactions, balances, and disclosures.

2. Assess identified risks, determining if they impact the financial statements overall and multiple assertions.

3. Link identified risks to potential assertion-level issues, accounting for controls to be tested.

4. Evaluate the likelihood of misstatement, including the chance of multiple misstatements, and assess if the potential misstatement could be materially significant.

Q-22 In a pharmaceutical company, why might the **disclosure of research and development** costs be considered for a materiality level lower than that for the financial statements as a whole?

Ans:

Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

1. Whether law, regulations or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items like in case of related party transactions, and the remuneration of management and those charged with governance.

2. The key disclosures in relation to the industry in which the entity operates. For example, research and development costs for a pharmaceutical company.

3. Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements like in case of newly acquired business.

Q-23 What should **auditors consider when deciding whether to use audit evidence** about the operating effectiveness of **controls from previous audits**, and how do they ensure the **continuing relevance of such evidence**?

Ans:

Auditors consider various points:

- The overall effectiveness of internal control elements, including the control environment and risk assessment.
- Risks associated with the control, such as whether it's manual or automated.
- The effectiveness of general IT controls.
- Application of the control by the entity, considering deviations noted in previous audits and personnel changes.
- Evaluation of whether unchanged controls pose a risk in evolving circumstances.
- The risks of material misstatement and reliance on the control.

To ensure continuing relevance, auditors must obtain evidence about significant changes in controls since the previous audit.

For example, consider a case where a company previously relied on automated controls for financial data accuracy. The auditor would assess changes in the system, personnel shifts, and any deviations observed in past audits to determine the ongoing suitability of relying on this control.

Q-24 Imagine you are an auditor tasked with examining the financial statements of XYZ Company. Explain **the concept of audit sampling according to SA 530, and discuss its significance in the audit process.** How does SA 530 guide auditors in **designing and selecting an audit sample, performing tests, and evaluating results?**

Ans:

Audit Sampling in SA 530: Audit sampling, as per SA 530, involves applying audit procedures to less than 100% of items within a relevant population under audit. It ensures that all items in the population have an equal chance of selection, aiming to represent the entire population and allow the auditor to draw conclusions for expressing an opinion based on predetermined objectives.

Significance in Audit Process:

1. Objective Achievement: The primary objective of audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the entire population from which the sample is selected.

2. Equal Chance of Selection: SA 530 emphasizes that each sampling unit (item in the population) should have an equal chance of being chosen, ensuring a fair representation.

3. Scope of SA-530: The standard becomes applicable when audit sampling is chosen. It covers both statistical and non-statistical sampling in designing and selecting the audit sample, performing tests, and evaluating results.

Relation to Other Standards:

1. Complement to SA 500: SA 530 complements SA 500, which deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence for drawing reasonable conclusions.

2. Testing Selection in SA 500: SA 500 lays down means for selecting items for testing, and one of those means is audit sampling, making SA 530 a crucial guideline in the audit process.

Conclusion:

Audit sampling, guided by SA 530, plays a vital role in the audit process by ensuring a representative sample, facilitating objective achievement, and complementing other standards like SA 500. It provides auditors with a systematic approach to designing, selecting, and evaluating samples, contributing to the overall reliability of audit conclusions and opinions.

Q-25 Imagine you are an auditor assigned to conduct a sample selection for the examination of purchase invoices in a large retail company. The population is extensive, and you need to ensure that the sample is representative of the entire population. **Evaluate and recommend an appropriate sample selection method.**

Ans:

1. Random Sampling:

Simple Random Sampling: Each unit in the population has an equal chance of selection, often using random number tables or generators.

Stratified Sampling: Population is divided into strata, and samples are taken proportionally from each stratum.

2. Interval Sampling or Systematic Sampling: Sampling units are selected at regular intervals, with a predetermined starting point. Use of computerized random number generators is recommended to enhance randomness.

3. Monetary Unit Sampling: Value-weighted selection where sample size, selection, and evaluation lead to conclusions in monetary amounts.

4. Haphazard Sampling: Selection without a structured technique, avoiding conscious bias or predictability. Not suitable for statistical sampling.

5. Block Sampling: Involves selecting contiguous blocks of items from the population. Generally not recommended for audit sampling due to potential bias and limitations in capturing diverse transaction types. Continuous transactions in a block may share similar characteristics, limiting representation of the entire population.

Q-26 As the lead auditor for a manufacturing company with recent changes in accounting software, **how do you ensure the adequacy of audit evidence for opening balances?** Briefly outline your approach, considering potential risks and the impact of the accounting system changes on accuracy and completeness.

Ans:

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.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Q-27 XYZ Corporation, a leading electronic device manufacturer, undergoes an annual audit by ABC Audit Firm. The **sufficiency of audit evidence**, and the **factors affecting auditor's judgement** as to the sufficiency of audit evidence.

Ans:

a) Materiality: XYZ introduces a new product line with a substantial financial impact. The audit team recognizes this as a material assertion, requiring in-depth audit procedures. Detailed audit procedures, including extensive testing, are applied to ensure the accuracy and completeness of financial information related to the new product line.

b) Risk of Material Misstatement: Inherent risk is higher in valuing inventory due to volatile electronic components' market prices. Recognizing the risk, the audit team plans more substantive procedures. Detailed inventory counts and price testing are conducted to gather sufficient evidence and mitigate inherent risks.

c) Size of Population: XYZ has a large and diverse customer base affecting accounts receivable. A larger, more varied sample size is necessary to cover diverse customer segments. The audit team selects a comprehensive sample size to ensure collectability assertions are well-supported and representative of the entire population.

Conclusion: The integration of materiality, risk of material misstatement, and size of population considerations in the audit of XYZ Corporation showcases the practical application of sufficiency of audit evidence. By tailoring audit procedures to specific factors, the audit team ensures a comprehensive and effective approach to address key financial statement assertions.

Q-28 Discuss the **objective of Auditor with respect to Opening balances** in conducting an initial audit engagement.

Ans:

In an initial audit engagement, the auditor's goal regarding opening balances is to gather enough evidence to determine:

(a) Accuracy: Check if there are any mistakes in the starting financial figures that would significantly impact the current financial statements.

(b) Consistency: Ensure that the accounting methods used in the opening balances are applied the same way in the current financial statements. If there are changes, confirm they are accounted for and disclosed properly according to the financial reporting rules.

Q-29 How does the source of information and the effectiveness of controls over data preparation **influence the reliability of data** when conducting substantive analytical procedures during an audit?

Ans:

1. Source: Reliable data often comes from independent sources outside the entity.

2. Comparability: Ensure that information is comparable, supplementing broad industry data when necessary.

3. Nature and Relevance: Assess if the information aligns with expected results, such as budgets reflecting anticipated outcomes.

4. Controls: Evaluate controls over data preparation to ensure completeness, accuracy, and validity.

5. Testing Controls: Consider testing the operating effectiveness of controls, especially for information used in substantive analytical procedures, to enhance confidence in data reliability. Testing may be done in conjunction with other control tests.

In summary, data reliability hinges on source independence, comparability, alignment with expectations, and effective controls. Testing control effectiveness boosts confidence in data reliability, particularly in non-financial information.

Q-30 While applying the **Substantive Analytical Procedures what techniques can be used** by the statutory auditor of a company to obtain sufficient and appropriate audit evidence?

Ans:

The auditor can use different techniques during Substantive Analytical Procedures to gather the right evidence:

1. Trend Analysis: Compare current data with past periods to see if it aligns with established trends or factors causing changes.

2. Ratio Analysis: Useful for understanding relationships between assets, liabilities, revenues, and expenses. Compares ratios over time or with similar entities in the industry.

3. Reasonableness Tests: Evaluate non-financial data for the current audit period, like occupancy rates for estimating rental income. Often applied to income statements and certain accrual accounts.

4. Structural Modelling: Use statistical models from past financial and non-financial data to predict current account balances, such as linear regression.

The choice of technique depends on data availability and specific case requirements.

For example, if assessing rental income, the auditor might use reasonableness tests by checking if occupancy rates align with expected rental income.

Q-31 What specific **audit procedures will you employ to gather sufficient and appropriate audit evidence** in order to assess the accuracy and completeness of revenue recognition in green Ltd Company's financial statements?

Ans:

Audit procedures to obtain audit evidence can include

1. **Inspection:** Examining records or physical assets, providing evidence of varying reliability. For example, checking authorization evidence in records.
2. **Observation:** Watching a process or procedure being carried out by others.
3. **External Confirmation:** Obtaining written responses directly from third parties, often used for account balances but not restricted to them.
4. **Recalculation:** Checking the accuracy of documents or records, either manually or electronically.
5. **Reperformance:** Independently redoing procedures or controls that were originally done by the entity.

6. Analytical Procedures: Evaluating financial and non-financial data relationships, investigating inconsistencies or significant deviations from predictions.

7. Inquiry: Seeking information from knowledgeable individuals within or outside the entity. Responses help corroborate evidence or provide new information, contributing to the audit process.

Q-32 Under what **circumstances should external auditors refrain from using the work of the internal audit function**, as outlined in auditing standards?

Ans:

The external auditor shall not use the work of the internal audit function if the external auditor determines that:

(a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;

(b) The function lacks sufficient competence; or

(c) The function does not apply a systematic and disciplined approach, including quality control.

Q-33 What is the **distinction between "Internal Financial Controls (IFC)" and "Internal Controls over Financial Reporting"?**

Ans:

Aspect	**Internal Financial Controls (IFC)**	**Internal Controls over Financial Reporting**
Purpose	Ensure reliability of financial reporting, operational effectiveness, efficiency, legal compliance, asset safeguarding, and fraud prevention and detection.	Focus specifically on the effectiveness of internal controls over financial reporting.

Scope	Broad, covering various aspects of company operations beyond financial reporting.	Narrow, concentrating on internal controls directly tied to financial reporting.
Auditor's Opinion	Not specifically subject to an auditor's separate opinion; integrated into the overall audit assessment.	Requires a distinct auditor's opinion on the effectiveness of internal controls over financial reporting, separate from the opinion on financial statements.
Legal Compliance	Encompasses compliance with applicable laws and regulations as part of its scope.	While indirectly addressing legal compliance through financial reporting, the primary emphasis is on controls related to financial reporting processes.

In summary, Internal Financial Controls (IFC) have a broader scope, covering various aspects of company operations, while Internal Controls over Financial Reporting are more specific, focusing on controls directly tied to financial reporting. The distinction lies in both purpose and scope, with the latter requiring a separate opinion from auditors.

Q-34 Given the circumstances prompting a reconsideration of reliance on the internal audit function in the annual external audit planning phase for the multinational technology company, **what specific factors or issues have been identified that necessitate a shift towards performing more audit work directly** and potentially reducing reliance on the internal audit function?

Ans:

The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly if:

a) The more judgment is involved in:

- ♦ Planning and performing relevant audit procedures; and
- ♦ Evaluating the audit evidence gathered;

b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant;

c) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and

d) The lower the level of competence of the internal audit function.

Q-35 Crossword Ltd. has issued shares for cash at a premium. **Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account.** Advise the means in which the amount in the account can be applied.

Ans:

Shares Issued at Premium: In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account, the securities premium account may be applied by the Company:

a) Towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

b) In writing off the preliminary expenses of the Company;

c) In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

d) In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

e) For the purchase of its own shares or other securities under section 68.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above

Q-36 In auditing **Employee Benefits Expenses**, how does the organization, XYZ Corporation, ensure a transparent and efficient process for **employee hiring, performance appraisal, and retirement,** and what controls are in place to mitigate potential risks in these processes?

Ans:

Employee Benefits Expenses: It is also known as payroll expenses, include the total amount a company pays its employees for their work, covering perks, post-employment benefits like gratuity, and contributions to funds. This expense is significant for many industries, so it's crucial for businesses to handle it wisely. Auditors play a key role in making sure these expenses are appropriate, following accounting standards and principles.

Auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

1. The auditor checks if the company's controls for paying employee benefits, like keeping attendance records and getting payroll approvals, are working well. If they are, the auditor can do less detailed testing. Controls also cover things like taxes and benefits.

2. The auditor looks at random examples of transactions and reviews documents like appointment letters, performance appraisals, attendance records, and HR policies.

3. The auditor does important checks, called substantive procedures. This includes looking at monthly expenses, comparing them to past periods, and setting expectations based on the company's activities and industry trends.

Q-37 For ABC Corp, **how does the auditor ensure that expenditures for rent, power, and miscellaneous expenses in the current period are valid**, properly documented, correctly classified, authorized according to the delegation matrix, and strictly business-related rather than personal?

Ans:

An entity, in addition to engaging in purchases and incurring employee benefit expenses, also deals with various other expenditures essential to its business operations, such as rent, power and fuel, repairs and maintenance, insurance, travel, and miscellaneous expenses. While the auditor may opt to analyse monthly trends for expenses like rent, power, and fuel, **they typically choose to vouch for other expenses to verify the following attributes:**

1. Whether the expenditure is relevant to the current audit period;

2. Whether the expenditure qualifies as revenue rather than capital expenditure;

3. Whether there are valid supporting documents such as travel tickets, insurance policies, third-party invoices, etc.;

4. Whether the expenditure has been correctly classified under the appropriate expense head;

5. Whether the expenditure was authorized in accordance with the delegation of authority matrix;

6. Whether the expenditure is related to the entity's business and not a personal expense.

Q-38 How should the statutory auditor of Horizon Enterprises Ltd. go about **verifying the validity of the company's legal ownership rights over the inventories listed in the balance sheet as of March 31, 2023?**

Ans:

The statutory auditor of Horizon Enterprises Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2023. **The auditor should:**

✓ Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).

✓ Evaluate the consigned goods.

✓ Examine client correspondence, sales and receivables records, purchase documents.

✓ Determine existence of collateral agreements.

✓ Review consignment agreements.

✓ Review material purchase commitment agreements.

✓ Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.

✓ Obtain confirmation for significant items of inventory.

For Example of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

Q-39 How should a company disclose its **cash and cash equivalents according to Schedule III of the Companies Act, 2013**, particularly emphasizing earmarked balances, the purpose of balances held with banks, and any repatriation restrictions on cash and bank balances?

Ans:

The following are the disclosure requirements as per Schedule III to the Companies Act, 2013, with respect to the cash & cash equivalents held by the company:

Cash and cash equivalents

➔ Cash and cash equivalents shall be classified as:

♦ Balances with banks;

♦ Cheques, drafts on hand;

♦ Cash on hand;

♦ Others (specify nature)

➔ Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

➔ Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

➔ Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

➔ Bank deposits with more than 12 months' maturity shall be disclosed separately.

Q-40 Has XYZ Company, after obtaining a special resolution, **issued Sweat Equity Shares to its employees and directors in compliance with Section 54 of the Companies Act, 2013,** specifying the number of shares, current market price, consideration, and the relevant class, while adhering to stock exchange regulations if listed?

Ans:

Issue of Sweat Equity Shares: According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares".

"**Sweat Equity Shares**" mean equity shares issued by the company to employees or directors at a

➔ Discount or

➔ For consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54):

(a) The issue is authorized by a special resolution passed by the company;

(b) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) Omitted

(d) Where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Further, the rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

Q-41 Visionary Dynamics Corporation, a manufacturing company, has hired you as an auditor to **verify its trade receivables**. You have started reviewing the process and procedures related to trade receivables.

Ans:

For Verification of Existence of Trade Receivables, the auditor should check the following:

- **Check for Duplicate Entries:** Ensure there are safeguards preventing the same invoice from being recorded more than once. Confirm that receivable amounts are automatically updated in the general ledger from the original invoices.
- **Verify Realization and Payment Handling:** Check if payments are recorded per invoice. that received payments are applied in chronological order (oldest invoices first).
- **Investigate Large Outstanding Balances:** If there are big outstanding amounts, ask the company for explanations and justifications.
- **Confirmation Letters:** Request an accounts receivable report at the end of the period. Match the report balance with the general ledger. Confirm selected receivables by sending request letters to customers.
- **Control over Confirmation Process:** Ensure strict control over the accuracy and delivery of confirmation letters. Confirmations and undelivered letters should be returned to the auditor, not the client.
- **Address Discrepancies:** Investigate any differences found in confirmations or additional tests. Recognize that discrepancies might impact other accounts not initially examined.
- **No Response from Customers:** If there's no reply from customers, perform alternative procedures to verify balances.
- **Subsequent Cash Receipts:** Verify the balance by comparing it with cash received after the confirmation date.
- **Detailed Analysis of Balances:** Scrutinize balances in-depth, ensuring they consist of real transactions. Confirm that the recorded revenue transactions actually occurred.

➢ **Review Related Party Receivables:** Assess the collectability of receivables involving related parties. Confirm proper authorization and reasonable values for these transactions.

➢ **Exclude Non-Relevant Receivables:** Ensure that only receivables related to sales or services are considered.

➢ **Analyse Trends:** Review the trend of sales and accounts receivable over time. Ask management about any unusual trends and document the explanations.

Q-42 Suppose an auditor is conducting an audit of a small business's financial statements. **How would the principles outlined in SA 230 regarding audit documentation be applied** in this scenario? Additionally, explain how the **nature of audit documentation**, as highlighted in SA 230, contributes to ensuring the audit's compliance with auditing standards and relevant legal requirements.

Ans:

Audit documentation

SA 230 on "Audit Documentation", deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The specific documentation requirements of other SAs do not limit the application of this SA. Laws or regulations may establish additional documentation requirements.

Nature of Audit Documentation

Audit documentation provides:

(a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Q-43 The **form, content and extent of audit documentation** depends upon number of factors. List out **any four such factors**

Ans:

Form, Content and Extent of Audit Documentation

1.) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) The nature, timing and extent of the audit procedures performed.

(b) The results of the audit procedures performed and the audit evidence obtained and

(c) Significant matters arising during the audit and the conclusions reached thereon and significant professional judgements made in reaching those conclusions.

2.) Further in documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

(a) The identifying characteristics of the specific items or matters tested.

(b) Who performed the audit work and the date such work was completed; and

(c) Who reviewed the audit work performed and the date and extent of such review.

3.) The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

4.) If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

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

- The identified risks of material misstatement.
- The nature and extent of exceptions identified.
- The size and complexity of the entity.
- The audit methodology and tools used.

Q-44 In the context of a large and complex audit, illustrate how the use of **an audit documentation** summary can enhance the effectiveness and efficiency of reviews and inspections of the audit documentation, highlighting specific benefits and considerations for such audits.

Ans:

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-

- ✓ The significant matters identified during the audit and
- ✓ 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.

Q-45 As a junior auditor, your supervisor stresses the purpose of audit documentation in maintaining quality and compliance. **How does the documentation you're reviewing contribute to these goals?**

Ans:

The following are the purpose of Audit documentation:

1) Assisting the engagement team to plan and perform the audit.

2) Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.

3) Enabling the engagement team to be accountable for its work.

4) Retaining a record of matters of continuing significance to future audits.

5) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

6) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Q-46 What is the recommended time limit, **as per SQC 1, for completing the assembly of the final audit file** after the date of the auditor's report, and **why is it considered an administrative process?**

Ans:

Assembly of the Final Audit File: 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 report. 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.

➔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

Q-47 Imagine you are an auditor reviewing the financial statements of a company. During your audit, you come across information about a planned merger that occurred between the date of the financial statements and the date of your auditor's report. How would you approach this **subsequent event in accordance with SA 560, and what specific objectives outlined in the standard would guide your actions?**

Ans:

Subsequent events: Subsequent events in financial reporting refer to occurrences between the financial statement date and the auditor's report date, as well as facts discovered by the auditor after issuing the report. These events can impact the financial statements, and financial reporting frameworks typically categorize them into two types:

(a) Events offering evidence of conditions existing at the financial statement date.

(b) Events providing evidence of conditions emerging after the financial statement date.

SA 560 Subsequent Events: It deals with the auditor’s responsibilities relating to subsequent events in an audit of financial statements.

The auditor's main goals, as per SA 560, are to:

(a) Collect enough relevant audit evidence to determine if any events happening between the financial statement date and the auditor's report date need adjustments or disclosure in the financial statements.

(b) React appropriately to any new information discovered after the auditor's report date that, if known earlier, might have led to changes in the auditor's report.

Q-48 Imagine you are a consultant hired by a medium-sized manufacturing company, XYZ Manufacturing Inc. The company has been facing challenges with its production efficiency and employee morale. The board of directors is concerned about **Why written**

representations about management responsibilities necessary, and could you provide a detailed description of management's responsibilities as outlined in these written representations?

Ans:

Written representations as audit evidence

Written representations are vital audit evidence, akin to responses to inquiries. They are essential for the auditor in evaluating the entity's financial statements. If management alters or withholds requested representations, it may signal potential issues. Written representations prompt thorough consideration by management, enhancing the quality of information. While valuable, written representations alone are insufficient for audit conclusions. They don't alter the need for diverse audit evidence on management responsibilities and specific assertions. **SA 580- Written representations** deals with the auditor’s responsibility to obtain written representations from management and, where appropriate, those charged with governance.

Why written representations about management responsibilities are necessary?

Audit evidence on management fulfilling responsibilities for financial statements isn't sufficient without explicit confirmation from management. The auditor cannot solely rely on other evidence to judge if financial statements are prepared as agreed. Written representations seek confirmation on management's acknowledgment and understanding of responsibilities in the audit engagement terms. Without asking and confirming, the auditor cannot conclude that all relevant information has been provided by management. Written representations may include reconfirmation of management's understanding of their responsibilities.

Description of management’s responsibilities in written representations: Management’s responsibilities shall be described in the “Written representations required about management responsibilities” in the manner in which these responsibilities are described in the terms of the audit engagement.

Q-49 Who are "Those charged with governance" in the context of Lady Shree Ram Corporation's audit, considering its governance structure involving both executive and supervisory boards? How should the auditor determine the appropriate persons with whom to communicate, and what factors should be taken into account when making this decision?

Ans:

Who are "Those charged with governance:

The individuals or groups responsible for guiding and overseeing the direction of an organization, ensuring accountability, and managing financial reporting are collectively known as those "charged with governance." This can include executive members of a governance board, company directors, or owner-managers. Governance structures differ based on cultural, legal, and ownership factors, ranging from separate supervisory and executive boards to a single combined board.

In most cases, governance is a shared responsibility among a governing body, such as a board of directors or trustees. However, in smaller entities, a single person, like an owner-manager or sole trustee, may be in charge. The diverse nature of governance structures makes it challenging to specify whom the auditor should communicate with in all cases. Some entities, like family-owned businesses or not-for-profit organizations, may not have a formally defined governance structure.

In such situations, the auditor may need to discuss and agree with the engaging party on the relevant individuals to communicate with. The decision is based on the auditor's understanding of the entity's governance structure obtained through SA 315. The appropriate individuals for communication may vary depending on the specific matter at hand.

Q-50 ABC Ltd. finalized its financial statements for the year ending December 31, 2023, and is now deliberating on the date to issue them. In the context of SA 560, **what considerations should ABC Ltd. take into account when determining the "Date the financial statements are issued"?**

Ans:

Date the financial statements are issued:

It reflects the date that the auditor’s report and audited financial statements are made available to third parties. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor’s report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor’s report, but must also be at or later than the date the auditor’s report is provided to the entity.

Q-51 As a financial analyst conducting a comprehensive review for Alpha Ventures Company, could you explain the concept of the term **'going concern'** and elaborate on the specific **responsibilities associated with assessing the entity's ability** to continue as a going concern?

Ans:

Going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

SA 570 Going Concern deals with the auditor’s responsibilities in the audit of financial statements relating to going concern and the implications for the auditor’s report.

Responsibility for assessment of the entity’s ability to continue as a going concern:

The preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so. 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: -

- 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.
- 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.
- 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

Q-52 In the context of **risk assessment procedures**, explain the auditor's role in evaluating the entity's ability to continue as a going concern. Highlight the key steps the auditor should take when management has not yet performed a preliminary assessment, and discuss the potential impact on the audit process.

Ans:

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.

The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Q-53 As the lead auditor for a retail company, **how do you adjust audit procedures when identifying significant events or conditions affecting financial statements?** Briefly outline your approach, considering the nature and potential impact of these events on the accuracy and completeness of financial information.

Ans:

Additional audit procedures when events or conditions are identified.

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 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 and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

Q-54 you are the lead auditor for Elysian Company, and during the audit of their financial statements, you have identified several misstatements. **Provide a comprehensive evaluation of the misstatements and discuss the necessary documentation procedures you would undertake.**

Ans:

When auditors are checking a company's financial statements, they find mistakes (misstatements). Before they give their final opinion on the financial health of the company, they have to look at the impact of these mistakes.

SA 450 deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

Documentation regarding misstatements identified during audit:

(a) The amount below which misstatements would be regarded as clearly trivial;

(b) All misstatements accumulated during the audit and whether they have been corrected;

(c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

Q-55 Why is it crucial to communicate significant deficiencies in internal control in writing to those charged with governance, and **how does this communication assist them in fulfilling their oversight responsibilities, as outlined in SA 265?**

Ans:

Why communication of significant deficiencies in internal control is necessary:

Communicating significant deficiencies in internal control in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities.

Scope of SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

SA 265 deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.

The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. SA 265 specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

Q-56 How would you recommend a **communication professional navigate the correction of misstatements i**n a press release, taking into account factors such as timing, coordination with the client, internal communication, and strategies for managing potential reputational damage if the misinformation has already been disseminated by media outlets?

Ans:

Communication and correction of misstatements:

The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.

The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

Q-57 M/s sun is an auditor of Delight Ltd. advising a class on **the essentials of an auditor's report on financial statements, outline the key components and considerations that should be part of a comprehensive "bird's eye view.** What critical information would you highlight to ensure a clear understanding of the financial health of a company and to meet regulatory requirements?

Ans:

M/s sun is an auditor of Delight Ltd. providing a bird's eye view on the financial statements of a company as below:

Standard on	Name of SA	Matters dealt with (Scope)

Auditing		
SA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements	➢ The auditor's responsibility to form an opinion on financial statements. ➢ The form and content of the Auditor's Report.
SA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report	✓ Auditor's responsibility to issue an appropriate report in circumstances when auditor concludes that a modification to auditor's opinion is necessary. **Three types of modified opinion:** ♦ A Qualified Opinion ♦ An adverse opinion ♦ A disclaimer of opinion
SA 701	Communicating Key Audit Matters in the Independent Auditor's Report	♦ The auditor's responsibility to communicate key audit matters in the auditor's report. ♦ What to communicate and the form and content of such communication
SA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	➔ Additional communication in the auditor's report when the auditor considers it necessary to draw users' attention to a matter: ♦ Presented or disclosed in the financial statements and which is fundamental for the user's understanding. ♦ Not presented or disclosed in the financial statements and which are relevant for the user's understanding.

Q-58 As an auditor reviewing Agarwal Corporation's financial statements, have uncovered a material contingent liability from a pending legal dispute. **How would you employ an Emphasis of Matter paragraph in the Independent Auditor's Report to provide necessary context on this issue while maintaining transparency?**

Ans:

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 judgement, 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.

Q-59 In the context of SA 700 (Revised) on "**Forming an Opinion and Reporting on Financial Statements**," discuss the significance of promoting consistency in the auditor's report globally. Additionally, outline the primary **objectives of the auditor as outlined in SA 700 (Revised).**

Ans:

Forming an opinion and reporting on financial statements:

SA 700 (Revised) focuses on the auditor's role in forming an opinion on financial statements and issuing a report. It emphasizes the balance between global consistency and relevance in auditor reporting, allowing flexibility for jurisdiction-specific considerations. Consistent auditor reporting, aligned with global standards, enhances credibility in the global marketplace, aiding user understanding and identification of unusual circumstances.

The objectives of the auditor as per SA 700 (Revised) are:

- To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- To express clearly that opinion through a written report.

Q-60 What is the requirement for the format of the auditor's report, including the use of specific headings to improve recognition, especially in audits conducted in accordance with the relevant Standards on Auditing?

Ans:

AUDITOR'S REPORT

The auditor's report shall be in writing. This SA- 700 requires the use of specific headings, which are intended to assist in making auditor's report more recognizable, where audit is conducted in accordance with the relevant Standards on Auditing.

Auditor's Report for Audits Conducted in Accordance with Standards on Auditing

1. Title: The auditor's report must clearly state its independence, such as "Independent Auditor's Report," to distinguish it from other reports.

2. Addressee: The report is appropriately addressed based on engagement circumstances, often directed to shareholders or governance entities as specified by law, regulation, or engagement terms. In the case of a company, it is typically addressed to the shareholders.

3. Basis for Opinion: The "Basis for Opinion" section in the auditor's report

- Confirms adherence to Standards on Auditing.
- Refers to the section outlining auditor responsibilities under SAs.
- Asserts auditor independence and compliance with ethical requirements.
- States if the audit evidence is deemed sufficient and appropriate for forming the opinion.

This section provides crucial context for the auditor's opinion.

4. Key Audit Matters (KAM): For audits of complete financial statements of listed entities, auditors communicate KAM in the report per SA 701. If required by law or chosen by the auditor, communication of KAM must align with SA 701. Law or regulation may mandate this for audits of non-listed entities.

5. Other Information: If applicable, auditors report in accordance with SA 720 (Revised) regarding other information.

6. The auditor's responsibilities for the audit of financial statements can be included:

✓ **Within the auditor's report:** The description is placed directly in the body of the auditor's report.

✓ **In an appendix to the auditor's report:** If included in an appendix, the auditor's report must reference the location of the appendix.

✓ **By specific reference within the auditor's report to a website:** The description can be on a relevant authority's website, referenced specifically in the auditor's report if permitted by law or standards.

7. Signature: The auditor's report is signed by the engagement partner in their personal name. If the audit firm is appointed, it's signed in the personal name of the auditor and in the name of the audit firm. The signing partner mentions their ICAI membership number, and the audit reports include the firm's registration number.

8. Place of Signature: The auditor's report specifies the location, typically the city where the report is signed.

9. Date of the Auditor's Report: The report is dated no earlier than when sufficient audit evidence is obtained. This evidence includes preparation of financial statements and a statement from those with authority asserting responsibility.

10. Responsibilities for the Financial Statements: 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.

(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.

Q-61 Which class of companies is specifically exempt from the applicability of the Companies (Auditor's Report) Order (CARO) 2020?

Ans:

CARO 2020 shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013, except–

(i) A banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) An insurance company as defined under the Insurance Act, 1938 (4 of 1938);

(iii) A company licensed to operate under section 8 of the Companies Act;

(iv) A One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act; and

(v) A private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

Q-62 XYZ Corporation engaged ABC Auditors for their annual audit. During the audit, ABC Auditors encountered significant uncertainties and challenges. **Despite obtaining sufficient evidence on individual uncertainties**, they faced difficulty assessing the potential cumulative effect of these uncertainties on the financial statements. In this scenario, **what type of modification to the auditor's opinion is appropriate?**

Ans:

Circumstances When a Modification to the Auditor's Opinion Is Required

➢ The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement**; or**

➢ The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Types of Modified Opinions

- **Qualified Opinion:** Material misstatements exist but are not pervasive. Inability to obtain sufficient evidence, with potential material effects not pervasive.
- **Adverse Opinion:** Given when the auditor, with enough evidence, finds material and pervasive misstatements in the financial statements.
- **Disclaimer of Opinion:** Unable to obtain sufficient evidence with potential material and pervasive effects. In extremely rare circumstances with multiple uncertainties, even with sufficient evidence, unable to form an opinion due to potential interactions and cumulative effects.

Q-63 How does the auditor determine Key Audit Matters, and 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

Ans:

Determining Key Audit Matters

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:**

♦ Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.

♦ Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.

♦ The effect on the audit of significant events or transactions that occurred during the period.

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.

Q-64 How do **audit procedures vary concerning comparative information** in financial statements, and what influences the **nature of comparative information** in an entity's financial statements?

Ans:

The Nature of the Comparative Information

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement. **The essential audit reporting differences between the approaches are:**

(a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas

(b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Audit Procedures regarding comparative information

♦ The auditor checks if financial statements include required comparative information and if it's correctly classified. This involves verifying:

(a) Agreement of comparative data with prior period amounts and disclosures.

(b) Consistency of accounting policies between comparative and current periods; changes, if any, should be appropriately accounted for and disclosed.

♦ If a potential material misstatement is detected in comparative information during the current audit, the auditor must conduct additional procedures to gather sufficient evidence. If the auditor had previously audited the prior period's financial statements, they should also adhere to the relevant requirements outlined in SA 560.

♦ As required by SA 580, the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

Q-65 What are the key objectives outlined in SA 580 regarding the auditor's consideration of management's use of the going concern assumption? How does the standard guide auditors in evaluating management's assessment, and what specific procedures are recommended to fulfil these objectives?

Ans:

Objectives of auditor in accordance with SA 580

(a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and

(c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

Q-66 The practice of appointing Chartered Accountants as **joint auditors** is quite widespread in big companies and corporations**. Explain stating the advantages of the joint audit.**

Ans:

JOINT AUDIT

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the advantages that flow may be the following:

♦ Sharing of expertise.

♦ Advantage of mutual consultation.

♦ Lower workload.

♦ Better quality of performance.

♦ Improved service to the client.

♦ In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.

♦ Lower staff development costs.

♦ Lower costs to carry out the work.

♦ A sense of healthy competition towards a better performance.

Q-67 Discuss the factors affecting the decision of the auditor regarding **which type of modified opinion is appropriate?**

Ans:

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.

The table below 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	**Auditor's Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Statements**	
	Material but not Pervasive	**Material and Pervasive**
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Q-68 What are the **reporting obligations outlined in CARO 2020** concerning funds raised through an **initial public offer (IPO)** or further public offer by a company? Additionally, **how does CARO 2020 address reporting requirements when a company conducts preferential allotment or private placement of shares?**

Ans:

The following are the disclosure requirements as per CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

(a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of noncompliance;

Q-69 In the case of innovateWorks Engineering Ltd, a company incorporated in India with branches both within and outside the country, **what are the criteria for appointing auditors for these branches?** Additionally, to **whom is the auditor of a branch, whether within or outside India, required to report?**

Ans:

Sub-section (8) of section 143 of the Companies Act, 2013 outlines the duties and powers of the company's auditor regarding the audit of branches. If a company has a branch office, the accounts can be audited by the company's auditor or any other qualified person appointed under section 139. For branch offices outside India, the audit can be conducted by the company's auditor or a qualified auditor according to the laws of that country. The branch auditor submits a report to the company's auditor, who incorporates it into their report as needed.

Rule 12 of the Companies (Audit and Auditors) Rules, 2014 states that the branch auditor must report to the company's auditor, and any fraud reported by the auditor extends to the branch auditor concerning the relevant branch.

To make things clearer, let's define the following terms:

1. Principal Auditor: The auditor responsible for reporting on the financial information of the entity, including components audited by another auditor.

2. Other Auditor: An auditor, excluding the principal auditor, responsible for reporting on the financial information of a component included in the financial information audited by the principal auditor.

3. Component: Refers to a division, branch, subsidiary, joint venture, associated enterprise, or any other entity. The financial information of this entity is included in the overall financial information audited by the principal auditor.

Q-70 Considering the Constitution of India, could you **elucidate the specific procedures and provisions governing the appointment of the Comptroller and Auditor General (C&AG)?**

Ans:

The Constitution of India contains specific provisions regarding the appointment, salary and duties and powers of the C&AG.

1. Appointment & Removal:

The President appoints the Comptroller & Auditor General (C&AG), ensuring independence. Removal requires a 2/3rd majority vote in each House of Parliament for proven misbehaviour or incapacity. Salary and conditions are determined by Parliament but can't be changed to the C&AG's disadvantage post-appointment.

2. Tenure:

The C&AG has a fixed tenure as per the Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. Receives a salary equal to a Supreme Court Judge, enhancing independence.

3. Constitutional Provisions:

Article 149: C&AG's duties and powers are prescribed by Parliament under laws.

Article 150: President, advised by C&AG, determines the form of Union and State accounts.

Article 151: C&AG's reports on Union/State accounts submitted to President/Governor, laid before Parliament/State Legislature.

Q-71 As the auditor for a charitable institution, Ashwin is scrutinizing Subscription and Donation accounts. Describe the specialized audit procedures Ashwin should implement for these transactions, highlighting unique considerations and challenges specific to auditing charitable institutions.

Ans:

AUDIT OF CHARITABLE INSTITUTION

1. General: Examine the constitution under which the institution is established. Verify compliance with the governing law. Review the internal check system, especially in accounting for collections. Detailed verification of income, ensuring timely bank deposits.

2. Subscriptions and Donations: Ascertain changes in subscription amounts. Confirm issuance of official receipts and control over receipt books. Test-check counterfoils with the cash book and reconcile with published figures.

3. Legacies: Verify received amounts through correspondence and available information.

4. Grants: Vouch amounts received with relevant documentation. Obtain a certificate from a responsible official on grant amounts.

5. Investments Income: Vouch amounts with dividend and interest counterfoils. Check interest calculations and dividends received from investments.

6. Rent: Examine rent roll and inspect tenancy agreements. Vouch rent from counterfoils to the rent roll, checking totals in the cash book.

7. Special Functions: Vouch receipts and outgoings for special events. Verify accounting for proceeds of issued tickets for events.

8. Income Tax Refunds: Verify Income-tax refund with correspondence. Check the calculation of repayment claims.

9. Expenditure: Vouch grant payments, ensuring compliance with charitable purposes. Verify securities schedules and property inventories through inspections. Confirm cash and bank payments. Ascertain proper utilization of funds contributed for specific purposes.

Q-72 In examining the financial administration of local bodies, **what specific aspects should auditors prioritize to ensure a comprehensive and effective audit?** Provide a detailed analysis highlighting key considerations and challenges that auditors might encounter in this context.

Ans:

The auditor must grasp the financial administration of local bodies before commencing an audit. Key aspects include:

(a) Budgetary Procedure: Municipal budget procedures aim for financial accountability and expenditure control. The focus is on aligning fund usage with legislative rules. Budget preparation determines tax levels and expenditure limits. Municipal budgets lack strict separation between revenue and capital items, often using an "extraordinary items" category for capital transactions. Special funds or separate budgets may exist for specific functions or enterprise activities like education, water supply, sanitation, transport, and electricity.

(b) Expenditure Control: Expenditure control in municipal government faces challenges due to the integration of legislative and executive powers, hindering the executive's inquisitorial role. The separation of executive functions makes it impractical to have an independent finance officer. As a result, external audits by the state government become the sole means of controlling municipal expenditure.

(c) Accounting System: Municipal accounting and budget formats are criticized for being complex and unclear. They often provide insufficient or excessive information, hindering effective management information systems.

Q-73 In the audit of Infinity Pulse accounts, where 15 film shows are hosted daily, the contractual agreement with Film Distributors is a focal point. **Discuss the critical aspects and specific points that, as an auditor, you would thoroughly examine in this agreement.** Provide a concise overview emphasizing key considerations to ensure financial accuracy and compliance.

Ans:

1. Internal Control Verification: Ensure cinema-hall entrance only through serialized, bound printed tickets. Differentiate ticket numbers for each show and class. Issue a separate ticket series for advance bookings. Custody of ticket inventory held by a responsible official.

2. Sales and Cash Reconciliation: Verify end-of-show statement for sold tickets, reconcile with cash collected.

3. Management of Free Passes: Confirm records and proper authorization for 'free passes.'

4. Tax Collection Verification: Reconcile collected tax with the total tickets issued for each class. Vouch and verify monthly tax returns.

5. Cash Book Entries Verification: Vouch cash collected for different shows by referencing Daily Statements.

6. Advertisement Charges and Shorts: Verify charges for advertisement slides and shorts with the Register of Exhibited Slides and Shorts and related agreements.

7. Expenditure Verification: Vouch for advertisement, repairs, and maintenance expenses. No capitalization of any part of such expenditure.

8. Depreciation Verification: Confirm appropriate depreciation on machinery and furniture.

9. Film Hire Payments Verification: Vouch payments for film hire with distributor bills, referencing agreements.

10. Advance Payment for Film Hire: Examine unadjusted balances of advances paid to distributors against film hire contracts. Enquire about unrecovered advances and make provisions for irrecoverable amounts.

11. Restaurant Income Collection: Enquire into the arrangement for restaurant income collection. Check accounts if the cinema runs the restaurant. Audit sales, purchases, and financial transactions similar to a club's audit.

Q-74 Can you outline the broad **differences between Operating Lease and Finance Lease,** detailing the distinctive characteristics that define each type of lease arrangement?

Ans:

The below table captures the broad differences under both the above said types of lease arrangements:

Basis	**Operating Lease**	**Financial Lease**
Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant and Machinery, Land, Office Building etc.
Ownership	Ownership of the asset remains with the lessor for the entire period of lease.	Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.
Accounting treatment	Operating lease is generally treated like a renting arrangement. That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee's balance sheet	Financial lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.
Purchase Option	Under operating lease, the lessee does not have any	Financial lease allows the lessee to have a purchase option at less than

	option to buy the asset during the lease period.	the fair market value of the asset.
Lease Term	Lease term generally extends to less than 75% of the projected useful life of the leased asset.	Lease term is generally more than or equal to estimated economic life of the asset under the lease arrangement.
Operating/ running expenses	Lessee pays only the monthly lease payments. No running or	Lessee generally bears insurance, maintenance and taxes.

Q-75 As an auditor tasked with examining the financial transactions of a hospital, encompassing patient treatment, receipt collections, donations, and capital expenditures, outline the specific points of consideration that you would prioritize**. Discuss the key audit considerations and challenges unique to the healthcare sector, ensuring a thorough and effective examination of the hospital's financial transactions.**

Ans:

AUDIT OF HOSPITAL

1. Register of Patients: Verify patient records with bills issued. Cross-check bills with attendance records to ensure accuracy. Confirm bills issued according to hospital rules.

2. Collection of Cash: Check cash entries in the Cash Book against receipts, counterfoils, and supporting evidence.

3. Income from Investments, Rent, etc: Confirm all expected income from properties, dividends, and securities has been collected.

4. Legacies and Donations: Ensure that received legacies and donations for specific purposes have been appropriately applied.

5. Reconciliation of Subscriptions: Trace subscription and donation collections in the Cash Book to the respective Registers. Reconcile total subscriptions due with amounts collected and outstanding.

6. Authorizations and Sanctions: Verify purchases and expenses, ensuring prior authorization for capital expenditure and staff appointments.

7. Grants and TDS: Confirm proper accounting for government grants and ensure the claim for tax deducted at source refunds.

8. Budgets: Compare actual expenditure and income with budgeted amounts, reporting significant variations.

9. Internal Check: Examine internal checks for the receipt and issue of stores to ensure proper recording and authorization.

10. Depreciation: Confirm that depreciation has been appropriately applied to all assets.

11. Registers: Inspect bonds, share scrips, and property title deeds, comparing details with Registers.

12. Inventories: Obtain and physically check a percentage of year-end inventories, comparing values with ledger balances.

13. Management Representation and Certificate: Obtain a proper Management Representation and Certificate covering various aspects of the audit.

Q-76 What is the **Government Audit**, and could you **elaborate on its objectives**, highlighting the key purposes and aims that government auditors aim to achieve through the auditing process?

Ans:

GOVERNMENT AUDIT:

Government audit has a long history, evolving with political, social, and economic developments. It ensures accountability for public revenue and expenditure, with Parliament or State Legislatures controlling government spending through demand for grants. After expenses, Appropriation Accounts are scrutinized by the Public Accounts Committee. The nature of government activities has transformed since independence, leading to a shift from expenditure-focused audits to evaluating overall operational outcomes. The scope expanded to include receipts, tax, non-tax, and commercial audits due to increased public enterprise growth. Government audit has adapted traditional auditing principles and introduced new concepts, techniques, and procedures to suit governmental transactions and enhance public accountability.

Objectives of Government Audit:

1. Accounting for Public Funds: Serves as a mechanism for public accounting of government funds.

2. Appraisal of Government Policies: Provides public accounting of operational, management, program, and policy aspects of public administration. Ensures accountability of officials administering these policies.

3. Base for Corrective Actions: Audit observations highlight lapses in the lower hierarchy, aiding supervisory officers in taking corrective measures.

4. Administrative Accountability: Government audit is not an investigating agency but aims to ensure accountability of administration to the legislature. Discharged by the independent statutory authority of the Comptroller and Auditor General in India through the Indian Audit and Accounts Department. Ensures compliance with the Constitution, laws, and rules governing financial matters.

Q-77 As the auditor of the Sporting Club of India, a prominent private sports promotion entity, **what specific audit measures would you employ to ensure that the expenditures incurred** during the year are duly authorized? **Please discuss its key points, taking into consideration the club's governance structure and financial processes.**

Ans:

AUDIT OF CLUB

1. Entrance Fee: Verify entrance fee receipts with member applications and committee minutes.

2. Subscriptions: Match member subscriptions with issued receipts, cross-check with the Register of Members. Reconcile total due subscriptions with collected and outstanding amounts.

3. Arrears of Subscriptions: Confirm accurate handling of previous year arrears and adjustments for the current year.

4. Arithmetical Accuracy: Check and reconcile column totals in the Register of Members.

5. Irrecoverable Member Dues: Identify overdue member dues, inquire about recovery efforts, and report any irrecoverable amounts.

6. Pricing: Verify charges for food, drinks, and services; check fees for special services like billiards and tennis.

7. Member Accounts: Confirm debits from subsidiary registers for supplies and services to members.

8. Purchases: Verify purchases of sports items, furniture, etc.; ensure proper recording in inventory registers.

9. Margins Earned: Check purchase prices of items and verify sales prices to ensure normal gross profit rates are maintained.

10. Inventories: Physically check furniture, sports materials, and assets against inventory registers.

11. Investments: Inspect investment documents, check current values for disclosure, and ensure safe custody arrangements.

12. Management Powers: Review the financial powers of the secretary; report any exceeded limits for confirmation by the Managing Committee.

Q-78 In your role as the appointed auditor of an NGO, outline the key focal points and considerations that would guide your audit planning process for this organization. Please discuss briefly, emphasizing the aspects critical to ensuring a **comprehensive and effective audit of the NGO**.

Ans:

Provisions Relating to Audit for NGOs

Auditors for NGOs under Societies Registration Act or Indian Trusts Act are appointed by management. For NGOs under Companies Act, auditors are appointed by members. Statutes like Companies Act, 2013, FCRA 2010, and Income Tax Act 1961 mandate NGO audits; non-compliance may lead to loss of exemptions. FCRA 2010 prescribes a format; reports must be submitted to the Ministry of Home Affairs within 60 days of financial year-end.

While planning the audit, the auditor may concentrate on the following:

✓ Understand NGO's work, mission, and operational environment.

✓ Stay updated on statutes, amendments, circulars, and judicial decisions.

✓ Review legal documents like Memorandum of Association, Articles of Association, and Rules.

✓ Examine organization chart, financial manuals, project guidelines, and budget policies.

✓ Scrutinize minutes for decisions impacting financial records.

✓ Study accounting systems, internal controls, and check their applicability.

✓ Set materiality levels for audit purposes.

✓ Determine the nature and timing of reports or communications.

✓ Assess the involvement of experts and their reports.

✓ Review the previous year's audit report for insights and continuity.

Q-79 You've been designated by the **Local Fund Audit** Wing of a State Government to audit the accounts of a local body under its jurisdiction. **As the appointed auditor, what specific areas would you focus on in your reporting?** Discuss the key reporting considerations and aspects critical to providing a thorough and effective audit of the local body's accounts.

Ans:

AUDIT PROGRAMME FOR LOCAL BODIES

1. Appointment: Local Fund Audit Wing or, in some cases, larger municipal corporations appoint auditors. Ensure own appointment if required.

2. Auditor's Concerns: Report on fairness of financial statements, strengths/weaknesses in financial control, adherence to legal/administrative requirements, and value for money. Objective: Detect errors, fraud, and resource misuse.

3. Rules & Regulations: Ensure expenditure aligns with relevant laws and complies with financial rules and regulations.

4. Authorizations: Verify all types of sanctions (special or general) accorded by competent authority.

5. Provisioning: Confirm the provision of funds, authorized expenditure by competent authority.

6. Performance: Check economic viability and results of schemes, programs, and projects with significant financial expenditures.

Q-80 CA Vabhav is consulted by Nebula Forge Engineering LLP for guidance on statutory compliance and filing returns. **How should CA Vabhav approach advising them? Outline the key steps and considerations** CA Vabhav should take to ensure Nebula Forge Engineering LLP understands and **fulfils its statutory obligations effectively.**

Ans:

Basics of Limited Liability Partnerships (LLP) Audit

LLP governed by the 2008 Act, blends Company and Partnership benefits. With a minimum of 2 partners, including 2 Designated Partners needing DPIN, the LLP structure thrives on a partnership agreement dictating partner rights and duties.

It defines a Small Limited Liability Partnership to denote any LLP

A Small Limited Liability Partnership (LLP) is one whose contribution does not surpass INR 25,00,000 (or a prescribed higher amount up to INR 5,00,00,000) and whose turnover, based on the previous financial year's statement, does not exceed INR 40,00,000 (or a prescribed higher amount up to INR 50,00,00,000).

Audit of the Accounts of an LLP

The audit of an LLP's accounts follows Rule 24 of LLP Rules 2009. If an LLP's turnover is below forty lakh rupees or its contribution is under twenty-five lakh rupees in a financial year, it is not mandatory to conduct an audit. However, if the partners choose to audit the accounts, it must be done in accordance with the specified rule.

Auditor's duties for LLP audit include

1. Engagement Letter: Obtain written instructions for the audit scope.

2. Minutes Book: Review partner meeting minutes for relevant resolutions.

3. LLP Agreement: Examine LLP agreement for key details

- Nature of business
- Capital contributions
- Interest on additional capital
- Partnership duration
- Partner drawings
- Partner salaries/commissions
- Borrowing powers
- Partner rights and duties
- Method of settling accounts

4. Reporting: State in the report

- Accuracy and reliability of LLP records
- Adequacy of information received
- Any imposed restrictions on the audit.

Q-81 You are assigned as the auditor for a Co-operative Society. Provide an overview of the audit approach and key considerations you would adopt in examining the financial transactions and records of the Co-operative Society. Briefly discuss the unique aspects and challenges associated with **auditing a Co-operative Society.**

Ans:

AUDIT OF CO-OPERATIVE SOCIETIES

A Cooperative is a voluntary association addressing common economic, social, and cultural needs through a jointly-owned enterprise. Governed by the Co-operative Societies Act, 1912, in India, states may have their own Acts. Co-operatives operate collectively, reducing middlemen and external exploitation. Auditors must know the applicable Act. Chartered accountants play a crucial role in developing co-operatives, and this unit offers guidelines for auditing.

The following points should be kept in mind in connection with the audit of a co-operative society:

1. Auditor Qualifications: Besides chartered accountants, some State Co-operative Acts allow auditors with a government diploma in co-operative accounts or experience in the co-operative department.

2. Appointment of Auditor: Registrar of Co-operative Societies appoints auditors, and they report to both the Registrar and the society. Audit fees are based on a statutory scale set by the Registrar.

3. Books and Records: Section 43(h) allows state governments to prescribe books and accounts for co-operative societies.

4. Share Holding Restrictions: Section 5 limits non-registered society members from holding over 20% of share capital or value exceeding ₹1,000.

5. Loan Restrictions: Section 29 restricts registered societies from lending to non-members, except with Registrar's sanction. State governments may impose additional restrictions on society loans.

6. Borrowing Restrictions: Section 30 limits borrowing, subject to society bye-laws. Auditor examines bye-laws for compliance.

7. Investment of Funds: Section 32 allows societies to invest in specified entities, subject to rules. Central and State Acts lack clarity on investing reserve funds outside the business.

8. Profits Appropriation: Section 33 mandates transferring a percentage of profits to the Reserve Fund before distributing dividends or bonuses.

9. Contributions to Charitable Purposes: Section 34 allows societies, with Registrar's approval, to contribute up to 10% of net profits to charitable purposes.

10. Use of Reserve Fund: Some State Acts permit using the Reserve Fund as working capital, investment, or for public purposes.

11. Contribution to Education Fund: Certain State Acts mandate annual contributions to the Education Fund based on the society's class.

12. Appropriation of Profits: Societies must strictly follow State Act provisions, bye-laws, and rules for profit appropriations. Entries must be made post General Body approval, deviating from corporate practices.

13. Contradictions with Accounting Principles: Some State Acts term transfers to Dividend Equalization Reserve and Share Capital Redemption Fund as charges, contradicting accounting principles. Auditors must highlight such inconsistencies.

Q-82 What critical factors should auditors thoroughly assess and consider before commencing the audit of a firm? Provide a comprehensive overview of the key matters that auditors need to take into account, including any specific challenges or nuances that might impact the audit planning process.

Ans:

Matters to be considered before starting audit: Also, before starting the audit, he should examine the partnership agreement and note the provisions therein as regards the following matters:

1. The name and style under which the business shall be conducted.

2. The duration of the partnership, if any, that has been agreed upon.

3. The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.

4. The period at the end of which the accounts of the partnership will be closed periodically and the proportions in which the profit shall be divided among the partners or losses shall have to be contributed by them; whether the losses shall be borne by the partners or whether any of the partners will not be required to do so.

5. The provisions as regards maintenance of books of account and the matters which must be taken into account for determining the profits of the firm available for division among the partners e.g., creation of reserves, provision for depreciation, etc. also the period within which accounts can be reopened for correcting a manifest error.

6. Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).

7. The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.

8. Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?

9. Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.

10. Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?

11. Limitations and restrictions that have been agreed upon, the rights and powers of partners and on their implied authority to pledge the firm's credit or to render it liable.

Q-83 As an auditor delving into the financial operations of a bank, **enumerate the key points that underscore the peculiarities associated with banking operations.** Provide a comprehensive list, discussing the distinctive aspects and challenges that require careful consideration in the audit process.

Ans:

Banking operations

Banking operations occur solely at branches, with other offices serving as controlling authorities. These administrative offices establish policies, internal controls, and systems for business conduct, ensuring compliance with statutory regulations and accounting principles. They delegate powers, set responsibilities, and supervise activities, monitoring adherence to established policies and procedures.

Peculiarities involved:

- High transaction volumes and complexity.
- Wide geographical reach of the banking network.
- Diverse range of offered products and services.
- Extensive reliance on technology.
- Rigorous oversight by banking regulators.

Q-84 Write a short note on the Reversal of Income as part of a bank audit. Highlight the key considerations, procedures, and reasons that may lead to the reversal of income in the context of auditing a bank's financial statements. Ensure clarity and conciseness in your response.

Ans:

Reversal of Income

(a) If any advance, including bills, turns NPA, reverse or provide for the entire previously accrued interest, even for government-guaranteed accounts.

(b) Stop accruing fees, commission, and similar income for current NPAs; reverse or provide for uncollected amounts from past periods.

(c) Banks recognizing income incorrectly should reverse interest for the current year or provision for the same amount recognized in previous year(s).

(d) Auditors should check for unexplained large debits in Interest Income, inquire about borrower communications on interest discrepancies, and verify appropriate actions taken.

Q-85 Explore and write about the various types of banking institutions in India. Provide an overview of each type. Ensure to cover the diversity in banking institutions prevalent in the Indian financial landscape.

Ans:

Introduction

The banking sector is vital for economic growth and financial stability, dealing with substantial public funds and facing various operational risks. Reliable financial information, supported by quality bank audits, is crucial for maintaining a healthy and safe banking sector.

Types of Banks in India

1. Commercial Banks: Provide a wide range of products and services. Main functions: accepting deposits and granting advances.

2. Regional Rural Banks (RRBs): Established in rural areas to meet basic banking needs. Examples: Punjab Gramin Bank, Tripura Gramin Bank, etc.

3. Co-operative Banks: Operate like commercial banks but follow cooperative principles. Cater to agricultural and rural sectors. Examples: The Gujarat State Co-operative Bank, Chhatisgarh Rajya Sahakari Bank, etc.

4. Payments Banks: Recently introduced by RBI. Accept restricted deposits, no loans or credit cards. Offer Current & Savings accounts, ATM cards, Internet-banking, and Mobilebanking. Examples: Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank, etc.

5. Development Banks: Provide funds for crucial infrastructural facilities. Examples: Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), SIDBI, etc.

6. Small Finance Banks: Established by RBI for the unserved and unorganised sectors. Serve small marginal farmers, small & micro business units. Examples: Equitas Small Finance Bank, AU Small Finance Bank, etc.

Q-86 As the statutory auditor of a bank, is there an obligation to report on the requirements outlined in the Companies (Auditor's Report) Order, 2020? Elaborate on the specific considerations and responsibilities that the statutory auditor must address in relation to this order while conducting the audit of a bank.

Ans:

The auditors, both central and branch, must ensure that their audit reports meet the standards outlined in Chapter 8 on Audit Reports. This includes providing information not only about unaudited branches but also quantifying details such as advances, deposits, interest income, and interest expense for those branches. Such disclosure aligns with international standards and offers valuable information to financial statement users.

Additionally, the auditor of a banking company must address matters covered by Section 143 of the Companies Act, 2013, in their report. However, it's essential to note that reporting requirements under the Companies (Auditor's Report) Order, 2020 do not apply to a banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949.

Q-87 Provide an explanation of the engagement team holding discussions to enhance their understanding of the bank and its environment, including internal control, and to assess the potential for material misstatements in the financial statements. Discuss the significance of documenting these **discussions for future reference in the context of auditing a bank.**

Ans

Bank Audit Approach

1. Audit Plan: Develop an audit plan based on

- Nature and level of operations.

♦ Adverse features.

♦ Compliance history from previous reports.

♦ Audit risks related to internal control inadequacies or breaches.

2. Control Environment: Ensure the bank has effective controls to manage risks. Key controls include segregation of duties, accurate reporting, transaction verification, limit setting, and contingency planning.

3. Engagement Team Discussions: The engagement team, including external experts, should discuss and understand the bank and its environment. Document discussions for future reference. Assess the potential for material misstatements in financial statements. Focus discussions on susceptibility to misstatements, typically during the planning stage of the audit.

The engagement team discussion ordinarily includes a discussion of the following matters

(a) Identify potential errors that are more likely to occur.

(b) Discuss errors identified in previous years.

(c) Address methods through which fraud could occur within specific account balances or disclosures involving bank personnel or others.

(d) Plan audit responses for Engagement Risk, Pervasive Risks, and Specific Risks.

(e) Emphasize the importance of maintaining professional skepticism throughout the audit.

(f) Stay alert for information or conditions indicating a material misstatement, such as the bank's application of accounting policies in specific circumstances.

Q-88 In a case where a business is **determining its drawing power,** discuss the essential factors and computations involved in arriving at an accurate drawing power assessment. Provide practical insights into how businesses can effectively compute drawing power, considering various financial aspects.

Ans:

COMPUTATION OF DRAWING POWER

1. Meaning of Drawing Power (DP): DP is crucial for Cash Credit (CC) facilities, representing the withdrawal limit within the sanctioned working capital.

2. Differentiation from Sanctioned Limit: The Sanctioned Limit is the overall exposure a bank can have, while Drawing Power is calculated based on primary security less margin.

3. Considerations for Accounts: Accounts must stay within drawing power and sanctioned limit. Irregularities should be promptly reported to Management/Head Office.

4. Bank's Responsibilities: Banks ensure drawings align with current assets. Drawing power is based on current stock statements, not older than three months, for large borrowers.

5. Auditor's Role and Concerns: Scrutinize borrower statements, audited Annual Reports, and monthly stock statements. Address deviations and report irregularities.

6. Computation of DP: DP calculation follows bank guidelines approved by statutory auditors. Proper reporting of sundry creditors is crucial for accurate drawing power.

7. Stock Audit: Mandatory for funded exposure over 5 crores. Auditors may advise stock audit as needed. Review stock audit reports, emphasizing security valuation and drawing power calculations.

Q-89 Assume you are advising a small business owner on the most **suitable mode of creating security for a loan application**. Explore the different modes of creating security available, and discuss the key considerations and implications associated with each option. how the choice of security creation mode can impact both the borrower and the lender in various financial scenarios.

Ans:

Mode of Creation of Security

1. Mortgage: Mortgage are tow types Registered Mortgage and Equitable Mortgage.

Registered Mortgage involves formal registration, while Equitable Mortgage relies on the borrower's equitable interest.

2. Pledge: Involves bailment or delivery of goods by the borrower to the lending bank. Goods' legal ownership stays with the pledger, creating a specific (fixed) charge.

3. Hypothecation: Equitable charge created without transfer of ownership or possession. Borrower retains physical possession as an agent/trustee, providing periodic asset statements for determining drawing power.

4. Assignment: Represents a transfer of debt, right, or property. Banks accept actionable claims (e.g., book debts, life insurance policies) as security through assignment, granting the assignee absolute rights.

5. Set-off: Statutory right to adjust a debit balance against a credit balance in another account. Applicable when both accounts are in the same name and capacity, allowing banks to combine accounts across branches.

6. Lien: Creation of a legal charge with the owner's consent. Grants the lender a legal right to seize and liquidate the asset under lien.

Q-90 During your audit as the auditor for XYZ Bank, you uncover potential deviations from **prudential norms related to income recognition, asset classification, and provisioning for advances.** Develop a comprehensive plan outlining the steps you would take to address this issue

Ans:

Classification of Advances as per RBI Prudential Norms

1. NPA Definition: An asset becomes non-performing (NPA) if: Term loan has overdue interest/principal for over 90 days. Overdraft/Cash Credit (OD/CC) remains 'out of order.' Bills purchased and discounted remain overdue for over 90 days.

2. Out of Order: Outstanding balance exceeds sanctioned limit/drawing power continuously. In cases where the balance is below the limit, no credits for 90 days or insufficient to cover interest.

3. Overdue: Any amount not paid by the due date is considered 'overdue.'

4. Regularization near Balance Sheet: Careful handling of borrower accounts with late credits before and after the Balance Sheet. If inherent weakness found, deem as NPA.

5. Government Guaranteed Advances: Central Govt. guaranteed: Standard Asset but treated as NPA for Income Recognition. State Govt. guaranteed: NPA if overdue for 90+ days for both Provisioning and Income recognition.

6. Consortium Advances: Joint loans by multiple banks. Based on recovery records, non-serviced accounts treated as NPA. Ensure proper sharing of recovery among consortium banks to maintain accurate asset classification.

Q-91 Assume you are leading the audit team for a bank or its branch. Discuss the various stages involved in the audit process, emphasizing the key activities and considerations at each stage. Highlight the challenges, best practices, and the significance of each stage in ensuring a comprehensive and effective audit of the bank or branch.

Ans:

1. Initial consideration by the statutory auditor: The statutory auditor's initial considerations encompass obtaining a declaration of indebtedness, refraining from concurrent internal assignments, adhering to planning standards, communicating with the previous auditor for a NOC, agreeing on audit terms as per SA 210, performing initial audit engagement procedures, assessing engagement risk, establishing a qualified team, and understanding the bank and its environment through SA 315.

2. Risk Identification (SA 315): Auditor must identify and assess risks of material misstatement at financial statement and assertion levels. Basis for designing and performing additional audit procedures.

3. Understanding Bank and Environment (SA 315, SA 315, SA 300): Enables risk identification and assessment. Forms the basis for audit plan development. Determines the operating effectiveness of controls and addresses specific risks.

4. Understanding Accounting Process: Accounting process provides financial and operational information. Contributes to internal control. Necessary for risk assessment and designing further audit procedures.

5. Understanding the Risk Management Process: Understanding the risk management process involves oversight by governance, approval of policies aligned with business objectives, identification, measurement, and monitoring of risks with controls, ongoing assessment of risk management models, and reliance on reliable information systems for timely and consistent risk-related information.

6. Engagement Team Discussions: Team discussions enhance understanding of the bank, its environment, and potential material misstatements.

7. Overall Audit Strategy (SA 300): Establishes strategy before audit commencement. Involves key team members and specialists based on engagement characteristics.

8. Audit Plan Development (SA 300): Requires involvement of key engagement team members for effective planning.

9. Audit Planning Memorandum: Summarizes scope and extent of audit procedures. Highlights significant issues and risks, demonstrating appropriate planning and response to engagement factors.

10. Determine Audit Materiality: Professional judgment-based determination considering bank knowledge, engagement risk, and reporting requirements.

11. Consider Going Concern: During bank understanding, assess events and conditions impacting the bank's ability to continue as a going concern.

12. Assess Risk of Fraud and Money Laundering (SA 240): Maintain professional skepticism. Follow RBI guidelines on preventing money laundering and implementing KYC norms**.**

13. Assess Specific Risks: Identify and assess risks pervasively impacting financial statements.

14. Risk Associated with Outsourcing: Banks using outsourcing must effectively manage associated risks.

15. Response to Assessed Risks (SA 330): Design and implement overall responses based on assessed risks at financial statement and assertion levels.

16. Stress Testing: Banks required to have a Board-approved stress testing framework integrating into risk management systems.

17. BASEL III Framework: Basel III proposes criteria for regulatory capital inclusion, focusing on resilience in the wake of financial crises.

18. Reliance on/Review of Other Reports: Auditor considers adverse comments on advances from previous audits, internal reports, RBI inspections, concurrent audits, security verification, and other relevant internal reports.

Q-92 You're advising a company on ethical frameworks**. Explain briefly the differences between a principles-based and rules-based approach to ethics.**

Ans:

Principles-based and rules-based approach to ethics

Ethical guidance may follow principles-based approach or rules-based approach. The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions. However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules- based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules. Therefore, it is necessary that spirit of code is followed.

Q-93 You're the lead auditor for a major client, and independence threats emerge. **Briefly discuss the specific threats and outline the steps you'd take to address and mitigate them. Emphasize the importance of safeguarding audit independence.**

Ans:

Threats to Auditor Independence:

1. Self-Interest Threats: Financial interests in the client. Loans or guarantees with/from the client. Overreliance on client fees. Close business relationships. Potential employment with the client. Contingent fees for the audit.

2. Self-Review Threats: Reviewing prior judgments or conclusions. Previous role as a director or senior employee of the client. Performing services subject to audit.

3. Advocacy Threats: Promoting client opinions. Dealing with client shares or securities. Acting as an advocate in litigation. Risks compromising perceived objectivity.

4. Familiarity Threats: Relationships impacting objectivity. Close relatives in senior positions. Former partners in client roles. Long associations between auditors and clients. Acceptance of significant gifts or hospitality.

5. Intimidation Threats: Deterrence from objective actions. Threat of replacement over disagreements. Pressure to reduce work in response to reduced fees. Threats of litigation to hinder objective conduct.

Q-94 Assume you're the auditor with a two-year history with a client. Noticing substantial changes in management and the client's expansion into new business areas**, discuss how the auditor's responsibilities, as per SA 210, should be addressed**. Provide a concise overview of the key actions and considerations needed to adapt to these changes while upholding auditing standards.

Ans:

TERMS OF ENGAGEMENT IN RECURRING AUDITS

A recurring audit is when an auditor examines a company's financial records over multiple years. In such cases, the auditor needs to check if any circumstances require updating the audit terms or reminding the company of the existing terms.

The auditor might not send a new agreement each time, but they should consider revising or reminding the entity about the terms if:

1. The company doesn't understand the purpose and scope of the audit.

2. There are new or special terms for the audit.

3. There's a recent change in top management.

4. There's a significant change in ownership.

5. The company undergoes a substantial change in its business size or nature.

6. There are new legal or regulatory requirements.

7. The financial reporting framework used for preparing statements changes.

8. Other reporting requirements change.

Q-95 As an auditor engaged in the audit process, **elaborate on the critical role of professional skepticism in mitigating audit risk.** Address its significance in identifying potential risks, ensuring accuracy in financial information, and enhancing overall audit effectiveness.

Ans:

PROFESSIONAL SKEPTICISM

Professional skepticism is a mindset that auditors should have during their work. It involves being curious and cautious, always questioning information and remaining alert to potential errors or fraud. The auditor needs to carefully assess the evidence and stay vigilant throughout the entire audit process.

Key points of professional skepticism include:

1. Questioning Mind: Auditors should always ask questions and challenge information based on the evidence available.

2. Alertness to Red Flags: Being attentive to anything unusual or conflicting in the audit evidence, as well as any information that might cast doubt on the reliability of documents or responses received.

3. Fraud Awareness: Keeping an eye out for signs of possible fraud and being ready to adapt audit procedures accordingly.

4. Critical Assessment: Carefully evaluating audit evidence to avoid overlooking unique situations, making broad assumptions, or using inappropriate assumptions in drawing conclusions.

5. Consideration of Reliability: While trusting the integrity of management and governance based on past experience, auditors should still maintain a skeptical approach and assess the reliability of the information at hand.

6. Investigative Approach: In cases of doubt or indications of possible fraud, auditors are required to dig deeper and modify or add audit procedures to address any concerns.

In essence, professional skepticism is about being inquisitive, cautious, and thorough throughout the audit process to reduce the risks of overlooking important details or making incorrect conclusions. Even with trust in the integrity of the management, auditors must maintain a vigilant and questioning mindset.

Q-96 Within the framework of SA 220, when an engagement partner assumes overall responsibility for maintaining audit quality, what specific objectives guide them in emphasizing and fulfilling this crucial role? Provide a comprehensive breakdown of the key objectives associated with an engagement partner's responsibility for ensuring and emphasizing audit quality in an audit engagement.

Ans:

Leadership responsibilities for quality on audits

The engagement partner holds the key responsibility for the quality of every audit engagement. This involves the partner taking specific actions and effectively communicating with the rest of the team to ensure overall quality.

(a) Discuss why it's crucial for audit quality to:

(i) Follow professional standards and laws.

(ii) Adhere to the firm's quality control policies.

(iii) Issue appropriate auditor's reports.

(iv) Allow the team to voice concerns without fear.

(b) Emphasize the significance of quality in conducting audit engagements.

Q-97 What are the fundamental principles of professional ethics, and how do they contribute to ethical conduct within the professional sphere? Provide a detailed examination of these principles, emphasizing their significance in upholding ethical standards.

Ans:

Fundamental principles of professional ethics

1. Integrity: Be honest and straightforward in all professional and business relationships. Don't be part of any reports or information that you know contains false or misleading statements. Never neglect or hide important information that could mislead others.

2. Objectivity: Make professional judgments without being influenced by personal biases, conflicts of interest, or pressure from others. Don't take on a job if your judgment could be unduly influenced by personal circumstances or relationships.

3. Professional Competence and Due Care: Stay knowledgeable and skilled at the level needed to provide competent service based on current standards and laws. Act diligently and follow the requirements of an assignment carefully, thoroughly, and on time.

4. Confidentiality: Respect the confidentiality of information you come across in your professional or business relationships. Only disclose confidential information if required by law, permitted by law and authorized by the client, or if there's a professional duty to disclose.

5. Professional Behavior: Follow all relevant laws and regulations. Avoid any actions that could harm the reputation of the accounting profession. Don't engage in any activities that could damage the integrity, objectivity, or good reputation of the profession.

Q-98 What factors should an auditor carefully consider before agreeing to transition from an audit engagement, providing a higher level of assurance, to an engagement offering a lower level of assurance? Provide practical insights and considerations based on auditing standards and professional judgment to navigate this decision effectively.

Ans:

If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may also need to assess any legal or contractual implications of the change.

If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement. However, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

(a) The original audit engagement **or**

(b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed- upon procedures and thus reference to the procedures performed is a normal part of the report.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

Q-99 Should the engagement partner document the conclusions reached regarding the **acceptance and continuance of client relationships and audit engagements?**

Ans:

Acceptance and Continuance of Client Relationships and Specific Engagements: Before accepting an engagement, a firm should gather crucial information about the client to assess

1. Integrity of the Client: Evaluating the client's trustworthiness, honesty, and ethical conduct.

2. Competence: Assessing the client's capabilities, availability of time, and resources to effectively perform the engagement.

3. Compliance with Ethical Requirements: Ensuring that the client adheres to ethical standards and requirements in conducting their business activities.

Before accepting, continuing, or taking on a new engagement with a client, the firm must gather necessary information and document how identified issues are resolved. Key considerations for assessing the integrity of a client include:

1. Client's Key Individuals: Assessing the identity and business reputation of principal owners, key management, related parties, and governance members.

2. Nature of Operations: Understanding the client's business practices and operations.

3. Attitude Towards Accounting Standards: Examining the client's stance on interpreting accounting standards and the internal control environment.

4. Fee Concerns: Checking if the client aggressively seeks to minimize the firm's fees.

5. Scope of Work and Limitations: Detecting signs of inappropriate limitations in the scope of work.

6. Risk of Illegal Activities: Investigating indications of money laundering or criminal involvement.

7. Reasons for Appointment: Understanding the reasons for choosing the firm and non-reappointment of the previous firm.

If conflicts of interest arise, they must be resolved before accepting the engagement. If information surfaces later that would have led to a decline, policies must address considerations such as professional and legal responsibilities, potential reporting obligations, and the option to withdraw from the engagement or both the engagement and the client relationship.

Q-100 Imagine you are an auditor working with a client on a full audit engagement. Before completing the audit, the client requests a change to a less rigorous review service. What steps should the auditor take in determining whether there's a reasonable justification for this change? If justified, how should the auditor handle the work already performed, and what elements should be considered when agreeing on the new terms for the engagement?

Ans:

Agreement on audit engagement terms

Except in the cases where it is required under law to get accounts audited (for example in case of companies), audit is a matter of contract between auditor and client. It is, therefore, important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement.

The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. Such a letter includes:-

(a) The objective and scope of the audit of the financial statements

(b) The responsibilities of the auditor

(c) The responsibilities of management

(d) Identification of the applicable financial reporting framework for the preparation of the financial statements and

(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.