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Descriptive Questions

Scanner

Use with Notes and ICAI Module

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Chapter 1

Question:

The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.

Answer:

"An audit is **independent examination** of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Analysis of the Definition

1. Audit is Independent examination of Financial information.
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

a. The accounts have been drawn up with **reference to entries** in the books of account;
b. The entries in the books of account are adequately **supported** by sufficient and appropriate evidence;
c. None of the entries in the books of account has been **omitted** in the process of compilation and nothing which is not in the books of account has found place in the statements;
d. The information conveyed by the statements is **clear and unambiguous**;
e. The financial statement amounts are **properly classified, described and disclosed** in conformity with accounting standards; and
f. The statement of accounts present a **true and fair** picture of the operational results and of the assets and liabilities.

Question:

Explain the overall objective of the auditor as contained in SA 200.

Answer:

As per **SA-200** "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

1. To obtain **reasonable assurance** about whether the financial statements as a whole are free from material misstatement; and
2. **To report** on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Question:

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

Or

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

Answer:

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Question:

The auditor is not expected to and cannot reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Briefly discuss with reference to SA 200, other matters that affect the limitations of an audit.

Answer:

As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Other Matters that Affect the Limitations of an Audit:

In the case of certain assertions or subject matters, the potential effects of the limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Question:

The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain.

Answer:

Timeliness of Financial Reporting and the Balance between Benefit and Cost:

The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

Question:

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.

Answer:

The Nature of Audit Procedures:

There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

1. There is the possibility that **management or others may not provide, intentionally or unintentionally**, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
2. **Fraud** may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
3. An **audit is not an official investigation** into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Question:

An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss.

Answer:

Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The objective of audit, on the other hand as we have already discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts.

However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.

Question:

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain.

Answer:

Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below:

1. It **safeguards the financial interest** of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
2. It acts as a **moral check** on the employees from committing defalcations or embezzlement.
3. Audited statements of account are helpful in **settling liability for taxes**, negotiating loans and for determining the purchase consideration for a business.
4. These are also useful for **settling trade disputes** for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
5. An audit can also help in the **detection of wastages and losses** to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
6. Audit ascertains whether the **necessary books of account and allied records** have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
7. As an **appraisal function**, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.

Question:

What do you mean by Assurance Engagement and discuss its elements. (New)

Answer:

"**Assurance engagement**" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the **evaluation or measurement of a subject matter against criteria**.

It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

Elements of an Assurance Engagement

Following elements comprise an assurance engagement:

1. Three party relationship involving a practitioner, a responsible party, and intended users:

   (a) **A practitioner** is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

   (b) **A responsible party** is the party responsible for preparation of subject matter. Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

   (c) **Intended users** are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

2. An appropriate subject matter

It refers to the information to be examined by the practitioner. For example, financial information contained in financial statements while conducting audit of financial statements.

3. Suitable criteria

These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.

4. Sufficient appropriate evidence

The practitioner performs an assurance engagement to obtain sufficient appropriate evidence. It is on the basis of evidence that conclusions are arrived and an opinion is formed by auditor. "Sufficient" relates to quantity of evidence obtained by auditor. "Appropriate" relates to quality of evidence obtained by auditor. One evidence may be providing more comfort to auditor than the other evidence. The evidence providing more comfort is qualitative and, therefore, appropriate. Evidence should be both sufficient and appropriate.

5. A written assurance report in appropriate form

A written report is provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is the outcome of an assurance engagement.

Question:

State the difference between Reasonable assurance engagement and Limited assurance engagement.

Answer:

Reasonable assurance engagement	***Limited assurance engagement***
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

Question:

Standards collectively known as the Engagements Standards issued by AASB under the authority of the council of ICAI.

Answer:

Engagement Standards

The following standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards.

1. Standards on Auditing (SAs), to be applied in the audit of historical financial information.
2. Standards on Review Engagements (SREs), to be applied in the review of historical financial information.

3. Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.
4. Standards on Related Services (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.

Question:

Principal aspects to be considered by an auditor while conducting an audit of final statements of accounts.

Or

GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects.

Answer:

Aspects to be covered in an audit: The principal aspects to be covered in an audit concerning final statements of account are the following:

1. An examination of the system of accounting and internal control to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
2. Reviewing the system and procedures to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
3. Checking of the arithmetical accuracy of the books of account by the verification of postings, balances, etc.

4. Verification of the authenticity and validity of transaction entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
5. Ascertaining that a proper distinction has been made between items of capital and of revenue nature and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
6. Comparison of the balance sheet and profit and loss account or other statements with the underlying record in order to see that they are in accordance therewith.
7. Verification of the title, existence and value of the assets appearing in the balance sheet.
8. Verification of the liabilities stated in the balance sheet.
9. Checking the result shown by the profit and loss and to see whether the results shown are true and fair.
10. Where audit is of a corporate body, confirming that the statutory requirements have been complied with.
11. Reporting to the appropriate person/body whether the statements of account examined do reveal a true and fair view of the state of affairs and of the profit and loss of the Organisation.

Notes

Chapter 2

Question:

"An adequate planning benefits the audit of financial statements." Discuss.

Or

Surya and Chand Ltd is a manufacturing company engaged in the production of miscellaneous electrical goods. Trilochan and Co. has been appointed as the auditors to carry out its audit. Auditor thinks that Planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning benefits the audit of financial statements in several ways. Analyse and Advise explaining the benefits of adequate planning.

Or

Explain the benefits of planning in the audit of financial statements.

Or

Engagement partner of Audit Firm MKC AND COMPANY thinks that Planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning would benefit the audit of financial statements in several ways. Analyse explaining the benefits of adequate planning.

Answer:

Benefits of Planning in the audit of financial statements:

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

1. Helping the auditor to **devote appropriate attention** to important areas of the audit.
2. Helping the auditor **identify and resolve potential problems on a timely basis.**
3. Helping the **auditor properly organize and manage the audit engagement** so that it is performed in an effective and efficient manner.
4. Assisting in **the selection of engagement team members** with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
5. **Facilitating the direction and supervision** of engagement team members and the review of their work.

Question:

"Planning is not a discrete phase of an audit, but rather a continual and iterative process." Discuss.

Or

Plans should be further developed and revised as necessary during the course of the audit. Explain.

Answer:

Audit Planning- a Continuous Process

Planning is not a discrete phase of an audit, but rather **a continual and iterative process** that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

Planning, however, includes **consideration of the timing of certain activities** and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

1. The **analytical procedures** to be applied as risk assessment procedures.
2. Obtaining a general understanding of the **legal and regulatory framework** applicable to the entity and how the entity is complying with that framework.
3. The determination of **materiality**.
4. The involvement of **experts**.
5. The performance of **other risk assessment procedures**.

Question:

Discuss the preliminary engagement activities are considered in Audit Planning. (New)

Answer:

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes:

1. Performing procedures regarding the continuance of the client relationship
2. Evaluating compliance with ethical requirements, including independence
3. Establishing an understanding of terms of engagement

Question:

You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy.

Answer:

As per **SA-300**, "Planning an Audit of Financial Statements", the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. In establishing the overall audit strategy, the auditor shall:

1. Identify the **characteristics of the engagement** that define its scope;
2. Ascertain **the reporting objectives** of the engagement to plan the timing of the audit and the nature of the communications required;
3. Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
4. Consider the results of **preliminary engagement activities** and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
5. Ascertain the **nature, timing and extent of resources** necessary to perform the engagement.

Question:

In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement.

Answer:

In establishing the overall audit strategy, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the **reporting objectives** of the engagement are:

1. The **entity's timetable for reporting**, such as at interim and final stages.
2. The organization of **meetings with management** and those charged with governance to discuss the nature, timing and extent of the audit work.
3. The **discussion with management** and those charged with governance regarding **the expected type and timing of reports** to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
4. The discussion with management regarding the **expected communications on the status of audit work** throughout the engagement.

Question:

In establishing the overall audit strategy, the auditor shall identify the characteristics of the engagement that define its scope. Explain with example.

Answer:

In establishing the overall audit strategy, the auditor shall Identify the **characteristics** of the engagement that define its scope.

For Example:

1. The **expected audit coverage**, including the number and locations of components to be included.
2. The **nature of the business segments** to be audited, including the need for specialized knowledge.
3. The **expected use of audit evidence obtained in previous audits**, for example, audit evidence related to risk assessment procedures and tests of controls.

Question:

Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources.

Or

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Discuss stating the process of establishing the overall audit strategy that would assist the auditor to determine key matters.

Or

Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall audit strategy assists the auditor to determine such matters as for example - the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters. Explain the other three such matters.

Answer:

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

1. The **resources to deploy for specific audit areas**, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters.
2. The **amount of resources to allocate** to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
3. **When these resources are to be deployed**, such as whether at an interim audit stage or at key cut-off dates; and
4. **How such resources are managed, directed and supervised**, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off -site), and whether to complete engagement quality control reviews.

Question:

Discuss the factors relevant for determining the nature, timing and extent of the direction and supervision of engagement team members and review of their work.

Answer:

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement
4. The capabilities and competence of the individual team members performing the audit work.

Question:

The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. Explain

Or

As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. Explain.

Answer:

The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls.

Question:

The auditor shall document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. Explain

Answer:

The auditor shall document:

(a) the overall audit strategy;
(b) the audit plan; and
(c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

For instance-

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

- A summary of discussions with the entity's key decision makers
- Documentation of audit committee pre-approval of services, where required
- Audit documentation access letters
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services
- auditor's report on the entity's financial statements.
- Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter)

Question: Other

Plans should be made to cover acquiring knowledge of the client's accounting systems, policies and internal control procedures. Explain.

Or

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Explain

Or

SA 300 states that auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. What matters should be covered in such Plan by the auditor?

Or

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Explain

Answer:

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover, among other things:

(a) Acquiring knowledge of the client's accounting systems, policies and internal control procedures;
(b) Establishing the expected degree of reliance to be placed on internal control;
(c) Determining and programming the nature, timing, and extent of the audit procedures to be performed; and
(d) Coordinating the work to be performed.

From the above, it is clear that statement given in the question is partly correct.

Question:

M/s TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them.

Answer:

The Assistant Engaged – Be Encouraged to Keep an Open Mind:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme.

As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped.

The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit.

In the given case, the attitude of assistants of TP & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified.

Question:

Evolving one audit programme applicable to all audit engagements under all circumstances is not practicable. Explain.

Answer:

Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all businesses under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

Question:

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed. Explain

Answer:

Periodic Review of The Audit Programme

There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed.

Question:

List out the points that should be kept in mind by the auditor for the purpose of constructing an audit programme.

Or

Arpana Hospitals Ltd having Gross Professional Charges of Rs. 50 crores is engaged in providing healthcare services. STP & Co., a firm of auditors is appointed as its auditors.

Advise what special points to be kept in mind for the purpose of construction of an Audit programme. Explain.

Or

Explain the significant points auditor would consider while developing an audit programme.

Answer:

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. Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
3. Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
4. Consider all possibilities of error.
5. Co-ordinate the procedures to be applied to related items.

Question:

"All the disadvantages of audit program may be eliminated by imaginative supervision of the work carried on by the assistants." Explain stating the advantages and disadvantages of an audit program.

Answer:

Advantages and Disadvantages of the use of an Audit Programme:

The advantages of an audit programme are:

1. It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
2. It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
3. Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
4. Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger is significantly less and the audit can proceed systematically.
5. The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
6. The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
7. It serves as a guide for audits to be carried out in the succeeding year.
8. A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

Some disadvantages are also there in the use of audit programmes but most of these can be removed by taking some concrete steps. The disadvantages are:

1. The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
2. The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
3. Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
4. A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

Notes

Chapter 3

Question:

Discuss in brief the types of audit risk and inter relationship of components of audit risk.

Answer:

Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is materially misstated. For example, an auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated.

Three components of audit risk are:

- Inherent Risk
- Control Risk
- Detection Risk

Question:

What do you understand by "Risk of material misstatement"? Describe its two components at the assertion level.

Answer:

Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit.

This consists of two components described as follows at the assertion level:

1. Inherent Risk: The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
2. Control Risk: The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

Question:

Explain the concept of Detection Risk.

Answer:

SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Detection risk comprises sampling and non-sampling risk:

1. Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.

2. **Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

Question:

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain.

Answer:

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

It can be concluded from the above that-

Risk of Material Misstatement= Inherent Risk x Control Risk

Question:

While auditing XYZ Ltd., you as an auditor observed that there is a likelihood of misstatement in the account balances and disclosures in the financial statements. For "Assessing the risk of Material Misstatement", what should be your consideration as an auditor?

Or

Mr. N has been appointed as an auditor of KB Sources Ltd. How as an auditor he can identify and assess the risk of material misstatement?

Answer:

As per SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

1. **Identify risks** throughout the process of obtaining an understanding of the entity and its environment, **including relevant controls** that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
2. **Assess the identified risks**, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
3. **Relate the identified risks** to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
4. **Consider the likelihood of misstatement**, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Question:

Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls.

Answer:

Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include:

1. Inquiring of entity personnel.
2. Observing the application of specific controls.
3. Inspecting documents and reports.
4. Tracing transactions through the information system relevant to financial reporting.

Question:

Knowledge of Client business' is one of the important principles in developing an overall audit plan. Explain.

Or

Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples.

Answer:

Knowledge of the Client's Business: It is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment" the auditor shall obtain an understanding of the following:

(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework.

(b) The nature of the entity, including:
   (i) its operations;
   (ii) its ownership and governance structures;
   (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
   (iv) the way that the entity is structured and how it is financed;

   to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(e) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgements regarding the appropriateness of accounting policies and disclosures.

Question:

Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples.

Answer:

Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

1. **Assessing risks of material misstatement** of the financial statements;
2. Determining **materiality** in accordance with SA 320;
3. Considering the appropriateness of the **selection and application of accounting policies**;
4. Identifying **areas where special audit consideration** may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
5. Developing **expectations** for use when performing analytical procedures;
6. **Evaluating the sufficiency and appropriateness of audit evidence obtained**, such as the appropriateness of assumptions and of management's oral and written representations.

Question:

Briefly discuss the limitations of Internal Control.

Or

"Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives." The likelihood of their achievement is affected by inherent limitations of internal control. Discuss those points.

Answer:

Limitations of Internal Control:

1. **Internal control can provide only reasonable assurance:** Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.
2. **Human judgment in decision-making:** Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.
3. **Lack of understanding the purpose:** Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.
4. **Collusion among People:** Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

5. Judgements by Management: Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.
6. Limitations in case of Small Entities: Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

Question:

The auditor of XYZ Ltd, engaged in FMCG (Fast Moving Consumable Goods) obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:

(i) Management has created and maintained a culture of honesty and ethical behavior; and
(ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Advise what is included in control environment. Also explain the elements of control environment.

Or

The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behaviour and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Advise what is included in control environment. Also explain the elements of control environment.

Answer:

Control Environment – Component of Internal Control: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

a. Management has created and maintained a culture of honesty and ethical behavior; and
b. The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control

What is included in Control Environment?

The control environment includes:

1. the governance and management functions and
2. the attitudes, awareness, and actions of those charged with governance and management.
3. The control environment sets the tone of an organization, influencing the control consciousness of its people.

Elements of the Control Environment: Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

1. Communication and enforcement of integrity and ethical values
2. Commitment to competence

3. Participation by those charged with governance
4. Management's philosophy and operating style – Characteristics such as management's
5. Organisational structure
6. Assignment of authority and responsibility
7. Human resource policies and practices

Question:

The auditor shall obtain an understanding of major activities that the entity uses to monitor internal control over financial reporting. Discuss "Monitoring of control'' as a component of Internal control.

Answer:

Monitoring of Controls: Component of Internal Control

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

Monitoring of controls Defined: Monitoring of controls is a process to assess the effective ness of internal control performance over time.

1. Helps in assessing the effectiveness of controls on a timely basis: It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
2. Management accomplishes through ongoing activities, separate evaluations etc.: Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
3. Management's monitoring activities include: Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
4. In case of Small Entities: Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

Question:

The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control.

Answer:

Division of Internal Control into Components: The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

1. The control environment;
2. The entity's risk assessment process;
3. Monitoring of controls.
4. Control activities; and
5. The information system, including the related business processes, relevant to financial reporting, and communication;

Question:

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain.

Answer:

Satisfactory Control Environment - not an absolute deterrent to fraud:

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.

The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

Question:

Explain the matters which should be included for factors relevant to the auditors' judgement about whether a control is relevant to the audit.

Answer:

Controls Relevant to the Audit:

Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

1. Materiality.
2. The significance of the related risk.
3. The size of the entity.
4. The nature of the entity's business, including its organisation and ownership characteristics.
5. The diversity and complexity of the entity's operations.
6. Applicable legal and regulatory requirements.
7. The circumstances and the applicable component of internal control.
8. The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
9. Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

Question:

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor.

Explain the above in context of SA-315.

Answer:

Identification of Significant Risks:

SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following-

1. Whether the risk is a risk of fraud;
2. Whether the risk is related to recent significant economic, accounting or other developments like changes in regulatory environment etc. and therefore requires specific attention;
3. The complexity of transactions;
4. Whether the risk involves significant transactions with related parties;
5. The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
6. Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

Question:

Auditor or Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is the view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions.

Answer:

Risk of Material Misstatement – Greater for Significant Non-Routine Transactions:

Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.

Risks of Material Misstatement– Greater for Significant Non-Routine Transactions

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

1. Greater management intervention to specify the accounting treatment.
2. Greater manual intervention for data collection and processing.
3. Complex calculations or accounting principles.
4. The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Keeping in view above, view of Auditor of Sunshine Ltd is correct.

Question:

So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Answer:

So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

1. Whether errors and frauds are likely to be located in the ordinary course of operations of the business;
2. Whether an adequate internal control system is in use and operating as planned by the management;
3. Whether an effective internal auditing department is operating;
4. Whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
5. Whether the controls adequately safeguard the assets;
6. How far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
7. How reliable the reports, records and the certificates to the management can be;
8. the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
9. What would be appropriate audit technique and the audit procedure in the given circumstances;
10. What are the areas where control is weak and where it is excessive; and
11. Whether some worthwhile suggestions can be given to improve the control system.

Question:

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. Analyse and explain.

Or

The extent and the nature of the audit programme is substantially influenced by the internal control system in operation. Analyse and explain.

Answer:

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.

From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.

A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme.

In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

Question:

A Flow Chart is a graphic presentation of each part of the company's system of internal control. Explain elaborating each and every aspect about flow chart.

Answer:

A Flow Chart: It is a graphic presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. It minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form. It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels of goods and materials as well as cash, both inward and outward; and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

Question:

Write short notes on Internal Control Questionnaire.

Answer:

Internal Control Questionnaire:

This is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.

An important advantage of the questionnaire approach is that oversight or omission of significant internal control review procedures is less likely to occur with this method. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an interim basis. The questionnaire form also provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review in detail.

In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given.

The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.

Question:

Why Test of Controls are performed? Also explain what does it include.

Answer:

Tests of Control: Tests of control are performed to obtain audit evidence about the effectiveness of the:

1. Design of the accounting and internal control systems, that is, whether they are suitably designed to prevent or detect and correct material misstatements; and
2. Operation of the internal controls throughout the period.

Tests of control may include:

- Inspection of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly, for example, verifying that a transaction has been authorized.
- Inquiries about, and observation of, internal controls which leave no audit trail, for example, determining who actually performs each function and not merely who is supposed to perform it.
- Re-performance of internal controls, for example, reconciliation of bank accounts, to ensure they were correctly performed by the entity.
- Testing of internal control operating on specific computerized applications or over the overall information technology function, for example, access or program change controls.

Question:

While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognises that some deviations may have occurred. Analyse and Explain.

Answer:

While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognises that some deviations may have occurred. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. When deviations are detected, the auditor makes specific inquiries regarding these matters, particularly, the timing of staff changes in key internal control functions. The auditor then ensures that the tests of control appropriately cover such a period of change or fluctuation.

Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. The evaluation of deviations may result in the auditor concluding that the assessed level of control risk needs to be revised. In such cases, the auditor would modify the nature, timing and extent of planned substantive procedures.

Before the conclusion of the audit, based on the results of substantive procedures and other audit evidence obtained by the auditor, the auditor should consider whether the assessment of control risk is confirmed. In case of deviations from the prescribed accounting and internal control systems, the auditor would make specific inquiries to consider their implications. Where, on the basis of such inquiries, the auditor concludes that the deviations are such that the preliminary assessment of control risk is not supported, he would amend the same unless the audit evidence obtained from other tests of control supports that assessment. Where the auditor concludes that the assessed level of control risk needs to be revised, he would modify the nature, timing and extent of his planned substantive procedures.

Question:

Explain the meaning of automated environment. Also discuss the key features of an automated environment.

Answer:

An **automated environment** basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.

For example, think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using "apps" on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Some of the key features of an automated environment are as follows:

Key features of an Automated Environment

- Enables faster business operation
- Accuracy in data processing and computation
- Ability to process large volume of transactions
- Integration amongst business operations
- Better security and controls
- Less prone to human errors
- Provides latest information
- Connectivity and networking capability

The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex.

For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Question:

List any five points that an auditor should consider to obtain an understanding of the Company's automated environment.

Or

Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.

Explain stating the points that an auditor should consider to obtain an understanding of the company's automated environment.

Or

Give some of the points that an auditor should consider to obtain an understanding of the company's automated environment:

Answer:

Understanding of the Company's Automated Environment:

Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment

- Information systems being used (one or more application systems and what they are)
- their purpose (financial and non-financial)
- Location of IT systems - local vs global
- Architecture (desktop based, client-server, web application, cloud based)
- Version (functions and risks could vary in different versions of same application)
- Interfaces within systems (in case multiple systems exist)
- In-house vs Packaged
- Outsourced activities (IT maintenance and support)
- Key persons (CIO, CISO, Administrators)

Question:

The auditor should understand and consider the risks that may arise from the use of Information Technology (IT) Systems.

Or

Which are specific risks to the company's internal control having IT environment?

Or

IT poses specific risks to an entity's internal control. Explain

Or

Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should understand the risks that arise from the use of IT systems. Explain those risks.

Answer:

Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems.

Given below are some such risks that should be considered,

1. Inaccurate processing of data, processing inaccurate data, or both
2. Unauthorized access to data
3. Direct data changes (backend changes)
4. Excessive access / Privileged access (super users)
5. Lack of adequate segregation of duties
6. Unauthorized changes to systems or programs
7. Failure to make necessary changes to systems or programs
8. Loss of data

Question:

Discuss the impact of IT related risks on Substantive Audit, Controls and Reporting.

Or

Analyse how risks in the IT system if not mitigated could have an impact on the audit.

Answer:

The IT 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.

Question:

Discuss the common methods applied by the auditor when testing in an automated environment is done by him.

Or

Explain some of the commonly used methods for testing in an automated environment

Answer:

When testing in an automated environment, some of the more common methods are as follows:

1. Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
2. Observe how a user processes transactions under different scenarios.
3. Inspect the configuration defined in an application.
4. Inspect the system logs to determine any changes made since last audit testing.
5. Inspect technical manual / user manual of systems and applications.

6. Carry out a test check (negative testing) and observe the error message displayed by the application.
7. Conduct reperformance using raw source data and independently applying formulae, business rules or validations on the source data using CAATs.

Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient.

Reperformance is most effective as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time.

Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence.

Question:

While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc., analyse various functions that can be performed even by the auditor also using Data Analytics tools and techniques in the audit process to obtain good results.

Or

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform check completeness of data and population that is used in either test of controls or substantive audit tests. Explain in detail stating all the relevant points.

Or

In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. Explain stating uses of Data analytics.

Answer:

The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:

1. Check completeness of data and population that is used in either test of controls or substantive audit tests.
2. Selection of audit samples – random sampling, systematic sampling.
3. Re-computation of balances – reconstruction of trial balance from transaction data.
4. Reperformance of mathematical calculations – depreciation, bank interest calculation.
5. Analysis of journal entries
6. Fraud investigation.
7. Evaluating impact of control deficiencies.

Question:

What are matters considered in Risk documentation.

Answer:

The auditor shall document:

1. The discussion among the engagement team and the significant decisions reached
2. Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components, the sources of information from which the understanding was obtained; and the risk assessment procedures performed
3. The identified and assessed risks of material misstatement at the financial statement level and at the assertion level and
4. The risks identified, and related controls about which the auditor has obtained an understanding.

Question:

Foreceful Limited is a company dealing in mobile spare parts and having its showrooms in almost all the states in the country. For FY 2020-21, the company transferred its accounts from manual to computerized system (SAP). PQR & Co., Chartered Accountants have specialization in the system audit and have been appointed as the system auditor. PQR & Co., at the end of the audit concludes that there are certain findings or exceptions in IT environment and IT controls of the company which needs to be assessed and reported. Mention those points of consideration.

Answer:

At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee.

Some points to consider are as follows:

1. Are there any weaknesses in IT controls?
2. What is the impact of these weaknesses on overall audit?
3. Report deficiencies to management – Internal Controls Memo or Management Letter.
4. Communicate in writing any significant deficiencies to Those Charged with Governance.
5. The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

Question:

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Explain.

Answer:

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

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

1. The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or
2. Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Question:

Discuss the matters the auditor may consider in determining the extent of tests of controls.

Answer:

Matters the auditor may consider in determining the extent of tests of controls: When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of tests of controls include the following:

1. The frequency of the performance of the control by the entity during the period.
2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The expected rate of deviation from a control.
4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The extent to which audit evidence is obtained from tests of other controls related to the assertion.

Question:

Discuss the various points which auditor needs to consider in determining whether it is appropriate to use audit evidence about operating effectiveness of controls obtained in previous audit, and if so, the length of the time period that may elapse before retesting.

Answer:

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

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

Question:

XYZ & Associates, Chartered Accountants, while evaluating the operating effectiveness of internal controls, detects deviation from controls. In such a situation, state the specific inquiries to be made by an auditor to understand these matters and their potential consequences.

Answer:

Evaluating the Operating Effectiveness of Controls:

When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
(b) Additional tests of controls are necessary; or
(c) The potential risks of misstatement need to be addressed using substantive procedures.

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

This requirement reflects the facts that:

1. The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement and
2. There are inherent limitations to internal control, including management override.

Question:

"A multinational co. wants to appoint you to carry the statutory audit." Discuss with reference to SA 330 the substantive procedures to be performed to assess the risk of material misstatement.

Or

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

Answer:

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

This requirement reflects the facts that:

1. The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement and
2. There are inherent limitations to internal control, including management override.

Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from test of controls are unsatisfactory.

In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

Question:

With Ref. to SA 320 "Materiality in planning and performing an audit" Indicate the factors which may effect the identification of an appropriate benchmark while determining materiality for the financial statements as a whole.

Or

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Discuss stating the factors that may affect the identification of an appropriate benchmark.

Answer:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

1. The elements of the financial statements (Example - Assets, liabilities, equity, revenue, expenses);
2. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (Example - For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets)
3. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
4. The entity's ownership structure and the way it is financed and (Example - If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;)
5. The relative volatility of the benchmark.

Question:

As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please, guide him.

Answer:

Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

Notes

Chapter 4

Question:

Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss.

Answer:

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes:

Information contained in the accounting records: Accounting records include the

- The records of initial accounting entries and supporting records, such as cheques and records of electronic fund transfers;
- Invoices;
- Contracts;
- The general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and
- Records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements.

Other information which the auditor may use as audit evidence includes, for example:

- Minutes of the meetings,
- Written confirmations from trade receivables and trade payables,
- Manuals containing details of internal control etc.

Question:

"Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability". Explain. Also state clearly generalisations about the reliability of audit evidence.

Answer:

Reliability of Audit Evidence: SA 500 on "Audit Evidence" provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

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

Question:

The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement. Auditor's judgment as to sufficiency may be affected by few factors. Explain.

Or

The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor's judgement as to sufficiency of audit evidence.

Or

Explain the various factors affecting the auditor's judgments as to the sufficiency of the audit evidence.

Answer:

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

Auditor's judgment as to sufficiency may be affected by the factors such as:

a. Materiality
b. Risk of material misstatement
c. Size and characteristics of the population.

Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.

Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level (a) Inherent risk—

The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls. (b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

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

Question:

What are the audit procedures to be performed by the Auditor to obtain Audit Evidence to draw reasonable conclusions on which he can base the audit opinion?

Answer:

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

1. Risk assessment procedures; and
2. Further audit procedures, which comprise:
    a. Tests of controls, when required by the SAs or when the auditor has chosen to do so; and
    b. Substantive procedures, including tests of details and substantive analytical procedures.

The audit procedures inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry described below may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context in which they are applied by the auditor.

Question:

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

Answer:

Audit Procedure:

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

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

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

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

Question:

CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations.

Answer:

Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples of audit procedures which include observation or inspection of the entity's operations are:

1. Documents (such as business plans and strategies), records, and internal control manuals.
2. Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)
3. The entity's premises and plant facilities.

Question:

Evaluating responses to inquiries is an integral part of the inquiry process. Explain.

Answer:

Inquiry – Audit Procedure to obtain Audit Evidence: Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

Question:

"The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time". Explain

Answer:

Nature and Timing of the Audit Procedures: The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

Question:

In the context of SA-315, state the assertions used by auditor to consider the different types of potential misstatements that may occur w.r.t. classes of transactions and events for period under audit.

Answer:

Assertions used by the auditor to consider the different types of potential misstatements that may occur with respect to classes of transactions and events for the period under audit:

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

Question:

Name the assertions for the following audit procedures:

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

Answer:

1. Year-end inventory verification: Existence Assertion.
2. Depreciation has been properly charged on all assets: Valuation Assertion.
3. Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
4. All liabilities are properly recorded in the financial statements: Completeness.
5. Related party transactions are shown properly: Presentation & Disclosure

Question:

In a company of 24,000 employees, the auditor faces the problem of judging the reasonableness of provision for leave encashment and employee cost. The company wants to take the help of the expert for the same. As an auditor how would you evaluate the adequacy of the work of the expert?

Answer:

If the entity has employed or engaged experts, the auditor may rely on the works of experts, provided he is satisfied that sufficient and appropriate audit evidence is obtained with reasonable assurance to form an opinion on the financial statements.

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

1. Evaluate the competence, capabilities and objectivity of that expert;
2. Obtain an understanding of the work of that expert; and
3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Question:

Discuss Audit Trail (New)

Answer:

An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity. It is used as audit evidence to establish authentication and integrity of a transaction. Audit trails help in

maintaining record of system and user activity. Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used

It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source. Audit trails are used to verify and track many types of transactions including accounting and financial transactions.

Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use. Audit trails help to enhance internal controls and data security. Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas. For example, audit trails can track activities of users thus fixing responsibility for users. These can also be used to rebuild events upon occurring of some problem. Audit trail analysis can specify reason of the problem. It can also help in ensuring operation of system as intended. In this way, audit trails can help entities in their regular system operations.

However, audit trails involve costs. The cost is not only in terms of system expenditure but also in terms of time involved in analysing data made available by audit trails. However, use of automated tools can be made to analyse large volume of data thrown up by audit trails.

Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not. It aids in verification whether a transaction was indeed performed by a person authorised to do it. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

Question:

Discuss the objectives and scope of internal audit functions with respect to activities relating to internal control.

Answer:

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

Activities Relating to Governance:

The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Activities Relating to Risk Management:

The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).

Activities Relating to Internal Control:

- Evaluation of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control.
- Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.
- Review of compliance with laws and regulations. The internal audit function may be assigned to review compliance with laws, regulations, and other external requirements, and with management policies and directives and other internal requirements.

Question:

CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishor, the statutory auditor of the Company, for his view and reporting. Can CA. Kishor rely on such report?

Answer:

As per SA 610 "Using the Work of Internal Auditors", while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-

(a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
(b) The level of competence of the internal audit function; and
(c) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Further, 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.

In the instant case, CA. Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible, he should also test check few items and he can also observe the procedures performed by the internal auditors.

If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

Question:

OPQ Ltd is in the business of software consultancy. The company has had large balances of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2021, in respect of the valuation of accounts receivable, the statutory auditor has assigned the checking of the accuracy of the aging of the accounts receivables and provision based on ageing to the internal auditor providing direct assistance to him. Please advise.

Answer:

As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) shall not use internal auditors to provide direct assistance to perform procedures that:

(a) Involve making significant judgments in the audit;

(b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
(c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
(d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

In the given case where the valuation of accounts receivable is assessed as an area of higher risk, the statutory auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance. However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

Question:

Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

(a) Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.
(b) Will your answer be different, if Mr. Anand ask direct assistance from Mr. Bhola, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

Answer:

A. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

1. Involve making significant judgments in the audit;
2. Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
3. Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
4. Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

B. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

(a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and

(b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

In view of above, Mr. Anand can seek direct assistance from internal auditor.

Question:

Sun Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

Answer:

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall:

- Evaluate the existence and significance of threats to objectivity and
- The level of competence of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

The external auditor shall not use an internal auditor to provide direct assistance if:

1. There are significant threats to the objectivity of the internal auditor; or
2. The internal auditor lacks sufficient competence to perform the proposed work.

The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

1. Involve making significant judgments in the audit;
2. Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;

3. Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
4. Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

Question:

In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'Non-Sampling risk'.

Or

While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

Answer:

Sampling Risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

1. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
2. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Example

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation. Sources of Non-Sampling risk are:

1. Human Mistakes
2. Applying audit procedures not appropriate to the objectives of audit
3. Relying on erroneous information e.g. erroneous confirmation
4. Misinterpreting the sample results

Non sampling risk can never be mathematically measured.

Question:

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non-Statistical sampling approaches.

Answer:

Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics. A sampling approach that does not have above characteristics is considered non-statistical sampling.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Sample must be representative.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

Question:

Factors that should be considered for deciding upon the extent of checking on a sampling plan.

Answer:

The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

1. Size of the organisation under audit.
2. State of the internal control.
3. Adequacy and reliability of books and records.
4. Tolerable error range.
5. Degree of the desired confidence.

Question:

State the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

Answer:

Audit Sampling: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-

Sample design - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

Sample Size- The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

Selection of Items for Testing- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

Question:

XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530.

Answer:

Stratification and Value-Weighted Selection: In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques.

Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.

The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population.

For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

Value-Weighted Selection: When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units. One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

Question:

With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details –

(i) The desired level of assurance

(ii) Stratification of the pollution.

Answer:

Examples of factors influencing Sample Size for Test of Details:

1. Desired Level of Assurance: An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.
2. Stratification of population: When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

Question:

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range. Explain about that method.

Answer:

Simple Random Sampling: Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. It is considered that random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum). Today random numbers are also generated using various applications on the cellphones like the random number generator.

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range.

Question:

"Sampling risk can lead to erroneous conclusions". Justify.

Answer:

Sampling Risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Sampling risk can lead to two types of erroneous conclusions:

1. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
2. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous

conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Question:

It is imperative for the auditor to project misstatements for the population while performing audit procedures through sampling. Comment.

Or

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain

Answer:

1. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.
2. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.
3. For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Question:

The auditor shall evaluate the results of the sample and whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. Explain

Answer:

The auditor shall evaluate-

(a) The results of the sample; and
(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested

Question:

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

Or

Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

Answer:

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

1. Nature of inventory.
2. Stages of completion of work in progress.
3. The risks of material misstatement related to inventory.
4. The nature of the internal control related to inventory.
5. Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.

6. The timing of physical inventory counting.
7. Whether the entity maintains a perpetual inventory system.
8. The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
9. Whether the assistance of an auditor's expert is needed.

Question:

Explain clearly the examples of matters relevant in physical verification when inventory is under control of third party?

Answer:

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both:

1. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
2. Perform inspection or other audit procedures appropriate in the circumstances.

Other audit procedure may include -

1. Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
2. Requesting confirmation from other parties when inventory has been pledged as collateral.
3. Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
4. Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.

Question:

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

Answer:

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

1. Inquiry of management and, where applicable, others within the entity, including inhouse legal counsel;
2. Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
3. Reviewing legal expense accounts.

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

Question:

SPR Ltd has been into the media business since 1990. During the F.Y 2021-2022 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances?

Answer:

Circumstances when becoming necessary to meet with external legal counsel: In the given case of SPR Ltd., Auditor requested the management for meeting with SPR's external legal counsel.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

This may be the case, for example, where:

1. The auditor determines that the matter is a significant risk.
2. The matter is complex.
3. There is disagreement between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Question:

Discuss the Audit procedures used by audit procedures related to segment information.

Answer:

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

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

Example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information:

1. Sales, transfers and charges between segments, and elimination of intersegment amounts.
2. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
3. The allocation of assets and costs among segments.
4. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Question:

CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External

Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level.

Answer:

Negative confirmations is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provide less persuasive audit evidence than positive confirmations.

Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

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

Question:

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

Answer:

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

If the management refuses to allow the auditor to send a confirmation request, the auditor shall-

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

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

Question:

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement?

Answer:

Other examples of situations where external confirmations may be used include the following:

- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchases from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.
- Long outstanding share application money.

Question:

Discuss external confirmation procedure as per SA-505.

Answer:

External Confirmation Procedures:

1. Determining the Information to be confirmed or Requested: External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".
2. Selecting the Appropriate Confirming Party: Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.
3. Designing Confirmation Requests: The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
4. Follow-Up on Confirmation Requests: The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

Question:

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

Analyse how would you deal as an auditor.

Answer:

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

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

Question:

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

Answer:

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

1. Determining the information to be confirmed or requested;
2. Selecting the appropriate confirming party;
3. Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
4. Sending the requests, including follow-up requests when applicable, to the confirming party.

Question:

Define the following:

a. Positive confirmation request
b. Negative confirmation request
c. Non-response
d. Exception

Answer:

Positive confirmation request – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party

Question:

M/s Suraj & Associates are the statutory auditors of Yuvraj Ltd. for the FY 2020-21. During the course of audit, CA Suraj, the engagement partner requested the management of the company to provide written representation with respect to valuation of a transaction. The management, however, did not provide the same to CA Suraj. What course of action should CA Suraj follow in such a situation?

Answer:

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

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

Question:

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. Analyse and Explain.

Answer:

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

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

Question:

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

Or

Discuss with reference to SA 510, "Initial Audit Engagement – Opening Balances", the procedures the auditor should undertake in respect of opening balances for a new audit engagement.

Or

The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose?

Answer:

Initial audit engagement is an engagement in which either:

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

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

Audit Procedures regarding Opening Balances:

The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

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

1. 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;
2. Determining whether the opening balances reflect the application of appropriate accounting policies; and
3. Performing one or more of the following:
   (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
   (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
   (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

Question:

Write short notes on Initial Engagements.

Answer:

Initial Engagements

In conducting an initial engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements; and appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Note: Alternative answer may be given on the basis of SA 210 or in relation to audit engagement letter.

Question:

What is the objective of the auditor with respect to the opening balances when conducting an initial audit engagement as per the relevant SA?

Answer:

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

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

Question:

Discuss with reference to SA-550, "Identification of significant related party transaction outside the entity's normal course of business".

Or

P Ltd. is a company from a business group "ABCD" and is engaged in trading of garments. The promoters of the company are promoters and directors of some other group companies also. You have been appointed as an auditor of P Ltd. P Ltd has entered into various inter company transactions (within group companies) during the year which are outside its normal course of business. What will be your duties as an auditor in relation to those transactions?

Answer:

Identification of significant related party transaction outside business:

As per SA 550 on "Related Parties", for identified significant related party transactions outside the entity's normal course of business, the auditor shall:

1. Inspect the underlying contracts or agreements, if any, and evaluate whether:
    - The business rationale (or lack thereof) the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
    - The terms of the transactions are consistent with management's explanations; and
    - The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
2. Obtain audit evidence that the transactions have been appropriately authorized and approved.

Alternate Answer (New Course):

The auditor shall inquire of management regarding:

1. The identity of the entity's related parties, including changes from the prior period;
2. The nature of the relationships between the entity and these related parties; and
3. Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:

1. Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
2. Authorise and approve significant transactions and arrangements with related parties; and
3. Authorise and approve significant transactions and arrangements outside the normal course of business.

Question:

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements. Analyse and explain stating the responsibility of auditor in this regard.

Answer:

Responsibilities of the Auditor

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:

1. Achieve a true and fair presentation; or
2. Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.
- Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

Question:

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

Answer:

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties.

However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.

Example

1. Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
2. Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.
3. Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Question:

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

Answer:

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

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

Question:

Explain the techniques available as Substantive Analytical procedures.

Or

Explain techniques available as substantive analytical procedures.

Or

Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales).

Explain stating the techniques available as substantive analytical procedures.

Answer:

Techniques Available as Substantive Analytical Procedures

The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

Trend analysis – A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis – Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests – Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts.

Structural modelling – A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

Question:

The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences?

Or

If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how would the auditor investigate such differences.

Answer:

If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

1. Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.
2. Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Conclusion: In the present case CA Raj identifies certain inconsistencies while applying analytical procedure to financial or non-financial data of ABC Ltd. CA Raj should inquire the management of ABC Ltd, and obtain sufficient and appropriate audit evidences relevant to the management response. Further CA Raj should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.

Question:

CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures.

Or

If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences. Explain

Answer:

The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:

1. Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
2. Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.
3. Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.
4. Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

Question:

With respect to SA 520 "Analytical procedures", explain the following factors to be considered by the auditor for substantive audit procedures.

(i) Account type (ii) Predictability (iii) Nature of Assertion.

Answer:

The auditor should consider the following factors for Substantive Audit Procedures:

Account Type – Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.

Predictability – Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.

Nature of Assertion – Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.

Question:

Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures with examples.

Answer:

Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

1. To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
2. To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

Example:

In XYZ Ltd., after applying analytical procedures as comparison of the gross profit ratio with that of the previous year, it is discovered that there has been fall in the ratio. Therefore, it became necessary for the auditor to make further enquiries as it may be due to pilferage of inventories/ misappropriation of a part of the sale proceeds/ a change in the cost of sales without a corresponding increase in the sales price.

Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

a. To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
b. To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

For instance, establishing the relationship that exists between certain balances included in the Balance Sheet and the Statement of Profit and Loss and comparing them with those that existed between the same set of balances in the previous year's reconciling the physical balances of assets with the relevant financial record; obtaining of account from the bankers, account receivables and account payables and reconciling with relevant balances in books of account; confirming amounts of outstanding income and expenses by preparing reconciliation statements, etc. These are helpful in the detection of unusual state of affairs and mistakes in accounts.

Question:

Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances.

Answer:

Trend analysis – A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Question:

Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain

Answer:

Substantive Analytical Procedure:

Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts

Question:

Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures.

Answer:

Since routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired lot of significance as substantive audit procedure. SA-520 on Analytical Procedures discusses the application of analytical procedures during an audit.

Meaning of Analytical Procedures. As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Question:

Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information

Answer:

Examples of Analytical Procedures having consideration of comparisons of the entity's financial information with are:

1. Comparable information for prior periods.

2. Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
3. Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry

Notes

Chapter 5

Share Capital

Question:

The securities premium account may only be applied by the company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Comment.

Or

ABC Ltd. has issued shares for cash at a premium of Rs 450, that is, at amount in excess of the nominal value of the shares which is Rs 10 for cash. 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.

Answer:

It is not correct to say that the securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares, other purposes for which securities premium account can be applied are-

1. In writing off the preliminary expenses of the Company;
2. In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
3. In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
4. For the purchase of its own shares or other securities under section 68.

Question:

What audit points are to be borne in mind in case of issue of “Sweat Equity Shares” by a limited company?

Answer:

Issue of Sweat Equity Shares: As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of ‘Sweat Equity Shares”.

“Sweat Equity Shares” means 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 may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

1. The issue is authorized by a special resolution passed by the company;
2. 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;
3. Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
4. Where the equity shares of the company are listed on a recognized 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.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank paripassu with other equity shareholders.

Question:

Validity and consequence of issue of shares at discount, check with respect to the provisions of the Companies Act, 2013.

Answer: Refer Notes/Module

Reserve

Question:

Explain the disclosure requirements of IND AS compliant Schedule III to Companies Act, 2013 for each component of "Other Equity."

Answer:

For each component of other equity, whether the company has disclosed the following (to the extent applicable):

1. Balance at the beginning of the reporting period
2. Changes in accounting policy or prior period error
3. Restated balance at the beginning of the reporting period
4. Total comprehensive income for the year end
5. Dividends
6. Transfer to retained earnings
7. Any other change (to be specified)
8. Balance at the end of reporting period

Question:

Reserves are amounts appropriated out of profits whereas on the contrary, provisions are amounts charged against revenue. Discuss explaining the difference between the two and also explain clearly revenue reserve and capital reserve.

Answer:

Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose

Examples- to supplement divisible profits in lean years, to finance an extension of business, to augment the working capital of the business or to generally strengthen the company's financial position.

Capital Reserve, on the other hand represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

Examples- share premium, capital redemption reserve.

It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.

A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

Cash and Bank

Question:

How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (part I) to Companies Act, 2013?

Answer:

Disclosure of Cash & Cash Equivalent in the Financial Statements:

Regarding Cash and cash equivalents- Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

(i) Cash and cash equivalents shall be classified as:
   a. Balances with banks;
   b. Cheques, drafts on hand;
   c. Cash on hand;
   d. Others (specify nature)

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

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

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

(v) Bank deposits with more than 12 months' maturity shall be disclosed separately.

Loans and Advances

Question

Write the audit procedures to be performed as an auditor for valuation (assertion) of following: Loans and Advances and other current assets.

Answer:

Audit procedure for valuation of Loans and Advances and other current assets

1. Assess the allowance for doubtful accounts. Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
2. Obtain the ageing report of loans and advances, split between not currently due, 30 days old, 30-60 days old, 60- 180 days old, 180- 365 days old and more than 365 days old. Also, obtain the list of loans and advances under litigation and compare with previous year. ▪ Scrutinize the analysis and identify those loans and advances that appear doubtful; Discuss with management their reasons, if any of these loans/ advances are not included in the provision for bad recoverable; Perform further testing

where any disputes exist; Reach a final conclusion regarding the adequacy of the bad and doubtful loans/ advances provision.

3. Assess bad loans/ advances write-offs. Prepare schedule of movements on Bad loans/ advances – Provision Accounts and loans/ advances written off.
4. Check that write-offs or other reductions in the recoverable balances have been approved by an appropriate and authorised member of senior management, for example the financial controller or finance director.
5. Check that the restatement of foreign currency loans and advances/ other current assets has been done properly.

Inventory

Question:

Inventory: ABC Limited has a closing balance of work in progress of inventories aggregating Rs. 850 lakhs in their balance sheet as at March 31, 2020. As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices.

Answer:

Audit procedure which needs to be performed to confirm work in progress worth Rs.850 lakhs has been valued appropriately and as per generally accepted accounting policies and practices is given hereunder:

1. Ascertain how the various stages of production/ value add are measured and in case estimates are made, understand the basis for such estimates.
2. Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
3. Ensure that material costs exclude any abnormal wastage factors.

Question

Write the audit procedures to be performed as an auditor for valuation (assertion) of following: Finished goods and goods for resale.

Answer:

Audit procedure for valuation of finished goods and goods for resale

1. Enquire into what costs are included, how these have been established and ensure that the overheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the draft financial statements.
2. Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. For any such items, also verify if the relevant semi/ partly processed inventories (work in progress) and raw materials have also been written down.
3. Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. For the purpose, request the client to provide inventory ageing split between less than 30 days, 30-60 days old, 60- 90 days old, 90- 180 days old, 180- 385 days old and more than 365 days old (refer screenshot below)
4. Follow up any inventories which at time of observance of physical counting were noted as being damaged or obsolete.

5. Compare recorded costs with replacement costs. Examine vendor price lists to determine if recorded cost is less than current prices.
6. Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower.
7. In manufacturing environments, test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included.
8. Verify the correct application of lower-of-cost-or-net realizable value principles.

Question

What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory.

Answer:

Meaning of Valuation Assertion– Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Example of Inventory explaining the valuation assertion is given hereunder: Inventory has been recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

Question

ABC Limited has a closing balance of work in progress of inventories aggregating Rs. 850 lakhs in their balance sheet as at March 31, 2020. As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices.

Answer:

Audit procedure which needs to be performed to confirm work in progress worth Rs.850 lakhs has been valued appropriately and as per generally accepted accounting policies and practices is given hereunder:

1. Ascertain how the various stages of production/ value add are measured and in case estimates are made, understand the basis for such estimates.
2. Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
3. Ensure that material costs exclude any abnormal wastage factors.

PPE & Intangibles

Question:

CA R is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that:

(i) All PPE (property, plant and equipment) are in the name of the entity he is auditing.
(ii) For all additions to land and building in particular, the auditor desires to have concrete about the ownership.
(iii) The auditor wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings.

Advise the auditor on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE.

Or

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Pland and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer:

Audit procedure to establish Rights and Obligations of the entity over PPE:

1. In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, CA R, the statutory auditor of B Ltd, while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. Verify whether the PPE additions have been approved by authorized personnel
2. For all additions to land, building in particular, CA R, the statutory auditor of B Ltd, should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.
3. The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.
4. In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, CA R, the statutory auditor of B Ltd should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
5. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

Question:

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer:

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date. In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess the PPE that has been given as security to any third parties.

Question:

While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. Explain.

Answer:

While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. The auditor should:

1. Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciable like freehold land;
2. Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
3. The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.

Question:

Indicate assertions in respect of transactions and events for the period relating to Fixed Assets.

			(₹)
	Plant & Machinery (at Cost)		*4,00,000*
Less:	*Depreciation:*		
	Up to Previous year	*1,40,000*	
	For the year	*26,000*	*1,66,000*
			2,34,000

Answer:

Assertions about transactions and events for the period relating to fixed assets:

1. Occurrence—transactions and events relating to fixed assets have been recorded, have occurred and pertain to the entity.
2. Completeness—all transactions and events relating to fixed assets that should have been recorded have been recorded.
3. Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
4. Cut-off—transactions and events have been recorded in the correct accounting period.
5. Classification—transactions and events have been recorded in the proper accounts.

The specific assertions are as follows:

1. the firm owns the plant and machinery;
2. the historical cost of plant and machinery is Rs. 4 lacs;
3. the plant and machinery physically exist;

4. the asset is being utilised in the business of the company productively;
5. total charge of depreciation on this asset is Rs. 1,66,000 to date on which Rs. 26,000 relates to the year in respect of which the accounts are drawn up; and
6. the amount of depreciation has been calculated on recognised basis and the calculation is correct.

Question:

The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices.

Answer:

The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should:

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any

Question:

Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period-end.

Answer:

Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion.

Question:

Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period-end.

Answer:

Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion.

Question:

You are an auditor of PQR Ltd. which has spent Rs.10 lakhs on Research activities of the product during period under audit. Board of Directors want to recognize it as an internally generated intangible assets. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements.

Answer:

No Intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

Thus, board of directors of PQR Ltd cannot recognize the expense as internally generated intangible asset.

An intangible asset shall be recognised if, and only if:

1. The said asset is identifiable;
2. The entity controls the asset i.e. the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
3. It is probable that future economic benefits associated with the asset will flow to the entity;
4. The cost of the item can be measured reliably.

Trade Receivable

Question

PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2022. It is also analysed from Export Sales account of the company that large number of small shipments were almost dispatched daily during month of March 2022. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables.

Answer:

Completeness assertion in respect of account balances means that all balances which should have been recorded have been recorded. The auditor needs to satisfy himself about cut off so that there is no understatement or overstatement in account balances of export receivables.

In this context, while verifying completeness assertion of export trade receivables, following audit procedures are required:

1. Check that in respect of invoices raised in last few days nearing the cutoff date, goods have been actually dispatched and not lying with the company.
2. Check stock records, e-way bill, and transporter receipt regarding actual movement of goods. It would provide assurance that export invoices in respect of which revenue was booked have been actually moved out of company's premises.
3. Ensure that all goods invoiced prior to cut off date/year end have been included in export receivables on test check basis.
4. Ensure that no goods dispatched after year end have been included in export receivables by tracing entries in export sales, stock records of next year. The same can be verified from e-way bills also.
5. Match invoices to dispatch/shipping details. Further match invoices dates to dispatch dates to see if sales are being recorded in correct accounting period.
6. Test invoices in receivable report. Select invoices from ageing report of export receivables and compare them with supporting documentation to ensure that these are billed with correct names, dates and amounts.

Current Liability

Question:

Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Explain stating also criteria for a liability to be classified as current liability.

Answer:

Liabilities in addition to borrowings, include trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity.

Further, a liability is classified as current if it satisfies any of the following criteria:

1. It is expected to be settled in the entity's normal operating cycle
2. It is held primarily for the purpose of being traded
3. It is due to be settled within twelve months after the reporting period
4. The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments does not affect its classification.

Provisions

Question:

Reserves are amounts appropriated out of profits whereas on the contrary, provisions are amounts charged against revenue. Discuss explaining the difference between the two and also explain clearly revenue reserve and capital reserve.

Answer:

Reserves are amounts appropriated out of profits that are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist as at the date of the Balance Sheet.

On the contrary, provisions are amounts charged against revenue to provide for:

- Renewal or diminution in the value of assets; or
- a known liability, the amount whereof could only be estimated and cannot be deter-mined with accuracy; or
- a claim which is disputed.

Amounts contributed or transferred from profits to make good the diminution in value of assets due to the fact that some of them have been lost or destroyed as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions. Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit. Reserves are appropriations out of profits.

Difference between Reserves and Provisions

The difference between the two is that provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.

Reserves on the other hand, represent amounts appropriated out of profits, held for equalising the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially.

If we examine the Balance Sheet of a company, at a given time, and deduct the total liabilities to outside trade payables from the value of assets shown therein, the difference between the two figures will represent the net worth of the company based on the book values of assets as on that date. The same shall include the capital contributed by the shareholders as well as total undistributed profit held either to the credit of the Statement of Profit and Loss or to reserves; the reserves again will be segregated as revenue or capital reserves.

Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose

Examples- to supplement divisible profits in lean years, to finance an extension of business, to augment the working capital of the business or to generally strengthen the company's financial position.

Capital Reserve, on the other hand represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

Examples- share premium, capital redemption reserve.

Income & Expense

Question:

Other Income: As a Statutory Auditor of the company list out audit procedure required to be undertaken for the recognition of following other income:

(i) Interest income from fixed deposit
(ii) ii. Dividend income
(iii) iii. Gain/(loss) on sale of investment in mutual funds.

Or

Also indicate disclosure requirements of above as per Companies Act, 2013.

Answer:

Statutory auditor would perform the following audit procedure for recognition of different items given in the question:

1. Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.
2. Dividends are recognised in the statement of profit and loss only when:
   (i) the entity's right to receive payment of the dividend is established;
   (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
   (iii) the amount of the dividend can be measured reliably.
3. Gain/(loss) on sale of investment in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Disclosure Requirements: Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:

Whether 'other income" has been classified as:

- Interest income
- Dividend income
- Other non-operating income (net of expenses directly attributable to such income)

Question:

Depreciation: Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortization expense.

Or

Mention any five attributes to be considered by an auditor while verifying for a depreciation and amortisation expenses.

Answer:

Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles. Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:

1. Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
2. Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
3. Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
4. Whether depreciation and amortisation charges are valid.
5. Whether depreciation and amortisation charges are accurately calculated and recorded.
6. Whether all depreciation and amortisation charges are recorded in the appropriate period.
7. Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified. Whether the most appropriate depreciation method for each separately depreciable component has been used.

Question:

Proft and Loss account of an organization shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations. What are the attributes that an auditor generally prefers for vouching these types of expenses?

Answer:

Attributes to be preferred for vouching other expenses:

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

1. Whether the expenditure pertained to current period under audit;
2. Whether the expenditure qualified as a revenue and not capital expenditure;
3. Whether the expenditure had a valid supporting documents like travel tickets, insurance policy, third party invoice etc.;
4. Whether the expenditure has been classified under the correct expense head;
5. Whether the expenditure was authorised as per the delegation of authority matrix;
6. Whether the expenditure was in relation to the entity's business and not a personal expenditure.

Question:

Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples.

Answer:

Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.

For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by sugar mill can be verified independently from the amount of excise duty/ GST paid.

Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

Question:

CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated?

Answer:

CA X, having doubts about fictitious sales being recorded by Joyful Ltd would ensure that revenue is not overstated by performing following audit procedures:

1. Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
2. Test check few invoices with their relevant entries in sales journal
3. Obtain confirmation from few customers to ensure genuineness of sales transaction
4. Whether any fictitious customers and sales have been recorded.
5. Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
6. Whether unearned revenue recorded as earned.
7. Whether any substantial uncertainty exists about collectability
8. Whether customer obligations are contingent on other actions (financing, resale etc.)

Question:

Name the assertions for the following audit procedures:

1. Year-end inventory verification.
2. Depreciation has been properly charged on all assets.
3. The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
4. All liabilities are properly recorded in the financial statements.
5. Related party transactions are shown properly.

Answer:

1. Year-end inventory verification: Existence Assertion.
2. Depreciation has been properly charged on all assets: Valuation Assertion.
3. Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
4. All liabilities are properly recorded in the financial statements: Completeness.
5. Related party transactions are shown properly: Presentation & Disclosure.

Question:

Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe any five such expenses.

Answer:

Expenses which are essentially of a Revenue Nature, if incurred for creating an asset or adding to its value for achieving higher productivity, are regarded as expenditure of a capital nature. Examples of capital expenditure are-

1. Material and wages- capital expenditure when expended on the construction of a building or erection of machinery.
2. Legal expenses- capital expenditure when incurred in connection with the purchase of land or building.
3. Freight- capital expenditure when incurred in respect of purchase of plant and machinery.
4. Repair- Major repairs of a fixed asset that increases its productivity.
5. Wages- Wages paid on installation costs incurred in Plant & machinery.
6. Interest- Interest paid for the qualification period as per AS-16 i.e. before the asset is constructed.

Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalised it is the duty of the auditor not only to examine the precise particulars of the expenditure but also the considerations on which it has been capitalised.

Question:

While auditing purchases which types of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price.

Or

Discuss the audit procedure to be considered by an auditor while performing analytical procedure to obtain audit evidence as to overall reasonableness of purchase quantity and price.

Or

CA Saurabh is the statutory auditor of UVW Ltd. for the FY 20-21. While verifying the purchases made by UVW Ltd., CA Saurabh decided to perform analytical procedures to obtain audit evidence regarding the overall reasonableness of purchase quantity and price of purchases. What analysis should CA Saurabh perform?

Answer:

Analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price may include:

(i) Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from Management If any significant variations found.

(ii) Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.

(iii) Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.

(iv) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and Consumption.

Question:

While reviewing Employee benefits expenses of a company, how you as an auditor you will evaluate its hiring, appraisal and retirement process?

Answer:

While reviewing Employee Benefits expenses auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

1. The auditor first tests the controls the company has set around the employee benefit payment process to determine how strong and reliable they are. If they are strong, the auditor can minimize the amount of transaction testing he must do. Common internal controls over the employee benefit payment cycle includes maintaining of attendance records, authorisation and approval of monthly payroll processing and disbursement.
2. The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.

3. The auditor performs Substantive analytical procedure consisting of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

Question:

"While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes.

Answer:

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

1. Whether the expenditure pertained to current period under audit;
2. Whether the expenditure qualified as a revenue and not capital expenditure;
3. Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoice etc.;
4. Whether the expenditure has been classified under the correct expense head;
5. Whether the expenditure was authorised as per the delegation of authority matrix;
6. Whether the expenditure was in relation to the entity's business and not a personal expenditure

Question:

ABC limited appointed XYZ & Company, Chartered Accountants, as a Statutory Auditor of the Company for the year 2019-20. CA X, partner of XYZ & Company, was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA X verify interest income on fixed deposits for the year 2019-20?

Answer:

CA X, partner of XYZ & Company, would carry out the following audit procedure for verifying interest income on fixed deposits of ABC Limited:

1. Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period. Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
2. For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from the respective bank/ financial institution.
3. Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
4. Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by client.

Question:

Discuss the audit procedures generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis.

Answer:

The audit procedure generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis is as under:

1. Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
2. Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
3. Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
4. Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

Question:

RJ Limited is in the business of trading of cycles having Head Office at Delhi and branch at Mumbai. Statutory audit of Head Office was to be done by CA D and statutory audit of branch at Mumbai was to be done by CA M. During the course of audit by CA D at head office, CA D Wanted to visit branch at Mumbai and verify the inventory records at Mumbai. The management of RJ Limited did not allow CA D to visit Mumbai office and verify the inventory records as the branch audit of Mumbai was already being undertaken by another CA M.

In the above situation, discuss the rights available with CA D in terms of the Companies Act, 2013.

Answer:

Section 143(1) of the Act provides that the auditor of a company, at all times, shall have a right of access to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per Section143(8).

In the given case where CA D was appointed as Statutory Auditor of Head office of RJ Ltd and CA M was appointed to conduct Statutory Audit of Branch office of RJ Ltd., CA D wanted to visit Mumbai Branch to verify the inventory records at Mumbai but management of RJ Ltd did not allow CA D to verify the inventory records at its Mumbai Branch on the ground that branch audit was already being undertaken by another CA M.

Keeping in view the above provisions of the Companies Act and facts of the case, it can be concluded that CA D has a right to visit the branch for verifying inventory records at Mumbai even if the branch accounts are audited by another auditor CA M, if he considers it necessary to do so for the performance of his duties as an auditor.

Question:

Explain the audit procedure to vouch/verify:

a. Rent expenses
b. Power and Fuel expenses

Answer:

Rent expense- Obtain a month wise expense schedule along with the rent agreements. Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement. Specific consideration should be given to escalation clause in the agreement to verify if the rent was to be increased/ adjusted during the period under audit. Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity

Power and fuel expense- Obtain a month wise expense schedule along with the power bills. Verify if expense has been recorded for all 12 months. Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis. In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends

Question:

State the disclosure requirements in respect of Statement of profit and Loss as per Schedule III of Companies Act, 2013, in case of Employee benefits expenses.

Answer:

Employee benefits expenses: The Company shall disclose by way of notes additional information regarding aggregate expenditure on the Employee benefits expenses:

1. Salaries and wages.
2. Contribution to provident and other funds.
3. Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP).
4. Staff welfare expenses.

Question:

What are the steps to be followed by the auditor while vouching refund of general insurance premium paid?

Answer

Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

1. Ascertain the reasons for refund of insurance premium.
2. Examine insurance policy or cover note to find out the amount of premium.
3. Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.
4. Scrutinise correspondence between the insurance company and the client.
5. Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

Question:

Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit.

Answer:

Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS).

A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures.

In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

1. Completeness;
2. Cut-off;
3. Existence/ occurrence;
4. Valuation/ measurement;
5. Rights and obligations; and
6. Presentation and disclosure

of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

Notes

Chapter 6

Question:

A new team member of the auditors of ABC Ltd. is of the view that audit documentation does not serve any purpose. You are required to explain with reference to SA 230, any three purposes of audit documentation.

Or

SA 230, "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Such audit documentation serves various purposes. Explain.

Answer:

According to SA-230, Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used).

Audit documentation serves a number of purposes:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
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.

Question:

The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc. Explain in detail.

Answer:

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

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

Question:

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. Explain

Answer:

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

SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's 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.

Examples of such changes include:

1. Deleting or discarding superseded documentation.
2. Sorting, collating and cross-referencing working papers.
3. Signing off on completion checklists relating to the file assembly process.
4. Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

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

Question:

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Explain with the help of examples.

Answer:

Documentation of Significant Matters and Related Significant Professional Judgments

Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

1. Matters that give rise to significant risks.
2. Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
3. Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
4. Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report.

An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results.

Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

1. The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.
2. The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
3. The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

Question:

Completion Memorandum" is helpful as part of the audit documentation. Explain.

Answer:

Completion Memorandum or Audit Documentation Summary.

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

1. The significant matters identified during the audit.
2. How they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits.

Further, the preparation of such a summary may assist auditor's consideration of the significant matters. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Question:

The working papers of the branch auditor are also the property of the Principal Auditor and the Management of the Company, so they have right to access them. State the relevant SA and comment.

Or

Clarification on the Auditor's rights where clients and other Auditors seek access to their audit working papers.

Answer:

Ownership of Working Papers: As per SA 230 "Audit Documentation", working papers are the property of the auditor. He may at his discretion, make available portions or extracts from his working paper to his client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.

An auditor is not required to provide the management/ clients or other auditors' access to his working papers. Main auditor of the company does not have right of access to the working papers of the branch auditor.

In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working paper and therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor.

From above, it is clear that working papers of the branch auditor are his property only and neither the Principal auditor not management has right to access that. Therefore, statement given in the question is incorrect.

Question:

CA R comes to know some very critical information with regards to the business cycle of an entity for which he has issued the audit report. He wants to perform additional audit procedures to satisfy himself. As an auditor what he shall document, on the matters arising after the date of audit report? (Topic Not in ICAI New Module)

Answer:

As per SA 230, "Audit Documentation", if, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

1. The circumstances encountered;
2. The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
3. When and by whom the resulting changes to audit documentation were made and reviewed.

Notes

Chapter 7

Question:

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

Answer:

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

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

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

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

Question:

Explain the meaning of term "Subsequent Events" as used in the SA560. Should all types of subsequent events be considered by the auditor in his attest functions?

Answer:

Meaning of Subsequent Events

SA 560 on "Subsequent Events", defines the term 'subsequent events" as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report "subsequent events" also refer to significant events which occurred up to the date of report of the auditor of that component. Thus, subsequent events are those events which occur after the date of the balance sheet till the audit report is signed by the auditor.

Consideration of Subsequent Events by the Auditor

SA 560 requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report. However, the exact manner of treatment would depend upon whether the event falls in the category of 'adjusting event' or 'non-adjusting event'. As per Accounting Standard (AS) 4, events occurring after the date of the balance sheet are of two types, viz., adjusting events which provide further

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evidence of conditions that existed at the date of the balance sheet; and, non-adjusting events are those which are indicative of conditions that arose subsequent to the date of the balance sheet.

Therefore, an auditor is required to consider all subsequent events while discharging his duties and determine whether those shall have to be adjusted or simply required to be disclosed. However, the auditor should perform work as near as practicable to the date of the auditor's report.

Question:

In the context of SA 560 "Subsequent events", state specific enquiries on matters by an auditor which may have effect on Financial Statements. (Not in ICAI New Module)

Answer:

Inquiring from Management to Evaluate Subsequent Event:

As per SA 560 "Subsequent Events", in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matter.

1. Whether new commitments, borrowings or guarantees have been entered into.
2. Whether sales or acquisitions of assets have occurred or are planned.
3. Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
4. Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
5. Whether there have been any developments regarding contingencies.
6. Whether any unusual accounting adjustments have been made or are contemplated.
7. Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
8. Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
9. Whether any events have occurred that are relevant to the recoverability of assets.

Question:

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

Answer:

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

1. Discuss the matter with management and, where appropriate, those charged with governance.
2. Determine whether the financial statements need amendment and, if so,

3. Inquire how management intends to address the matter in the financial statements.

Question:

Management's assessment of the entity's ability to continue as a going concern involves making a judgement about inherently uncertain future outcomes of events or conditions. What are relevant factors to that judgement?

Answer:

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

The following factors are relevant to that judgment:

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

Question:

Explain "Going Concern" assumption with reference to SA. State some financial events or conditions that may cast doubt about going concern assumption.

Answer:

Going Concern Assumption

SA 570, "Going Concern" deals with the auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements.

Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Financial Events or Conditions That May Cast Doubt about Going Concern Assumption

The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption.

1. Net liability or net current liability position.
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
3. Indications of withdrawal of financial support by creditors.

4. Negative operating cash flows indicated by historical or prospective financial statements.
5. Adverse key financial ratios.
6. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
7. Arrears or discontinuance of dividends.
8. Inability to pay creditors on due dates.
9. Inability to comply with the terms of loan agreements.
10. Change from credit to cash-on-delivery transactions with suppliers.
11. Inability to obtain financing for essential new product development or other essential investments.

Question:

Discuss the following: "Operating Conditions" that may cast doubt about going concern assumption

Answer:

Operating Conditions casting doubt about going concern assumption: The following are examples of operating events or conditions that, may cast significant doubt about the going concern assumption.

1. Management intentions to liquidate the entity or to cease operations.
2. Loss of key management without replacement.
3. Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
4. Labour difficulties.
5. Shortages of important supplies.
6. Emergence of a highly successful competitor.

Question:

On the basis of which assumption, the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern.

Or

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern.

Answer:

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. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Objectives of the auditor regarding going concern are:

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

Question:

Explain the objectives of the auditor regarding written representations.

Answer:

The objectives of the auditor regarding written representation:

To obtain written representations

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

To support other evidence

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

To respond appropriately

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

Question:

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

Answer:

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

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

1. Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
2. The terms of the audit engagement were prepared in a previous year;
3. There is any indication that management misunderstands those responsibilities; or
4. Changes in circumstances make it appropriate to do so.

Question:

Written representations are to be provided by the management to the auditor when requested. Comment.

Answer:

Management from Whom Written Representations Requested:

SA-580, "Written Representations", the auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.

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

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

The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:

1. The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations about management fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions are not reliable; or
2. Management does not provide the written representations relating to fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions.

Question:

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

Answer:

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

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

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

Question

"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.

Answer:

As per SA 260 "Communication with those Charged with Governance", the auditor shall communicate with those charged with governance, the responsibilities of the auditor in relation to the financial statement audit, including that:

The auditor's responsibilities in relation to the financial statement audit

1. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
2. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Planned scope and timing of the audit

The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.

Significant findings from the audit

The auditor shall communicate with those charged with governance:

1. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
2. Significant difficulties, if any, encountered during the audit;
3. Unless all of those charged with governance are involved in managing the entity:
   - Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
   - Written representations the auditor is requesting;
4. Circumstances that affect the form and content of the auditor's report, if any and
5. Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

Question:

During the course of audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while communicating significant deficiencies in internal control system.

Answer:

The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.

The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:

1. In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and
2. Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

The auditor shall include in the written communication of significant deficiencies in internal control:

1. A description of the deficiencies and an explanation of their potential effects; and
2. Sufficient information to enable those charged with governance and management to understand the context of the communication.

In particular, the auditor shall explain that:

1. The purpose of the audit was for the auditor to express an opinion on the financial statements;
2. The audit included consideration of internal control relevant to the preparation of the financial statements 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; and
3. The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

Question:

CA.N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA.N with some examples of matters to be considered while determining `significant deficiency' in internal control with reference to relevant SA.

Answer:

As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

1. The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
2. The susceptibility to loss or fraud of the related asset or liability.
3. The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
4. The financial statement amounts exposed to the deficiencies.
5. The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
6. The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
7. The importance of the controls to the financial reporting process, for example:
   - General monitoring controls (such as oversight of management).
   - Controls over the prevention and detection of fraud.
   - Controls over the selection and application of significant accounting policies.
   - Controls over significant transactions with related parties.
   - Controls over significant transactions outside the entity's normal course of business.

- Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).

Question:

Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same.

Or

The auditor of XY & Co. Ltd. has intimated the management that certain misstatements identified during the course of audit need to be corrected. As an auditor, discuss the impact of such misstatements in case the management does not carry out the said corrections.

Answer:

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

1. The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and
2. The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

Notes

Chapter 8

SA 700

Question:

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

Answer:

Factors to be considered to form an opinion:

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

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

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

Question:

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

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

Advise about qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Answer:

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

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

Qualitative Aspects of the Entity's Accounting Practices

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. 2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments.
4. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
   (a) The selective correction of misstatements brought to management's attention during the audit
   (b) Possible management bias in the making of accounting estimates.
5. SA 540 addresses possible management bias in making accounting estimates.

Question:

"An auditor is required to make specific evaluations while forming an opinion in an audit report." State them.

Answer:

Specific Evaluations by the auditor:

In particular, the auditor shall evaluate whether:

1. The financial statements adequately disclose the significant accounting policies selected and applied;
2. The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
3. The accounting estimates made by management are reasonable;
4. The information presented in the financial statements is relevant, reliable, comparable, and understandable;
5. The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
6. The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Question:

The description of management's responsibilities in the auditor's report includes reference to management's responsibilities as it helps to explain to users the premise on which an audit is conducted. Explain

Or

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

Answer:

Responsibilities of Management for the Financial Statements:

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

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

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

1. 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.
2. Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Question:

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

Answer:

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

1. The selective correction of misstatements brought to management's attention during the audit. Example: Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings
2. Possible management bias in the making of accounting estimates

Question:

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

Or

The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also Identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section.

Answer:

Basis for Opinion:

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

1. States that the audit was conducted in accordance with Standards on Auditing;
2. Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;

3. Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
4. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

SA 705

Question:

What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section?

Answer:

An auditor should state in "Basis for Opinion" section of Auditor's Report as under: Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

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

Amendments an Auditor should make:

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

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

Question:

Differentiate between 'Qualified report' and 'Adverse report'.

Answer:

Distinction between Qualified report and Adverse report

1. A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate, to disclose the misleading or incomplete nature of the financial statements.
2. In qualified report, the auditor's reservation is generally written as "subject to or except for, we report that the Balance Sheet shows a true and fair view". Whereas in case of adverse report, the auditor

states that “the financial statements do not present a true and fair view of the state of affairs and working results”.

3. In the qualified report, the auditor gives an opinion subject to certain reservations whereas in the case of adverse report the auditor concludes that on the basis of his examination he is not satisfied with the affirmation made in the financial statements.

Question:

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

Answer:

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

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

Question:

ADKS & Co LLP are the newly appointed statutory auditors of PKK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of financial statements. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise.

Answer:

As per SA 705, if 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, the auditor shall modify the opinion in his report.

The auditor in such a case needs to determine the modification as follows:

Qualified Opinion:

The auditor shall express a qualified opinion when:

1. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

2. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion:

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

Disclaimer of Opinion:

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Question:

CA Omkar is the statutory auditor of Sabhyata Ltd. for the FY 2020-21. The company is engaged in the business of manufacture of floor tiles. During the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Discuss as to how CA Omkar should deal with the situation in the auditor's report.

Answer:

SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

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 judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Further, the auditor shall modify the opinion in the auditor's report when the auditor concludes that based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

In the present case, during the course of audit, CA Omkar obtained certain audit evidence which were not consistent with the affirmation made in the financial statements. Therefore, CA Omkar should modify his report in accordance with SA 705- "Modifications to the Opinion in the Independent Auditor's Report.

CA Omkar should issue either a qualified opinion or an adverse opinion depending upon the circumstances of the case:

1. CA Omkar shall express a qualified opinion when, having obtained sufficient appropriate audit evidence, he concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements

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

SA 706

Question:

Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report?

Answer:

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

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

1. Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
2. 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
3. Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Question:

Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report?

Answer:

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

Emphasis of Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

a. The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
b. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Separate section for Emphasis of Matter paragraph

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

a. Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";

b. 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
c. Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Question:

Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.

Answer:

Examples of circumstances to include Emphasis of Matter Paragraph: As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

1. An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
2. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
3. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
4. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

SA 710

Question:

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited.

Answer:

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

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

Question:

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. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information.

Answer:

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.

Definition of Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

Audit Procedures regarding comparative information

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
(b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

Question:

The audit report of P Ltd. for the year 2019-20 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2020-21, how would you report, if:

1. The company does not make provision for doubtful debts in 2020-21?
2. The company makes adequate provision for doubtful debts in 2020-21?

Answer:

Auditor's responsibilities in cases where audit report for an earlier year is qualified is given in SA 710.

As per SA 710, When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements.

In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

1. Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
2. In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

SA 701

Question:

Explain clearly the purpose of communicating key audit matters.

Answer:

Purpose of communicating key audit matters:

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", the purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.

Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

Question:

How would an auditor determine Key Audit Matters as per SA - 701, "Communicating Key Audit Matters in the Independent Auditor's Report"?

Or

As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters".

Answer:

Determining Key Audit Matters: As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", 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:

1. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
2. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
3. The effect on the audit of significant events or transactions that occurred during the period.

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

Question:

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. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items?

Or

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

Answer:

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", 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. Communicating key audit matters in the auditor's report is not:

1. 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;
2. A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report";
3. 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
4. A separate opinion on individual matters.

Notes

Chapter 9

Government Audit

Question:

C&AG: In case of Government entities, audit of accounts of stores and inventories has been developed as a part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG.

Answer:

Audit of Accounts of Stores and Inventories in Government Companies:

Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted:

1. To ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.
2. To bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.
3. To verify that the purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.
4. To ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.
5. To check the accounts of receipts, issues and balances regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

Question:

C&AG: Define Government Audit and explain its objectives.

Answer:

Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions

- ❖ by the responsible officials
- ❖ and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

Objectives of Govt Audit are:

1. Accounting for Public Funds: Government audit serves as a mechanism or process for public accounting of government funds.
2. Appraisal of Government policies: It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
3. Base for Corrective actions: Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.
4. Administrative Accountability: The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

Question:

C&AG: Discuss the power of C & AG in Government audit.

Answer:

Powers of C&AG:

The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties.

1. To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.

2. To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
3. To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine.

Question:

C&AG: Write basic standards set for Expenditure Audit of Government.

Answer:

The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

1. That the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
2. That there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.

3. That there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
4. That the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
5. That the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

Question:

C&AG: The audit of receipts of government is not as old as audit of expenditure but with the rapid growth of public enterprises audit of receipts tax or non-tax has come to stay. Discuss audit of receipts with respect to Government Audit.

Answer:

Government auditing in India as elsewhere was primarily expenditure- oriented. Gradually, audit of receipts-tax and non-tax was taken up.

The audit of receipts is neither all pervasive nor as old as audit of expenditure but has come to stay in some countries. Such an audit provides for checking:

1. Whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities;
2. Whether adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases;
3. Whether such regulations and procedures are actually being carried out;
4. Whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or wilful omission or negligence to levy or collect taxes or to issue refunds; and
5. Review of systems and procedures to see that the internal procedures adequately secure correct and regular accounting of demands collection and refunds and pursuant of dues up to final settlement and to suggest improvement. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. Are important within the area of test check. A review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure.
6. The extent and quantum of audit required to be done under each category of audit are determined by the C&AG. These are neither negotiable nor questioned. The prescribed extent and quantum of audit are structured in accordance with the design of test check, random sampling, general review ,in-depth study of specified areas, etc .as may be warranted by the nature of transactions, its importance in the scheme of activities of a department and the totality of its transactions, the frequency of check and total plan of audit to be executed during a period.
7. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader. Planning, executing and reporting of work is directed and monitored at middle and top levels of the audit hierarchy. There are built –in arrangements within the C&AG to ensure that the work assigned to each employee is carried out as prescribed.
8. The audit is conducted both centrally where accounts and original vouchers are kept and locally where the drawing and disbursing functions are performed depending on the organisational and institutional arrangements obtaining.

Question:

C&AG: What is the function of audit while examining various rules, regulations and orders with regard to Audit against Rules & Orders by C&AG?

Answer:

Audit against Rules & Orders – Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

a. They are not inconsistent with any provisions of the Constitution or any laws made there under;
b. They are consistent with the essential requirements of audit and accounts as determined by the C&AG;
c. They do not come in conflict with the orders of, or rules made by, any higher authority; and
d. In case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

Question:

C&AG: Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards.

OR

C&AG: The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure.

Answer:

Expenditure Audit: The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

1. That the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
2. That there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
3. That there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
4. That the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
5. That the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

Question:

C&AG: Write a short note on classification of commercial accounts maintained by the public enterprises.

Answer:

Audit of Commercial Accounts:

Public enterprises are required to maintain commercial accounts and are generally classified under three categories—

1. Departmental enterprises engaged in commercial and trading operations, which are subject to the same laws, financial and other regulations as other government departments and agencies;
2. Statutory bodies, corporations, created by specific statutes mostly financed by government in the form of loans, grants, etc.; and
3. Government companies set up under the Companies Act, 2013.

Question:

C&AG: "Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while audit against propriety.

Or

Audit against the propriety seeks to ensure that expenditure confirms to certain principles.

Answer:

Exceptions to the rule – Audit Against Propriety:

Public moneys should not be utilised for the benefit of a particular person or section of the community unless:

1. The amount of expenditure involved is insignificant; or
2. A claim for the amount could be enforced in a Court of law; or
3. The expenditure is in pursuance of a recognised policy or custom; and
4. The amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

Question:

C&AG: An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:

a. Audit against Rules and Orders
b. Audit of Sanctions
c. Audit against Provision of Funds
d. Propriety Audit
e. Performance Audit.

Or

Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards.

Answer:

Government Expenditure Audit:

Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

1. Audit against Rules & Orders: The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
2. Audit of Sanctions: The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
3. Audit against Provision of Funds: It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
4. Propriety Audit: It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
5. Performance Audit: This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

Question:

C&AG: Explain in detail the duties of Comptroller and Auditor General of India.

Answer:

Duties of C&AG: The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under:

1. Compile and submit Accounts of Union and States - The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.
2. General Provisions Relating to Audit - It shall be the duty of the C&AG –
   i. to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
   ii. to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;

iii. to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

3. Audit of Receipts and Expenditure - Where any body or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.
4. Audit of Grants or Loans - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.
5. Audit of Receipts of Union or States - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.
6. Audit of Accounts of Stores and Inventory - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.

7. Audit of Government Companies and Corporations - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

Charitable Institution

Question:

Charitable Institution: CA A is appointed as the auditor of a charitable institutions. Discuss the audit procedure undertaken by him while auditing the Subscription and Donation received by the charitable institution.

Answer:

Audit Procedure in audit of Subscriptions & donations:

Audit Procedure to be undertaken by CA A in respect of Subscriptions and donations received by a Charitable Institution is:

1. Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
2. Whether official receipts are issued;
   (a) confirming that adequate control is imposed over unused receipt books;
   (b) obtaining all receipt books covering the period under review;
   (c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;
   (d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
   (e) examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and
   (f) verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Question:

Charitable: In the case of audit of a charitable institution, what attentions should be paid by the auditor regarding audit of expenditure items?

Answer:

Audit of Expenditure of Charitable Institution:

1. Vouching payment of grants also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the management committee has benefited there from either directly or indirectly.
2. Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test basis.
3. Check payment along with supporting documents in regard to salary and other expenses. Verify that all payments are made after proper sanction by appropriate authority.
4. Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.
5. Verifying the cash and bank balances/payments

NGO

Question:

NGO: As an Auditor of NGO, how do you check/verify atleast four receipts of income during the year?

Answer:

The receipt of income of NGO may be checked on the following lines:

1. Contributions and Grants for projects and programmes: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution

receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.

2. Receipts from fund raising programmes: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
3. Membership Fees: Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
4. Subscriptions: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine/ circulars/periodicals. Check the receipts with subscription rate schedule.
5. Interest and Dividends: Check the interest and dividends received and receivable with investments held during the year.

Question:

NGO: An NGO operating in Mumbai has collected large scale donations for Kerala flood victims. This NGO has appointed you to audit its accounts for the specific period in which it collected donations. Draft audit programme, mentioning six points peculiar to the situation, which you would like to incorporate in your audit programme.

Answer:

Receipt of Donations:

1. Internal Control System: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
2. Custody of Receipt Books: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
3. Receipt of Cheques: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
4. Bank Reconciliation: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
5. Cash Receipts: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
6. Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

Question:

NGO: You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?

Answer:

While planning the audit of an NGO, the auditor may concentrate on the following:

1. Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
2. Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions related to the statutes.
3. Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
4. Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
5. Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
6. Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
7. Setting of materiality levels for audit purposes.
8. The nature and timing of reports or other communications.
9. The involvement of experts and their reports.
10. Review the previous year's Audit Report.

Question:

NGO: As an auditor, how would you check and verify the receipt of income of NGO?

Answer:

The receipt of income of NGO may be checked on the following lines:

1. Contributions and Grants for projects and programmes: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
2. Receipts from fund raising programmes: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
3. Membership Fees: Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
4. Subscriptions: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine /circulars/ periodicals. Check the receipts with subscription rate schedule.
5. Interest and Dividends: Check the interest and dividends received and receivable with investments held during the year.

Local Body

Question:

Local body: Local Fund Audit Wing of a State of a State Government has appointed you to audit the accounts of one of the Local body governed by it. As an auditor, what will be your reporting areas?

Answer:

Reporting areas in audit of Local Fund:

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

The important objectives of audit are:

1) Reporting on the fairness of the content and presentation of financial statements;
2) Reporting upon the strengths and weaknesses of systems of financial control;
3) Reporting on the adherence to legal and/or administrative requirements;
4) Reporting upon whether value is being fully received on money spent; and
5) Detection and prevention of error, fraud and misuse of resources.

Question:

Local Body: Explain the different types of revenue grants which local bodies may receive.

Answer:

Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

1. General purpose grants: These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.
2. Specific purpose grants: These grants which are tied to the provision of certain services or performance of certain tasks.
3. Statutory and compensatory grants: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

Question:

Local Body: State the objectives of audit of Local Bodies.

Or

State the important objectives of Local bodies Audit.

Answer:

Objective of Audit of Local Bodies:

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. The municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit. The important objectives of audit are:

1. Reporting on the fairness of the content and presentation of financial statements;
2. Reporting upon the strengths and weaknesses of systems of financial control;
3. Reporting on the adherence to legal and/or administrative requirements;
4. Reporting upon whether value is being fully received on money spent; and
5. Detection and prevention of error, fraud and misuse of resources.

Question:

Local Body: Before commencing the Audit of Local Bodies, your audit assistant seeks your assistance in preparation of audit programme for local bodies. Please give your advice in this connection.

Or

Draft an audit programme for conducting audit of accounts of a Local Body.

Answer:

Audit Programme for local bodies

1. The Local Fund Audit Wing of the State Government is generally in-charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc have power to appoint their own auditors for regular external audit. So, the auditor should ensure his appointment.
2. The auditor while auditing the local bodies should report on the fairness of the contents and presentation of financial statements, the strengths and weaknesses of system of financial control, the adherence to legal and/or administrative requirements; whether value is being fully received on money spent. His objective should be to detect errors and fraud and misuse of resources.
3. The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.
4. He should ensure that all types of sanctions, either special or general, accorded by the competent authority.
5. He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.
6. The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

Club

Question:

Club: You have been appointed as internal auditor of 'City Club' in Delhi. The receipts of the club were 50 lakhs during the previous year ending 2019-20. You are required to mention special points of consideration while auditing such receipts of the club.

Answer:

The special steps involved, to be considered by the Internal Auditor of City Club in conducting the audit of receipts of the club are stated below-

1. Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
2. Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
3. Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
4. Check totals of various columns of the Register of members and tally them across.
5. See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.

6. Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.

Hospital

Question:

Hospital: You have been appointed as an auditor of a health care service provider. Briefly discuss the special points that should be kept in mind as an auditor for developing an audit programme.

Or

The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital

Answer:

The special points to be kept in mind as an auditor for developing an audit programme of healthcare service provider are:

1. Register of Patients: Auditors to vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. Collection of Cash: Auditor to check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. Income from Investments, Rent etc: See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. Legacies and Donations: Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. Reconciliation of Subscriptions: Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
6. Authorisation and Sanctions: Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
7. Grants and TDS: Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. Budgets: Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
9. Internal Check: Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
10. Depreciation: See that depreciation has been written off against all the assets at the appropriate rates.
11. Registers: Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.

12. Inventories: Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
13. Management Representation and Certificate: Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

Question:

Hospital: What steps would you take into consideration in auditing the receipts from patients of a Hospital?

Answer:

Auditing the Receipts from Patients of a Hospital: Following are the steps to be considered -

1. Examine the internal check system as regards the receipts of bills from the patients.
2. Vouch the register of patients with copy of bills issued to them.
3. Verify bills for a selected period with the patient's attendance record to see that the bills have been correctly prepared.
4. See that bills have been issued to all the patients according to the rules of the hospital.
5. Check cash collections as entered in the cash book with the receipts, counterfoils and other evidence.

Compare the total income with the amount budgeted for the same and report to the management for significant variations which have been taken place.

LLP & Partnership

Question:

LLP: Tomo Construction Engineering LLP approached CA K to understand various returns to be maintained and filed by them. Guide/Discuss the various returns to be maintained and filed by them.

Answer:

Returns to be maintained and filed by an LLP:

- Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.
- Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months or the financial year to which the Statement of Account and Solvency relates.

Question:

Partnership: Discuss the matters which should be specially considered in the audit of accounts of a partnership.

Or

Partnership: There are certain points which are required to be considered specially in the audit of accounts of a partnership. Discuss any three points briefly.

Answer:

Matters which should be specially considered in the audit of accounts of a partnership:

1. Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
2. Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
3. Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
4. Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
5. Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.
6. Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
7. Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

Co-Operative and Multi Co-Operative

Co-Operative: Mr. M, has served as an auditor in the Co-Operative Department of a Government, is appointed as a statutory auditor by a Co-Operative Society that has receipts over Rs. 3 crores during the financial year. He is not a Chartered Accountant. Mr. D, Chartered Accountant is appointed to conduct tax audit of the society under section 44AB of the Income Tax Act, 1961. Comment.

Answer:

Qualifications and Appointment of Auditors - Apart from a chartered accountant within the meaning of the Chartered Accountants Act, 1949, some of the State Co-operative Acts have permitted persons holding a government diploma in co-operative accounts or in co-operation and accountancy and also a person who has served as an auditor in the co-operative department of a government to act as an auditor.

An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society.

Thus, in view of above provisions, appointment of Mr. M as statutory auditor and Mr. D as tax auditor under Section 44 AB is in order.

Question:

Multi Co-operative: Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002.

Answer:

Qualification of Auditors -Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However, the following persons are not eligible for appointment as auditors of a Multi-State co-operative society-

a. A body corporate.
b. An officer or employee of the Multi-State co-operative society.
c. A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.
d. A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

Appointment of Auditors - Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors.

The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting. The auditor or auditors so appointed shall hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

Question:

Multi Co-Operative: Central Govt. hold 55% of the paid up share Capital in Kisan Credit Co-operative Society, which is incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co-operative Society Act.

Answer:

Central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one percent or more of the paid-up share capital in such Multi -State co-operative society. Under section 77 of the Multi-State Cooperative Societies Act, 2002, where the Central Government is of the opinion:

1. That the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual deed and co-operative principles or prudent commercial practices or with sound business principles; or
2. That any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or
3. That the financial position of any Multi-State co-operative society is such as to endanger its solvency.

Thus, in the given case since Central Govt is holding 55% shares and financial position of Kisan Credit co-operative society is in danger, Central government can direct for special audit.

Question:

Co-Operative: You are appointed as an auditor of co-operative society. State the special features of the co-operative audit to be borne in mind by the auditor, concerning:

a) Audit classification of society.

b) Discussion of draft audit report with the management committee

Answer:

Audit classification of society - After a judgement of an overall performance of the society, the auditor has to award a class to the society. This judgement is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.

Discussion of draft audit report with managing committee – On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

Question:

Multi Co-Operative: Explain the powers and duties of auditors under the Multi-State Co-operative Societies Act, 2002.

Answer:

Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi- State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.

As per section 73(2), the auditor shall make following inquiries:

1. Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State co-operative society or its members,
2. Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,
3. Whether personal expenses have been charged to revenue account, and
4. Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.

Educational

Question:

Educational: Mention the eight important points which an auditor will consider while conducting the audit of educational institutions.

Or

What are the special steps involved in conducting the audit of an Educational Institution?

Answer:

Audit of Educational Institutions

The important points which an auditor should consider while conducting the audit of education institutions are as follows:

1. Examine the Trust Deed or Regulations, in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder.
2. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
3. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
4. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
5. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
6. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
7. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prescribed by the Managing Committee.
8. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
9. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

Question:

Educational: You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying Assets and Liabilities of VJM Schools.

Answer:

Verification of Assets & Liabilities of VJM Schools:

1. Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
2. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet and not transferred to revenue, unless they are not refundable.
3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
4. Ascertain that the system ordering inspection on receipt and issue of provisions, food stuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
5. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

CA Inter with CA Himanshu

Leasing

Question:

Leasing: ABC Ltd. wants to buy some equipment on lease and hence required to sign lease agreement with the supplier of the equipment. What are the important points to be examined in the lease agreement?

Answer:

The important points to be examined in the lease agreement are:

1. the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).
2. the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
3. whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
4. whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.

Chapter 11

Question:

Explain the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements in accordance with Code of Ethics issued by ICAI.

Or

Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements. Discuss with reference to those fundamental principles of professional ethics.

Answer:

The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the Institute of Chartered Accountants of India.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles;

(a) Integrity;
(b) Objectivity;
(c) Professional competence and due care;
(d) Confidentiality; and
(e) Professional behaviour.

Question:

"Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors." Explain.

Answer:

Independence" implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of the entity subject to the audit. There are two interlinked perspective of independence of auditors, one independence of mind and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term "Independence" as comprising both-

1. Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
2. Independence in appearance – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised." Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

Question:

The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. Discuss any four examples of professional skepticism.

Answer:

Professional skepticism includes being alert to, for example:

1. Audit evidence that **contradicts** other audit evidence obtained.
2. Information that brings into question the **reliability of documents** and responses to inquiries to be used as audit evidence.
3. Conditions that may indicate **possible fraud**.
4. Circumstances that suggest the need for **audit procedures in addition** to those required by the SAs.
5. Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
   (a) **Overlooking** unusual circumstances.
   (b) **Over generalising** when drawing conclusions from audit observations.
   (c) Using **inappropriate assumptions** in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Question:

CA S is requested to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present?

Answer:

SA 210 – Agreeing the Terms of Audit Engagements:

In order to establish whether the **preconditions for an audit** are present, the auditor of Luck Ltd, CA S shall:

1. Determine whether the **financial reporting framework** is acceptable; and
2. Obtain the **agreement of management** that it acknowledges and understands its responsibility:
   a. For the **preparation** of the financial statements in accordance with the applicable financial reporting framework;
   b. For the **internal control** as management considers necessary; and
   c. To provide the auditor with:
      (i) **Access to all information** such as records, documentation and other matters;
      (ii) **Additional information** that the auditor may request from management for the purpose of the audit; and
      (iii) **Unrestricted access** to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Question:

"An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss.

Answer:

Acceptance of a Change in Engagement: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to-

a. the original engagement; or
b. any procedures that may have been performed in the original engagement, except where the 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.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so. 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.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall-

(a) Withdraw from the audit engagement where possible under applicable law or regulation; and
(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

Question

R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.

Answer:

As per SA 210 on "Agreeing the Terms of Audit Engagements", the auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

1. Any indication that the entity misunderstands the objective and scope of the audit.
2. Any revised or special terms of the audit engagement.
3. A recent change of senior management.
4. A significant change in ownership.
5. A significant change in nature or size of the entity's business.
6. A change in legal or regulatory requirements.
7. A change in the financial reporting framework adopted in the preparation of the financial statements.
8. A change in other reporting requirements.

Question

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2020-21. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited?

Answer:

Agreement on Audit Engagement Terms:

As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

Subject to prescribed details under Law or Regulations, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

1. The objective and scope of the audit of the financial statements;
2. The responsibilities of the auditor;
3. The responsibilities of management;
4. Identification of the applicable financial reporting framework for the preparation of the financial statements; and
5. 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.

In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2020-21 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors. However, engagement letter issued by MEA Ltd. does not specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management.

Question:

CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which information, he should obtain before accepting an engagement?

Answer:

SQC 1 requires the firm to obtain information before accepting an engagement. Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate:

1. The **integrity** of the principal owners, key management and those charged with governance of the entity
2. Whether the engagement **team is competent** to perform the audit engagement and has the necessary capabilities, including time and resources.
3. Whether the firm and the engagement team can **comply with relevant ethical requirements**; and

4. **Significant matters** that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Question:

The firm's system of quality control should include policies and procedures addressing each element. Explain

Answer:

The firm's system of quality control should include policies and procedures addressing each of the following elements:

1. Leadership responsibilities for quality within the firm.
2. Ethical requirements.
3. Acceptance and continuance of client relationships and specific engagements.
4. Human resources.
5. Engagement performance.
6. Monitoring

Question:

The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

Answer:

The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

1. Adherence to professional standards and regulatory and legal requirements;
2. Whether the quality control system has been appropriately designed and effectively implemented; and
3. Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

Question:

The engagement partner shall take the responsibility for the overall 'quality on each audit engagement to which that partner is assigned. Discuss with reference to SA 220 "Quality Control for an audit of financial statements".

Or

The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise the importance to audit quality. Explain w.r.t SA 220

Answer:

As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

1. The importance to audit quality of:
   a. Performing work that **complies with professional standards** and regulatory and legal requirements;
   b. Complying with the **firm's quality control policies and procedures** as applicable;
   c. Issuing **auditor's reports that are appropriate** in the circumstances; and
   d. The engagement team's ability to **raise concerns without fear of reprisals**; and
2. The fact that **quality is essential** in performing audit engagements

Question:

As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. Explain

Answer:

Information which assists the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client.

The following information would assist the auditor in accepting and continuing of relationship with the client:

1. The integrity of the principal owners, key management and those charged with governance of the entity;
2. Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
3. Whether the firm and the engagement team can comply with relevant ethical requirements; and
4. Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Question:

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended 31 March 2021 got completed on 1 May 2021. The auditor's report was dated 12 May 2021. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on 15 May 2021. Engagement partner had completed his reviews in entirety by 10 May 2021. Please comment.

Answer:

As per SA 220, the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:

1. Determine that an engagement quality control reviewer has been appointed
2. Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control review er; and
3. Not date the auditor's report until the completion of the engagement quality control review.

SA 700 also requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In the given case, the signing of auditors' report before completion of review of engagement quality control review is not right.

Question

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Answer:

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

1. Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence
2. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
3. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

Notes

CA Inter Audit May 24

Correct or Incorrect

Scanner

Use with Notes and ICAI Module

CA Himanshu

Correct and Incorrect Questions
There is a very thin difference between advocacy threats and intimidation threats to an auditor while performing his duty. Incorrect: Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised. e.g., when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third-party disputes. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees. So, it can be concluded that there is not very thin difference between the advocacy threats and intimidation threats
A compilation engagement will also include engagement to provide limited assistance to a client in the preparation of financial statements. Incorrect: A compilation engagement would ordinarily include the preparation of financial statements (which may or may not be a complete set of financial statements) but may also include the collection, classification and summarisation of other financial information. Engagements to provide limited assistance to a client in the preparation of financial statements (for example, on the selection of an appropriate accounting policy) do not constitute an engagement to compile financial information
It is not necessary to follow standards on auditing as they are meant only for reference purposes.   Correct: Removal of auditor before expiry of his term i.e., before he has submitted his report is a serious matter and may adversely affect his independence. Hence, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re -appointed after expiry of their term.
The principle of confidentiality precludes auditor to disclose the information about the client to a third party at all circumstances without any exception. Incorrect: The principle of confidentiality is one of the basic principles of auditing. Auditor is generally not expected to disclose the information of his client to others. But it is not the case always. He can disclose the information to others if (a) permitted by his client or (b) he has to disclose it as per any statutory obligation dictated by any law.
Standards on Review Engagements (SREs) - to be applied in the audit of historical financial information. Incorrect: Standards on Review Engagements (SREs) - to be applied in the review of historical financial information.
The basic objective of audit does not change with reference to nature, size or form of an entity. Correct: An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.
The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.

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

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 30 days after the date of the auditor's report.

Incorrect: 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

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The Auditor is expected to, reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

Incorrect: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.

For auditor's opinion, reasonable assurance is an absolute level of assurance.

Incorrect: Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

There are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being conclusive rather than persuasive.

Incorrect: As per SA 200, the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive

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It is necessary for the auditor to maintain professional skepticism throughout the audit.

Correct: As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Thus, it is necessary for the auditor to maintain professional skepticism throughout the audit.

The primary objective of an audit is to detect fraud and errors in Financial Statements.

Incorrect: Detection of fraud and errors in the financial statements is not the primary objective of audit. The primary objective of an audit is to obtain reasonable assurance about whether the financial statements are free from material misstatements thereby enabling the auditor to express an opinion on the financial statements.

The objective of audit is to obtain absolute assurance and to report on the financial statements.

Incorrect: As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. Incorrect: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
An audit is an official investigation into alleged wrongdoing. Incorrect: An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
The matter of difficulty, time, or cost involved is in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative. Incorrect: The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.
The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. Incorrect: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
Audit procedures used to gather audit evidence may be effective for detecting an intentional misstatement. Incorrect: Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
Even if law or regulation prescribes sufficient details of the terms of the audit engagement the auditor should record them in a written agreement. Incorrect: 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.
The terms of audit engagement can restrict the scope of an audit. · Incorrect: The scope of an audit of financial statements will be determined by the auditor for having regard to the terms of the engagement, the requirement of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.
SA 210 does not require the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

Incorrect: SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.
Preconditions for an audit have not been defined in SA 210 "Agreeing the Terms of Audit Engagements." Incorrect: As per SA 210 "Agreeing the Terms of Audit Engagements", preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted
The audit engagement letter is sent by the client to auditor. Incorrect: As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.
Working papers are property of client, as it contains client's information. Incorrect: Working papers are the property of the auditor and he is entitled to retain them. He may, at his discretion, make portions of or extracts from his working papers available to clients.
Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit. Incorrect: SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.
An Auditor is bound to provide copies of the working papers to the CEO of the company. Incorrect: Working papers are the property of the auditor, thus he is not bound to provide copies of the working papers to anyone unless otherwise specified by law or regulation. However, the auditor may, at his discretion, make portions of or extracts from his working papers available to CEO of the Company or any third party.
Audit documentation is a substitute for the entity's accounting records. Incorrect: The auditor may include copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation. Audit documentation is not a substitute for the entity's accounting records.
As per SA 230 on "Audit Documentations", the working papers are not the property of the auditor. Incorrect: As per SA 230 on "Audit Documentations" the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.
Branch auditor of a company should give photocopies of his working papers on demand by Company Auditor. Incorrect: As per SA 230 on "Audit Documentation", audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Main auditor does not have right of access to the working papers of the branch auditor. In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working papers and therefore, the branch auditor is under no compulsion to give photocopies of his working papers to the principal auditor of the Company.
Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit. Incorrect: SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.
As per SA 230 on "Audit Documentation", the working papers are not the property of the auditor. Incorrect: As per SA 230 on "Audit Documentation" the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.
The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. Correct: The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it.
Joint auditor is always bound by the views of majority of the joint auditors regarding matters to be covered in report. Incorrect: Where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s). Therefore, joint auditor is not bound by the views of the majority of the joint auditors regarding the matters to be covered in the audit report.
A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the auditor's report. Correct: As per SA 299 "Responsibility of Joint Auditors", if a joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.
In respect of audit work divided among the joint auditors, each joint auditor shall be responsible for the work allocated to such joint auditor only. Correct: In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.
The concept of "joint audit" has legal foothold under the Companies Act, 2013. Correct: Under provisions of section 139(3), the members of a company may resolve to provide that audit shall be conducted by more than one auditor. Hence, the concept of "joint audit" has legal foothold also under Companies Act, 2013.

A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit. Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.
Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically. Correct: Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Thus, under a properly framed programme, the danger is significantly less and the audit can proceed systematically.
The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other. Correct: Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.
It is not necessary for the auditor to periodically review the audit programme. Incorrect: There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.
Development of an audit plan is important before the establishment of the overall audit strategy to address the various matters. Incorrect: As per SA-300, "Planning an Audit of Financial Statements", the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same. Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.

Once the overall audit has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy. The establishment of the overall audit strategy and the detailed audit plan are closely inter -related.

Correct: Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

The auditor need not discuss elements of planning with the entity's management in any case.

Incorrect: The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement.

Planning is a discrete phase of an audit.

Incorrect: According to SA-300, "Planning an Audit of Financial Statements", planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan

Development of an audit plan is important before the establishment of the overall audit strategy to address the various matters.

Incorrect: As per SA-300, "Planning an Audit of Financial Statements", the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.

Planning is not a discrete phase of an audit, but rather a continual and iterative process.

Correct: According to SA-300, "Planning an Audit of Financial Statements", planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management.

Incorrect: The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Planning is a discrete phase of an audit.

Incorrect: Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begin shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures

A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.

Incorrect: Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be

rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.
The audit plan is more detailed than the overall audit strategy. Correct: The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.
The Complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be less complex. Incorrect: The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex. If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.
The objectives and scope of internal audit functions are restricted to activities relating to evaluation of internal control only. Incorrect: As per SA-610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control. From the above, it can be concluded that the objective and scope of internal audit function are not restricted to activities relating to evaluation of control only.
If the purpose of an audit procedure is to test for understatement in the existence or valuation of accounts payable then testing the recorded accounts payable may be relevant audit procedure. Incorrect: If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.
Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. Incorrect: Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.
With reference to General IT control, the objective of Data Center and Network Operations is to ensure that systems are developed, configured and implemented to meet financial reporting objectives. Incorrect: Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives.

Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.
Satisfactory Control environment is not an absolute deterrent to fraud. Correct: The existence of a Satisfactory Control environment can be a positive factor when an auditor assesses the risk of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory Control environment is not an absolute deterrent to fraud.
Judgemental matters are transactions that are unusual due to either its size or nature and that therefore occur infrequently. Incorrect: Significant risks often relate to significant non-routine transactions or judgemental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Thus, judgemental matters are not always unusual due to their size or nature.
When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method. Incorrect: There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence
For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion.   Incorrect: The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.
Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates. Correct: Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following: ➢ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation. Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.
There is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. Correct: There is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. The entity's objectives, and therefore controls, relate to financial reporting, operations and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment.
Maintenance of internal control system is responsibility of Auditor. Incorrect, it is the responsibility of the management for the maintenance of internal control system rather than of the Auditor. Because, Internal control is the process designed, implemented and maintained by

those charged with governance, management to provide reasonable assurance about the achievement of entity's objectives.
The use of computer facilities by a small enterprise may increase the control risk. Correct: Many controls which would be relevant to large entities are not practical in the small business. For example, in case of small business using computer facilities, accounting work may not be segregated and be performed by only a few persons. These persons may have both operating and custodial responsibilities, and segregation of functions may be missing or severely limited thereby increasing the control risk.
General CIS controls may have pervasive effect on the processing of transactions in application system. Correct: The general CIS controls may have a pervasive effect on the processing of transactions in application systems. If these controls are not effective, there may be a risk that misstatements might occur and go undetected in the application systems.
There is no relation between Inherent risk, Control risk and Detection risk. Incorrect: There is an inverse relationship between detection risks and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.
Inherent and control risk, and detection risk have same meaning. Incorrect: Inherent and control risks differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce an acceptable level of detection risk, thereby reducing audit risk to an acceptably low level.
Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk. Incorrect: When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.
In the planning stage, analytical procedures would not in any way assist the auditor. Incorrect: In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

CA Inter with CA Himanshu

Risk assessment procedures are not performed to obtain an understanding of the entity and its environment. Incorrect: Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
According to SA 315, the objective of the auditor is to identify and assess the risk of material misstatement, whether due to fraud or error, only at assertion level. Incorrect: According to SA 315, the objective of the auditor is to identify and assess the risk of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control.
Control environment can prevent, detect and correct a material misstatement. Incorrect: The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement
Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. Incorrect: Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.
Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
There is no relation between Audit Plans and knowledge of the client's business Incorrect: The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business
There is an inverse relationship between detection risks and the combined level of inherent and control risks. Correct: There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high. acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.
The assessment of risks is a matter capable of precise measurement. Incorrect: The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
Risk of material misstatement may be defined as the risk that the financial statements are materially misstated subsequent to audit.

Incorrect: Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit.

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

The SAs ordinarily refer to inherent risk and control risk separately.

Incorrect: The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. Control risk, on the other hand is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

Incorrect: Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

Determining materiality involves the exercise of professional judgement.

Correct: Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements.

Correct: Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in

case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.
The concept of materiality is an important and relevant consideration for the auditor in financial statement. Correct: The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not and ensure that a material item is disclosed separately and distinctly.
Materiality is not a matter of size. Incorrect: Financial statements should disclose all 'material items', i.e., the items the knowledge of which might influence the decisions of the user of the financial statement. Materiality is not always a matter of relative size. For example - a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future. In certain cases, quantitative limits of materiality are specified.
The auditor's substantive procedure at the assertion level means substantive analytical procedures only. Incorrect: The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.
Substantive procedures do not test the balances of accounts. Incorrect. Substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. It comprise (i) tests of details (of classes of transactions, account balances, and disclosures), and (ii) substantive analytical procedures
"Substantive procedures" may be defined as audit procedures designed to evaluate the operating effectiveness of controls in preventing, detecting and correcting material misstatements. Incorrect: 'Substantive procedure' may be defined as an audit procedure designed to detect material misstatements at the assertion level whereas 'tests of controls' is an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk. Incorrect: When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.
Substantive procedure may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting material misstatements at the assertion level. Incorrect: Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

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

(i) Tests of details (of classes of transactions, account balances, and disclosures), and

(ii) Substantive analytical procedures

When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk.

Incorrect: When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.

Correct: Tests of control are performed to obtain audit evidence about the effectiveness of the –

(i) design of the accounting and internal control systems, that is, whether they are suitably designed to prevent or detect and correct material misstatements; and

(ii) operation of the internal controls throughout the period.

Tests of control include tests of elements of the control environment where strengths in the control environment are used by auditors to reduce control risk.

While auditing the books of accounts of ABC Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection".

Incorrect: The audit procedure used by the auditor of ABC Ltd. is known as "observation". Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

Sufficiency is the measure of the quantity of audit evidence.

Correct: Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required).

Inquiry alone is sufficient to test the operating effectiveness of controls.

Incorrect: Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls.

Evaluating responses to enquiries is an integral part of the inquiry process.

Correct: Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Internal control questionnaires are a good source of identifying weakness in internal control system.

Correct: The questionnaire form provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review in detail. In the questionnaire, generally questions are so framed that a 'Yes' denotes satisfactory position and a 'No' suggests weakness.

A flow chart is a graphic presentation of each point of the company's system of internal control.

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Correct. Flow chart is a graphic presentation of each part of the entity's system of internal control. It minimizes the amount of narrative explanation and thereby achieves a presentation not possible in any other form. It gives bird's eye view of system for suggestion
While auditing the books of accounts of XYZ Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection". Incorrect: The audit procedure used by the auditor of XYZ Ltd. is known as "observation". Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
Inquiry alone provides sufficient audit evidence of the absence of a material misstatement at the assertion level and of the operating effectiveness of controls. Incorrect: Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls
Narrative Record is a series of instructions and/or questions which a member of the auditing staff must follow. Incorrect: Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor. On the other hand, a Check List is a series of instructions and/or questions which a member of the auditing staff must follow. Or Incorrect: The Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor whereas checklist is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instructions are usually Yes, No or Not Applicable
Inspection consists of looking at a process or procedure being performed by others. Incorrect: Observation consists of looking at a process or procedure being performed by others.
Sales invoice is an example of external evidence. Incorrect: External evidence is the evidence that originates outside the client's organisation. Since sales invoice originates within the organisation being audited, therefore, it is an example of internal evidence and not external evidence.
Purchase invoice is an example of internal evidence. Incorrect: Internal evidence is the evidence that originates within the client's organisation. Since purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.
Sufficiency is the measure of the quality of audit evidence. Incorrect: Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence.
Inquiry alone is sufficient to test the operating effectiveness of controls. Incorrect: Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls
When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries.

Incorrect: When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries.

When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management.

Incorrect: When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- Perform inspection or other audit procedures appropriate in the circumstances.

When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management.

Incorrect: When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- Perform inspection or other audit procedures appropriate in the circumstances.

Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information provided in the request.

Incorrect: In Positive confirmation request confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information whereas Negative confirmation request is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Audit evidence obtained from external confirmation is always reliable.

Incorrect: The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.

External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only.

Incorrect: External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmation need not be restricted to account balances only.

Negative assertions, encountered in the financial statements, may be expressed or implied.

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Correct: Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is no contingent liability it would be an expressed negative assertion; on the other hand, if in the balance sheet there is no item as “building”, it would be an implied negative assertion that the entity did not own any building on the balance sheet date.

Confirmations received by the auditor directly from third parties are conclusive evidence in support of a transaction.

Incorrect: Confirmations received directly from the third parties by the auditor are more reliable but same cannot be treated as conclusive evidence.

An auditor is not concerned with consistency of accounting policies relating to opening balances.

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

The Auditor shall express an unqualified opinion if the Auditor is unable to obtain sufficient audit evidence regarding the opening balances.

Incorrect: As per SA 510 “Initial Audit Engagements—Opening Balances”, if the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate.

It is no part of subsequent auditor's duty to verify opening balances of Ledger accounts of current years, on the basis of Balance Sheet audited by Previous Auditor.

Incorrect: According to SA 510 “Initial Audit Engagements - Opening Balances”, it is the responsibility of the auditor to verify and obtain appropriate evidence in respect of opening balances brought forward from the preceding period.

When Profit before tax from continuing operations is non-volatile, other benchmarks will be appropriate.

Incorrect: Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

Analytical procedure is a part of routine audit checking.

Incorrect: By routine checking we traditionally think of extensive checking and vouching of all entries whereas “Analytical procedure” means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data. It includes the consideration of comparisons of the entity’s financial information. Routine checks cannot be depended upon to disclose all the mistakes or manipulations that may exist in accounts, certain other procedures also have to be applied.
From the above, it may be concluded that analytical procedure is not a part of routine audit checking.

SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements.

Incorrect: SA 520 deals with the auditor’s use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

As per the Standard on Auditing (SA) 520 “Analytical Procedures” ‘the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among financial data only.

Incorrect: As per the Standard on Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non- financial data.

Analytical Procedures are required in the planning phase only.

Incorrect: Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition, these are also required during the completion phase.

Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.

Incorrect: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time

Ratio analysis is useful in analysing revenue and expense account only.

Incorrect: Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts

Reasonableness test rely only on the events of the prior period like other analytical procedures.

Incorrect: Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non-financial data for the audit period under consideration.

The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements.

Incorrect: Analytical procedures may be applied to consolidated financial statements, components and individual elements of information

Statistical sampling being more scientific and without personal bias, bias will always be appropriate to use under all circumstances.

Incorrect: Statistical sampling is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.
Under some audit circumstances, statistical sampling methods may not be appropriate. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

Incorrect: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.

Incorrect: Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.

Correct: The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated. The closeness of the qualities projected by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques

Cluster sampling is less effective than random sampling.

Correct: In cluster sampling population is divided into group called cluster and a number of cluster is selected on random basis. In case of random sampling, each item is randomly chosen and so every item has an equal chance of being selected. Thus, cluster sampling is less effective.

Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Correct: The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results

Stratified sampling method involves dividing the whole population to be tested in a few separate groups.

Correct: Stratified sampling method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and proportionate of items are selected from each of these stratums. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgement.

Statistical sampling has narrower application where a population to be tested consists of a large number of similar items.

Incorrect: Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

The level of sampling risk that the auditor is willing to accept will not affect the sample size.

Incorrect: As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

The method which involves dividing the population into groups of items is knows as block sampling.

Incorrect: The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.

Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Incorrect: Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions

Non-Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

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Incorrect: Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics

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Sample need not be representative.

Incorrect: Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

Incorrect: The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk

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When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.

Incorrect: Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

Stratified Sampling is used for homogeneous population.

Incorrect: Stratified sampling is used when the population is diversified i.e., heterogeneous. The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.

Non statistical sampling is considered to be more scientific than the statistical sampling.

Incorrect: Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.

In case of Statistical sampling, auditor's bias in choosing sample is involved.

Incorrect: Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in non-statistical sampling and not Statistical.

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

Incorrect: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

Low acceptable sampling risk requires larger sample size.

Correct: Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

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In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater.

Correct: In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

Written representation by management as to the quality of inventory is substitute for verification.

Incorrect: Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying its quality for example, obsolete, damaged or ageing inventory. Written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

Alternative Reason for incorrect may be given as: One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So, it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

Letter of Representations received from Management relieve the auditors of their responsibility.

Incorrect: The purpose of letter of representation is to place on record of representations of management on significant matters affecting the accounts such as the ownership and basis of stating the amount of assets, liabilities, and contingent liabilities. In addition, they act as a reminder to management of their responsibilities. Such letters, however, do not relieve the auditors of any of their responsibilities.

Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.

Incorrect: One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So, it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available

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Written representation can be a substitute for other audit evidence.

Incorrect: One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So, it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

A branch auditor is a joint auditor according to SA 299 and his relationship with the company auditor is governed by the said Standard.

Incorrect: Branch auditor is not a joint auditor within the meaning of SA 299. He is another auditor within the meaning of SA 600

The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of the auditor's report.

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

- Within the body of the auditor's report

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➢ Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix ➢ By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so
Deviation in accounting policies are to be reported in auditor's report. Incorrect: It is not that all deviations in accounting policies be reported in the auditor's report. Only those deviations in accounting policies are to be reported in the auditor's report in respect of which proper disclosure regarding such deviations in the accounting policies have not been made.
Financial Statements should show "True and correct" view of the affairs of the entity. Incorrect: Financial statements are frequently described as showing a true and fair view of the financial position, performance and cash flows of an enterprise. The application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information. There has been a shift of emphasis from arithmetical accuracy to the question of reliability to the financial statements. A statement may be reliable even though there are some errors or even frauds, provided they are not so big as to vitiate the picture. The word "correct" was somewhat misplaced as the accounting largely consists of estimates.
SA-700 deals with modification to the opinion in the Independent Auditor's Report. Incorrect: SA 700 deal with forming an opinion and reporting of financial statement whereas SA 705 deals with modifications to the opinion in the Independent Auditor's Report.
There is no need of addressee in the Auditor's report. Incorrect: The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.
The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement. Incorrect: The auditor shall modify the opinion in the auditor's report when: ➢ 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
The auditor shall express a disclaimer of opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. Incorrect: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements.

Incorrect: Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.
Communicating key Audit matters is not a substitute for disclosure in the financial statements. Correct: As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.
Communicating key audit matters in the auditor's report is 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. Incorrect: 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. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.
Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements. Incorrect: 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. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.
Communicating Key Audit Matters is a substitute for the auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with SA 705. Incorrect: Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
An auditor should issue disclaimer of opinion when there is difference of opinion between him and the management on a particular point. Incorrect: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. In case of difference of opinion, either the auditor will issue qualified report or adverse report and not disclaimer of opinion.
The auditor shall not modify the opinion in the auditor's report. Incorrect: The auditor shall modify the opinion in the auditor's report when 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.
If financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion.

Incorrect: As per SA 705 "Modifications to the Opinion in the Independent Auditor's Report", the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. However, the auditor shall express qualified opinion when he concludes that misstatement, individually or in aggregate are material but not pervasive.

The auditor will issue a disclaimer of opinion if he disagrees with the management with regard to the acceptability of the accounting policies and the inadequacy of disclosures in the financial statements.

Incorrect: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

If the auditor disagrees with the management in the matters relating to the acceptability of Accounting policies selected and inadequacy of disclosures in the financial statements, he should issue a qualified report or express an adverse opinion.

An auditor issues unqualified opinion when he concludes that the financial statements give true and fair view.

Correct: An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.

It indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.

When the auditor has to express an adverse opinion, he need not communicate with those charged with governance as this may have an impact on payment of his audit fees.

Incorrect: When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.

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

The inclusion of an Emphasis of Matter paragraph in the Auditor's Report affects the auditor's opinion.

Incorrect: When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall Indicate that the auditor' s opinion is not modified in respect of the matter emphasized. Such a paragraph shall refer only to information presented or disclosed in the financial statements. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor' s opinion.

Emphasis of Matter paragraph in the Auditor's Report is a substitute of Disclaimer of Opinion.

Incorrect: As per SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. Whereas the auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. Therefore, an Emphasis of Matter paragraph is not a substitute for the auditor expressing a disclaimer of opinion

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When the auditor includes an Other Matter paragraph in the auditor's report, the auditor need not include the paragraph within a separate section. Incorrect: When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.
The auditor shall disclaim an opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. Incorrect: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Incorrect: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.