

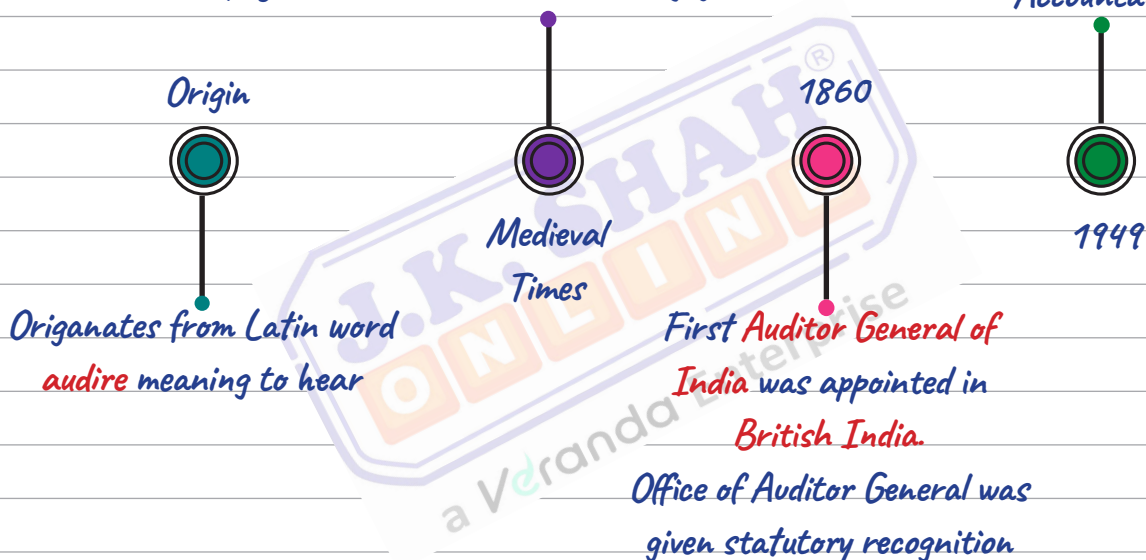
1 NATURE, SCOPE AND OBJECTIVES OF AUDIT



QUESTION 1

Auditor used to **HEAR** the accounts read out to them to check that employees were not careless and negligent

ICAI was established as a statutory body for regulating the profession of Chartered Accountancy



QUESTION 2

As per **ICAI**

- 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.**

ANALYSIS OF DEFINITION

- Independence, here, implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
- The purpose of audit is to express an opinion on the FS.
- Understand that preparation and presentation of FS of an entity is responsibility of management of entity. The auditor expresses an opinion on financial statements by means of written audit report.
- In doing so, he has to see that FS would not mislead anybody by ensuring 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 SAAE;
 - (c) none of the entries in the books of account has been omitted in the process of compilation;
 - (d) the information conveyed by the statements is clear and unambiguous; the FS amounts are properly classified, described and disclosed in conformity with accounting standards;
 - (e) and the statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

Question 1

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

Explain how the person conducting this task should care to ensure that FS would not mislead

Answer:

Meaning + Analysis of Definition

Question 2

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

Answer:

Meaning + Analysis of Definition

Question 3

Explain clearly meaning of Auditing. How would you as an auditor perform the audit.

Answer:

Meaning + Analysis of Definition

**QUESTION 3****INTERDISCIPLINARY NATURE OF AUDITING- RELATIONSHIP WITH DIVERSE SUBJECTS****1. Financial management :**

Auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.

2. Law

An auditor should have a good knowledge of business laws affecting the entity.

3. Accounting :

Auditing reviews the financial statements which are nothing but a result of the overall accounting process.

4. Production:

Good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.

5. **Behavioral science:**

Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.

6. **Economics**

Auditor is expected to be familiar with the overall economic environment of the client

7. **Data processing:**

EDP auditing in itself is developing as a discipline in itself.

8. **Statistics and Mathematics**

Auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.

Question 4

Both accounting and auditing are closely related

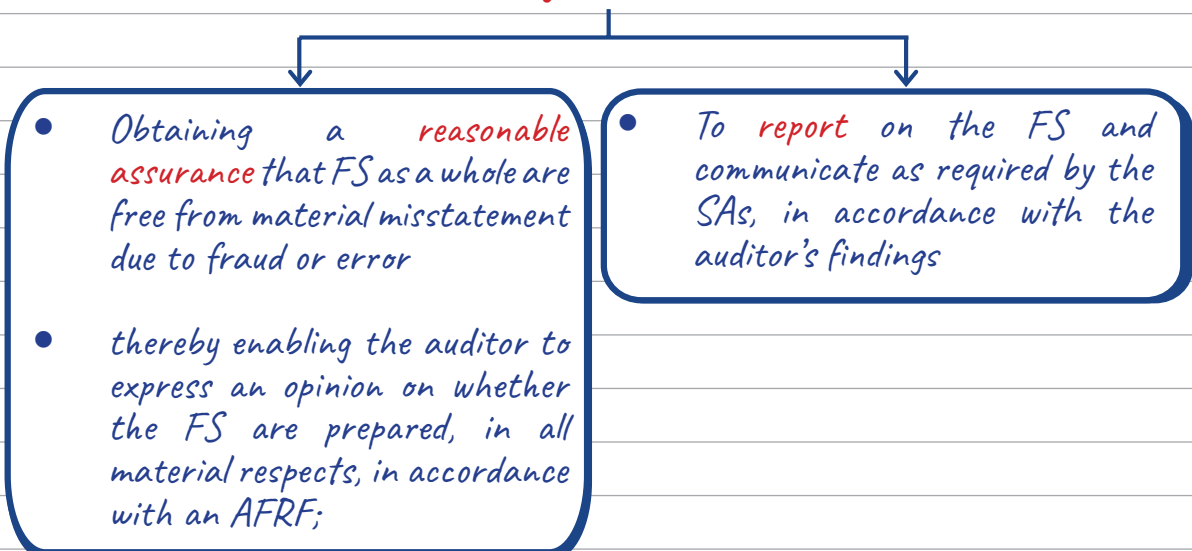
Answer:

Relationship between accounting and auditing.



QUESTION 4

OBJECTIVES



Question 5

State the objectives of Audit according to SA 200

Answer:

Relationship between accounting and auditing.

Question 6

CA Ramesh is the auditor of Reddy Ltd. The auditor expressed his opinion on the FS without ascertaining as to whether the FS as a whole are free from material misstatements or not. In your opinion, whether CA N has complied with the objectives of audit considering the applicability of relevant SA?

Answer:

Objectives of auditor

+ CA Pushpa did not comply with the objectives

Question 7

Lalji Bhai has purchased shares of a company listed on NSE. The audited FS of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct?

Answer:

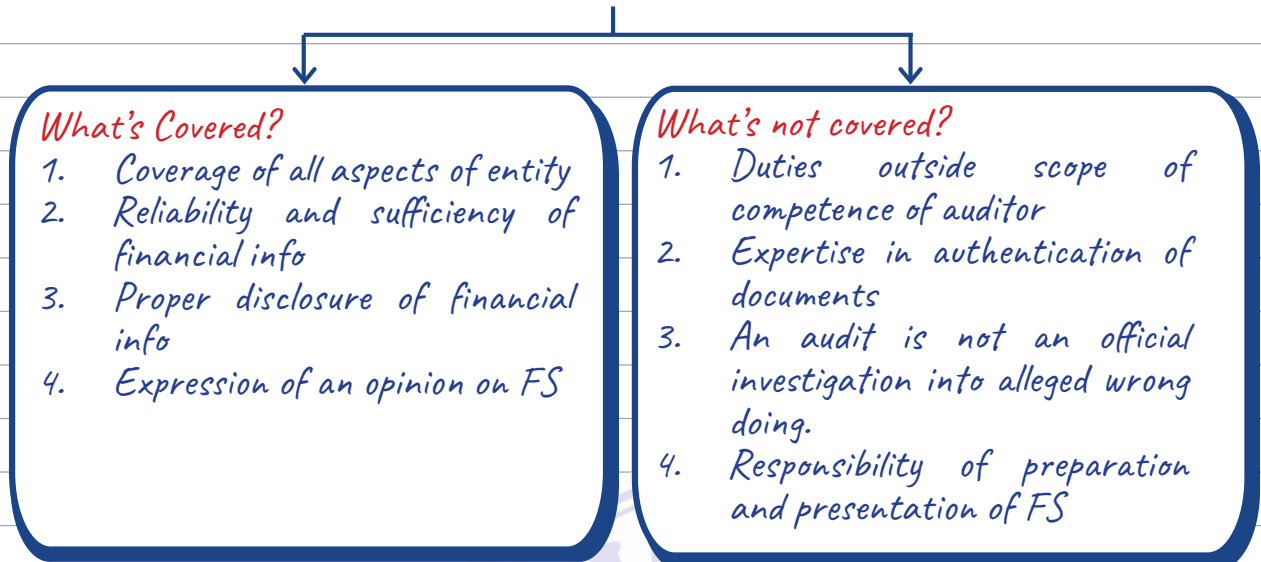
An audit does not provide assurance to investor in shares regarding safety of his money. Share prices of securities are affected by range of factors. An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. Hence, thinking of Lalji Bhai is not correct.

+ CA Pushpa did not comply with the objectives



QUESTION 5

SCOPE OF AUDIT



A. What is included?

1. Coverage of all aspects of entity

- Audit of FS should be organized adequately to cover all aspects of the entity relevant to the FS being audited

2. Reliability and sufficiency of financial information

- The auditor should be reasonably satisfied that **information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of FS.**
- The auditor makes a **judgment of reliability and sufficiency of financial information by**
 - ✓ making a study and assessment of accounting systems and IC and
 - ✓ by carrying out appropriate tests, enquiries and procedures.

3. Proper disclosure of financial information

- The auditor should also decide whether relevant information is properly disclosed in the FS. He should also keep in mind applicable statutory requirements in this regard.

- It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.
- The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

B. What is not included?

1. Auditor is not expected to perform duties which fall outside domain of his competence.
 - For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him. Similarly, it is not expected from an auditor to determine suitability and life of civil structures like buildings.
 - These require different skillsets which may be performed by qualified engineers in their respective fields.
2. An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field.
3. An audit is not an official investigation into alleged wrong doing.
 - He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official 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 is to obtain reasonable assurance on the FS and to express an opinion
 - The scope of audit is general and broad whereas scope of investigation is specific and narrow.

Question 8

Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean.

During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit?

Answer:

What is included in scope of audit + Proper disc

Question 9

A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report?

Answer:

Appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. It is an investigation and not in nature of audit report.

Question 10

“Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management”. Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.

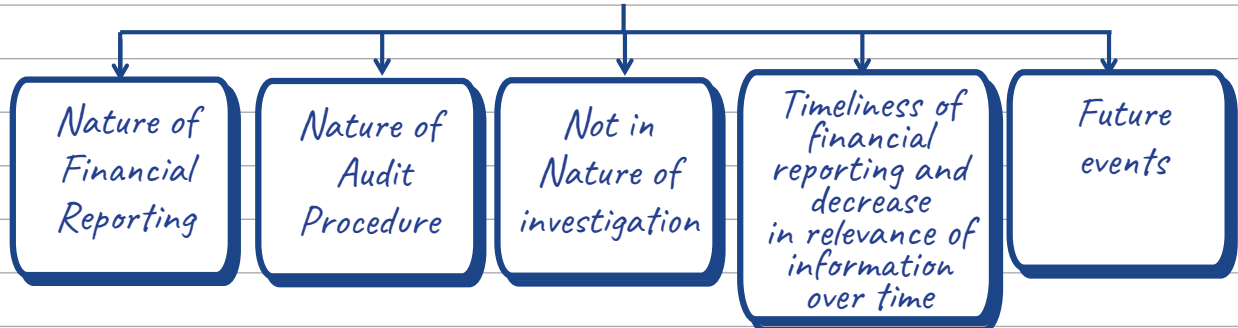
Answer:

Scope of audit.

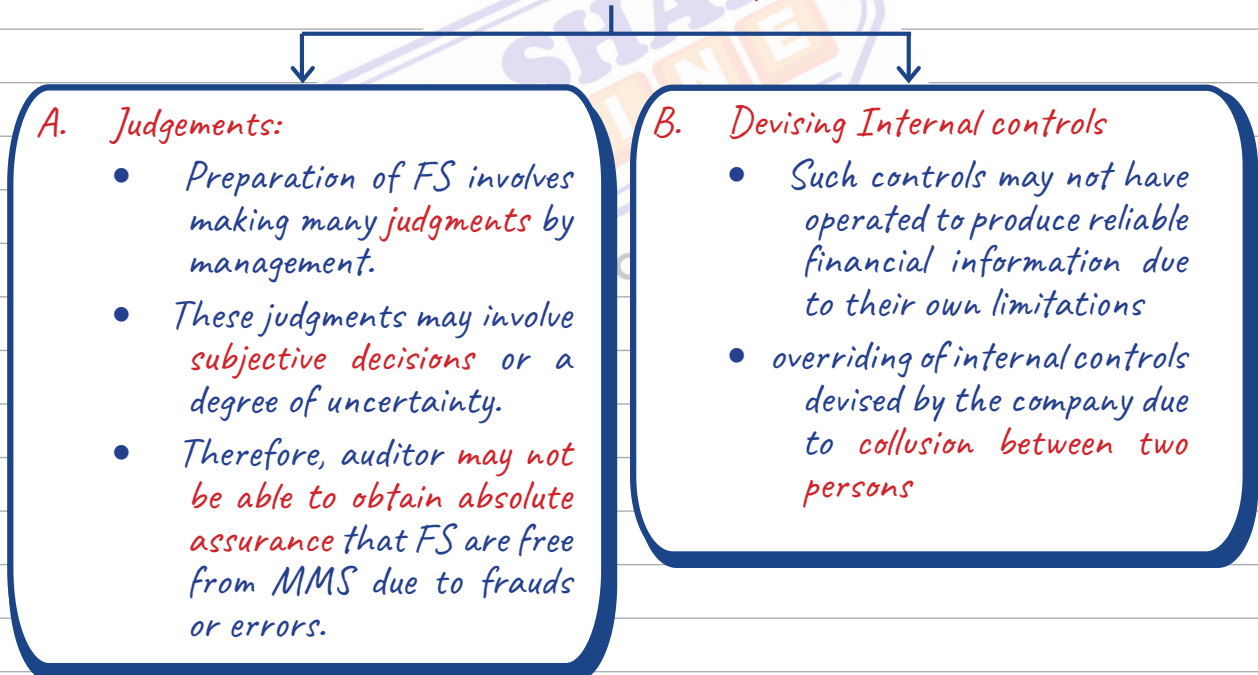


QUESTION 6

INHERENT LIMITATION OF AUDIT:



1. Nature of financial reporting:



2. Nature of audit procedures:

- There are **practical and legal limitations** on ability of auditor to obtain audit evidence .
- For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of **practical limitation** on auditor's ability to obtain audit evidence.
- Management may not provide complete information as requested by auditor.

- There is *no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report.* It is an example of *legal limitation* on auditor's ability to obtain audit evidence.
- The management may consist of *dishonest people* and may be, itself, involved in fraud
- It is quite possible that entity may have entered into some *transactions with related parties.* Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

3. *Not in nature of investigations*

- *Audit is not an official investigation.*
- *Hence, auditor cannot obtain absolute assurance that FS are free from MMS due to frauds or errors*

4. *Timeliness of financial reporting and decrease in relevance of information over time*

- *The relevance of information decreases over time and auditor cannot verify each and every matter.*
- *Therefore, a balance has to be struck between reliability of information and cost of obtaining it.*
- *Consider, for example, an auditor who is conducting audit of a company since last two years.*
- *During these two years, he has sought detailed information from management of company regarding various matters. During his third- year stint, he chooses to rely upon some information obtained as part of audit procedures of second year. However, it could be possible that something new has happened and that information is not relevant. So, the information being relied upon by auditor is not timely and may have lost its reliability.*

5. *Future events*

- *Future events or conditions may affect an entity adversely.*
- *Adverse events may seriously affect ability of an entity to continue its business.*
- *The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.*

Question 11

- *“Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm.*
- *However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers.*
- *Payments to these dealers were also made in connivance with accountant through banking channel.*
- *The partners of firm blame auditors for futile audit exercise. Are partners of firm correct in their view point? Imagine any probable reason for such a situation.*

Answer:

It is example of failure of internal controls of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls. This is an inherent limitation of audit.

Question 12

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 vs Investigation.

Question 13

MNO Ltd requested the auditor CA P to provide for absolute assurance in respect of its ten branches scattered in Delhi and confirm that the financial statements are free from material misstatement due to fraud or error. Advise.

Answer:

Inherent Limitations.

Question 14

DEF & Co. Chartered Accountants successfully carried out the audit of Shree Garments for the Fy. 2015. After the completion of audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the auditor. Management alleges that it is failure on the part of auditor. Comment

Answer:

Inherent Limitations.

Question 15

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

Answer:

Inherent Limitations – Nature of audit procedures

Question 16

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:

Inherent limitations-Only Timeliness

Question 17

“There are practical and legal limitations on the auditor’s ability to obtain audit evidence. Explain with examples. Also explain the difference between audit and investigation

Answer:

Inherent Limitations

- *Nature of audit procedure*
- *Difference between audit and investigation*

Question 18

A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement.

Answer:

It is not a reasonable assurance engagement. It is in nature of investigation.

Question 19

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

Answer:

Inherent Limitations – Nature of audit procedure

Question 20

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:

*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 7

ENGAGEMENT

Arrangement to do something



Formal agreement between the client and the auditor under which auditor agrees to provide audit services

Takes the shape of invitation card



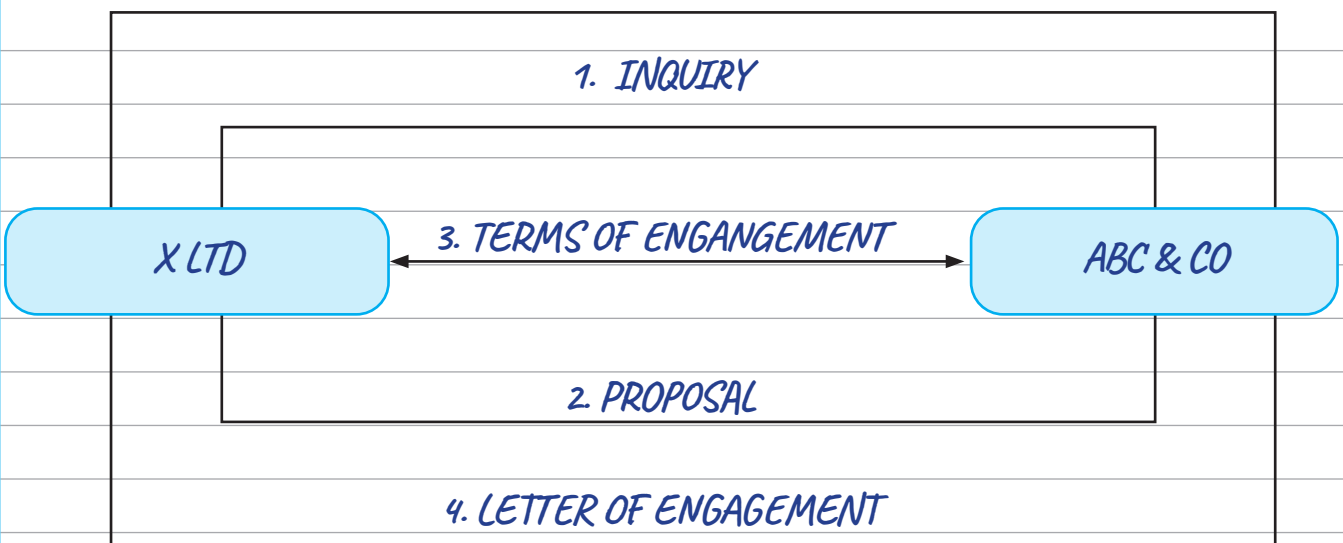
Takes the shape of an engagement letter

Marriage



SA 210: AGREEING TO THE TERMS OF AUDIT ENGAGEMENTS

5. LETTER OF APPOINTMENT



**QUESTION 8**

(DOG Loves HIM)

D → Detect fraud or error or both

O → An audit reviews existence and operations of various controls operating in any entity. Hence, it is useful at pointing out deficiencies.

G → Helpful to government authorities

L → Relied upon by lenders

H → Audited accounts provide high quality information.

I → Interest is safeguarded by an audit

M → Moral check on Employees

Question 21

RAGA is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total t/O of 30 crores. It has also availed cash credit limit of 5 crores from Canara Bank. In the year 2023-2024, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited.

Answer:

Advantages of Audit

Question 22

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 organizations where audit is not compulsory. Explain

Answer:

Advantages of Audit



QUESTION 9

AUDIT MANDATORY

STATUTORY (C²A PEBI)

- **C** → Companies Act 2013
- **C₂** → Co perative Society Act 1912
- **A** → Act of Parliament Such as LIC
- **P** → Public and charitable trust
- **E** → Electricity supply Act, 1948
- **I** → Specified entities under Income tax Act, 1961
- **M** → Moral check on Employees

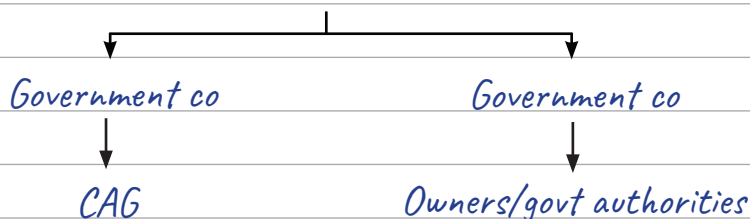
VOLUNTARY

- Incoming partner
- Death of a partner



QUESTION 10

WHO APPOINTS THE AUDITOR



**QUESTION 11****TO WHOM REPORT IS SUBMITTED:**

Incase of Co – Shareholders

Incase of firm - Partners

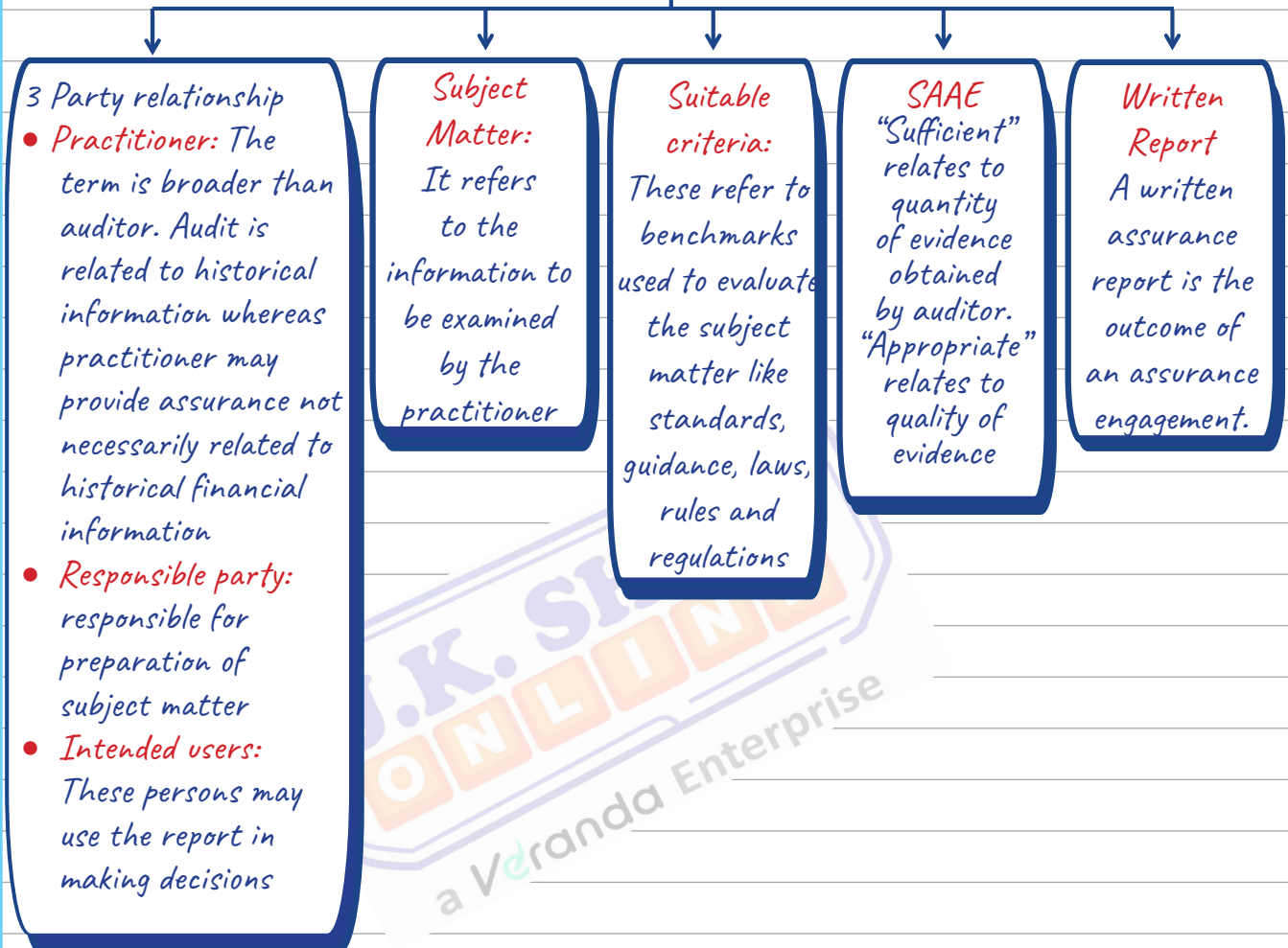
**QUESTION 12****ASSURANCE ENGAGEMENT**

- 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.



QUESTION 13

ELEMENTS OF ASSURANCE ENGAGEMENT



Question 23

An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement

Answer:

3 parties



QUESTION 14

AUDITOR & ITS QUALITIES (TIKAT)

T → The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education

I → He must have the highest degree of integrity backed by adequate independence.

K → He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert

A → He must know thoroughly all accounting principles and techniques.

T → Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability are some of qualities which an auditor.

Question 24

Explain the qualities of an auditor

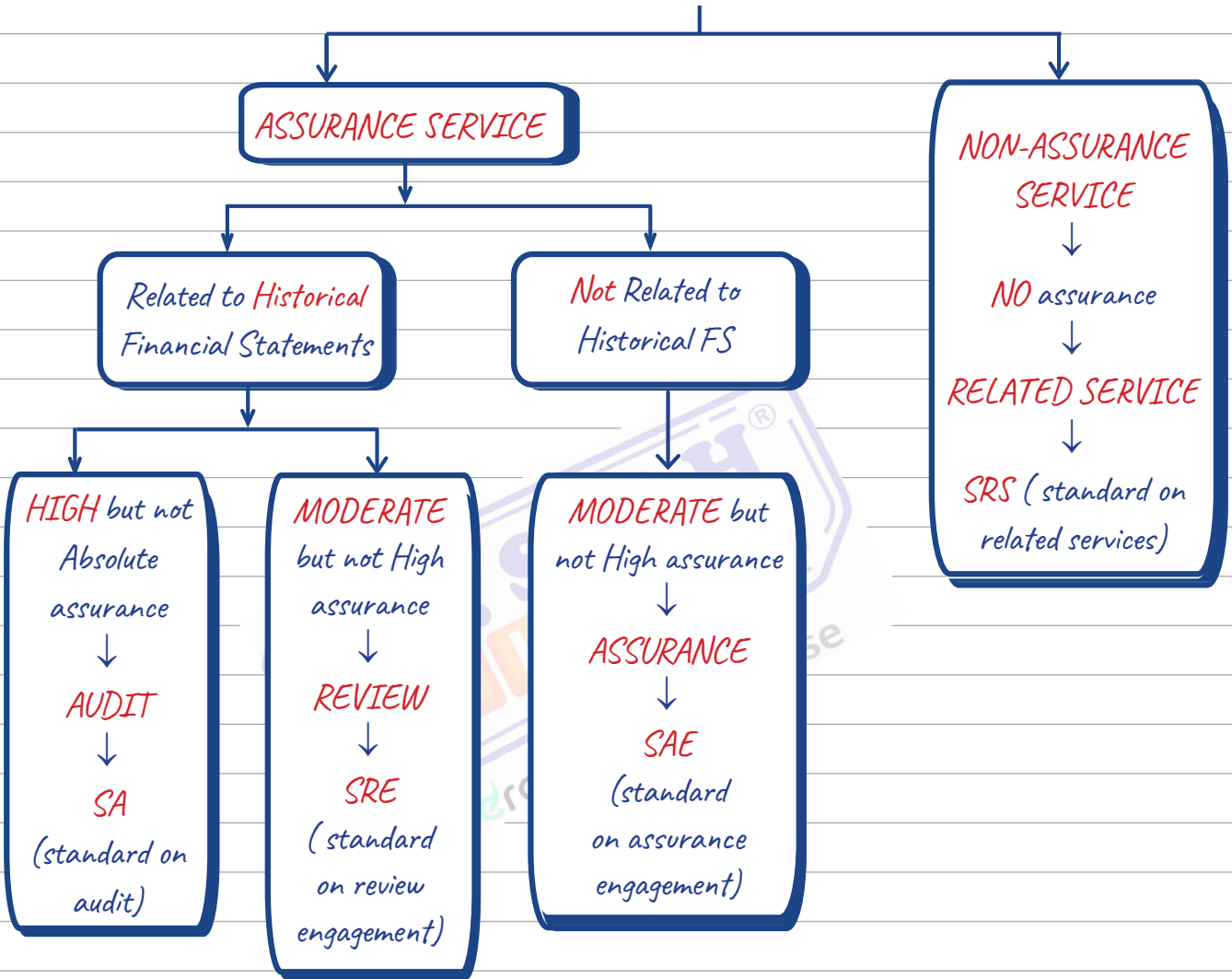
Answer:

Qualities



QUESTION 15

AUDIT VS REVIEW VS ASSURANCE VS RELATED SERVICE



Question 25

Assurance engagements are not restricted to audit of financial statements alone. Discuss.

Answer:

Types of engagement

A. AUDIT VS REVIEW

| AUDIT | REVIEW |
|----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|
| Audit is a <i>reasonable assurance</i> engagement. It provides <i>reasonable assurance</i> . | Review is a <i>limited assurance</i> engagement. It provides <i>lower level</i> of assurance than audit |
| Audit involves <i>more procedures</i> and gathers SAAE | Review involves <i>fewer procedures</i> and gathers SAAE on the basis of which limited conclusions can be drawn up. |
| Related to FS prepared on the basis of <i>historical financial information</i> | Related to FS prepared on the basis of <i>historical financial information</i> |

Question 26

Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.

Answer:

Audit vs Review

B. REASONABLE ASSURANCE VS LIMITED ASSURANCE

| REASONABLE ASSURANCE | LIMITED ASSURANCE |
|----------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Provides <i>high level</i> of assurance | Provides <i>lower level</i> of assurance than reasonable assurance engagement. |
| It performs <i>elaborate and extensive procedures</i> to obtain SAAE | It performs <i>fewer procedures</i> as compared to reasonable assurance engagement. |
| It draws <i>reasonable conclusion</i> on the basis of SAAE | It involves obtaining SAAE to draw <i>limited conclusions</i> . |
| Example: audit engagement. | Example: review engagement. |

C. EXAMINATION OF PROSPECTIVE FINANCIAL INFO:

- “Prospective financial information” means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.
- It is to be noted that in such type of assurance engagements, examination is not of historical financial information.
- The practitioner obtains SAAE to the effect that management’s assumptions are not unreasonable, and it is properly presented and all material assumptions are adequately disclosed.
- Prospective financial information relates to future events. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future-oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
- Hence, such type of assurance engagement provides only a “moderate” level of assurance.

Question 27

The management of Exotic Tours and Travels Limited requests its auditor Raja & Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures.

Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?

Answer:

Such report would be in nature of “review”. However, auditors would have to obtain sufficient appropriate evidence.



QUESTION 16

WHY ARE STANDARDS NEEDED:

- Standards improve quality of financial reporting thereby helping users to make diligent decisions.
- Standards ensure carrying out of audit against established benchmarks at par with global practices.
- Standards promote uniformity as audit of financial statements is carried out following these Standards.
- Standards equip professional accountants with professional knowledge and skills
- Standards ensure audit quality

Question 28

CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing.

Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

Answer:

He is required to document how alternative procedures performed achieve the purpose of required procedure. Reason for departure has to be documented unless it is clear. His report should draw attention to such departure. (refer after chap 4)