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CHAPTER 1: NATURE, OBJECTIVE AND SCOPE OF AUDIT

1. Mr. P is the auditor of a limited liability company formed for charitable purpose under Section 8 of the Companies Act, 2013. However, the Board of Directors is of the view that audit is not required for charitable companies. Advice.

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

In the given case, the Board of Directors is of the view that audit is not required for charitable companies formed under Section 8 of the Companies Act, 2013. Requirement of Audit applies in case of every business whether profit oriented or not (like an NGO or a Charitable Trust) irrespective of size of entity (like small, medium or large) or legal form of the entity (like proprietor, partnership, LLP or company).

Therefore, it can be concluded that the view point of Board of Directors is wrong and they have to get audited by Mr. P.

2. The auditor expresses an opinion on financial statements by means of written audit report. Mention the matters which he has to see to ensure that the financial statements would not mislead anybody.

Answer: Auditor engaged to perform task of performing audit need to ensure the following:

- Accounts have been drawn up with reference to entries in the books of account;
- Entries in the books of account are adequately supported by sufficient and appropriate evidence;
- None of the entries in the books of account has been omitted in the process of compilation;
- Information contained in the financial statements is clear and unambiguous;
- Amounts shown in the financial statement are properly classified, described and disclosed in conformity with accounting standards; and
- Financial statements reflect a true and fair picture of the financial results and financial position.

3. Explain few relationships that auditing has with different fields.

Answer: Auditing is interdisciplinary in nature. It draws from diverse subjects including accountancy, law, behavioral science, statistics, economics and financial management.

- Auditing and Accounting: Auditing reviews the financial statements which are a result of the overall accounting process.
- Auditing and Law: An auditor should have a good knowledge of business laws affecting the entity.
- Auditing and Economics: Auditor is expected to be familiar with the overall economic environment of the client.
- Auditing and Behavioral Science: Knowledge of human behavior is essential for an auditor to effectively discharge his duties.
- Auditing and Statistics & Mathematics: Auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.
- Auditing and Financial Management: Auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.

4. Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements 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 only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error.

In the given case, Lalji Bhai is absolutely satisfied that the money invested by him in the shares of a company listed on NSE is safe and there is no chance of losing his money due to the audited financial statements of the company providing picture of healthy financial performance.

Therefore, it can be concluded that the thinking of Lalji Bhai is not correct.

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

Answer: As per SA 200 “Overall Objectives of the Independent Auditor and the Conduct of the Audit in accordance with Standards on Auditing”, 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, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.

In the given case, CA N is the auditor of SR Ltd. who has expressed his opinion on the financial statements of SR Ltd. without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not.

Therefore, it can be concluded that CA N did not comply with the objective of audit as stated in SA 200.

6. Discuss how reasonable assurance differs from absolute assurance.

Answer: Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.

Auditor obtains reasonable assurance about whether the financial statements are free from material misstatement and express an opinion on whether the financial statements are prepared in accordance with an applicable financial reporting framework. It leads to high level of assurance but it is not absolute assurance.

7. 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: An Audit of Financial Statements includes within its scope the following:

- Coverage of All Aspects of Entity: Audit of financial statements should be organized adequately to cover **all aspects** of the entity relevant to the financial statements being audited.
- Reliability and Sufficiency of Financial Information: The auditor should be **reasonably satisfied** that information contained in **accounting records** and **other source data** (like bills, vouchers, documents etc.) is **reliable** and **sufficient**. For this purpose, the auditor is required to study and assessment of accounting systems and internal controls.
- Proper disclosure of financial information: The auditor should decide whether relevant information is **properly disclosed** in the financial statements as per **statutory requirements**. It is done by ensuring that financial statements properly summarize transactions and events recorded therein. Auditor should evaluate whether **accounting policies selected by management** is proper and whether chosen policy has been applied consistently on a period-to-period basis.

8. “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: Choosing of appropriate accounting policies is responsibility of management. Auditor evaluates the **selection** and **consistent** application of accounting policies by management.

Auditor should evaluate whether **accounting policies selected by management** is proper and whether chosen policy has been applied consistently on a period-to-period basis.

9. XYZ Ltd., a manufacturing company based in India, operates multiple plants across the country and deals in complex machinery, which requires specialized maintenance and valuation expertise. XYZ Ltd. appointed CA Dhruv as Statutory auditor. During the audit, he observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher reported profits. Does such a matter fall within scope of audit?

Answer: The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. The scope of audit of financial statements includes coverage of all aspects of entity, reliability and sufficiency of financial information and proper disclosure of financial information.

In the given case, CA. Dhruv observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher profits.

Since proper disclosure of financial information is covered under the scope of audit, thus, the auditor should decide whether relevant information is properly disclosed in the financial statements as per statutory requirements.

The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.

Auditor should evaluate whether accounting policies selected by management is proper and whether chosen policy has been applied consistently on a period-to-period basis.

Therefore, it can be concluded that proper disclosure of financial information is well within scope of audit.

10. 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: An audit is an independent examination of financial information of any entity, whether or not profit oriented and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon. An audit is not an official investigation into alleged wrong doing.

In the given case, CA was appointed 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.

Therefore, it can be concluded that work performed by CA is nature of investigation and hence his report will not be in nature of audit report.

11. The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word “audit” in proposed assignment. Comment. Also, discuss how audit is different from investigation.

Answer: Audit is distinct from investigation. An audit is not an official investigation into alleged wrong doing. The auditor 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 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. The scope of audit is general and broad whereas scope of investigation is specific and narrow.

In the given case, management of company suspects that some of its employees may be involved in making fraudulent payments on account of dummy workers at its different plants in the country. Such an assignment is in the nature of “investigation”.

Therefore, it can be concluded that Mr. P is right in objecting the use of word “audit” in the proposed assignment.

12. PD & Co., Chartered Accountants, were appointed as the statutory auditors of MR Limited for the financial year 2024-25. MR Limited included the following clause in the appointment letter to the auditors: "The Auditor shall be responsible for detecting the frauds that may happen in the company during the financial year 2024-25." The auditor objected to inclusion of such a clause in the appointment letter. Discuss in the light of scope of audit.

Answer: As per SA 200 “Overall Objectives of the Independent Auditor and the Conduct of the Audit in accordance with Standards on Auditing”, the objective of the auditor 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.

An audit is not an official investigation into alleged wrong doing. The auditor 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.

Therefore, it can be concluded that inclusion of such a clause in the engagement letter is uncalled for and outside the scope of audit.

13. RST Ltd., a retail company, has set up internal controls requiring all invoices to be stamped and signed by an authorised person in “Goods Receiving Section” of the company stating the date and time of receiving goods in premises to ensure that only those purchase bills are produced for payment for which goods have been actually received. During the audit, the auditor finds that two employees – a purchasing manager and an accounts clerk – have worked together to bypass this control, submitting fake invoices that resulted in payments for goods that were never received. Explain why auditor can provide only reasonable, rather than absolute, assurance that the financial statements are free from material misstatement due to fraud or error in the context of the given situation?

Answer: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the factors such as nature of financial reporting, nature of audit procedures, not in the nature of investigation, timeliness of financial reporting and decrease in relevance of information over time and future events.

Preparation of financial statements involves making many judgments by management which may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. Preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls is the responsibility of management. However, such controls may not have operated to produce reliable financial information due to their own limitations.

In the given case, the management of RST Ltd. designed a control requiring that all invoices be stamped and signed by an authorized person in the Goods Receiving Section to confirm receipt of goods. However, collusion between two employees — the purchasing manager and the accounts clerk— allowed them to bypass this control by submitting fake invoices for payment. Collusion is a significant limitation of internal controls as it overrides controls designed to prevent such fraud.

Therefore, it can be concluded that auditor cannot provide absolute assurance that the financial statements are entirely free from material misstatements due to fraud or error.

14. Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain.

Answer: Preparation of financial statements involves making many judgments by management which may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. Preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls is the responsibility of management. However, such controls may not have operated to produce reliable financial information due to their own limitations.

15. The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations.

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

a. 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.

b. Auditor cannot force the management for providing necessary information. 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.

16. Explain qualities of auditor.

Answer: An auditor is concerned with reporting on financial matters of business and other institutions set with the problems of human fallibility. An auditor is required to possess all those personal qualities that make a good businessman contribute to the making of a good auditor. The qualities required are tact, caution, firmness, good temper, integrity, discretion, industry, judgment, patience, clear headedness and reliability. He must have the highest degree of integrity backed by adequate independence.

The auditor must have the basic human qualities apart from the technical requirement of professional training and education. He critically reviews financial statements if his knowledge is that of an expert.

An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing.

He must know thoroughly all accounting principles and techniques.

17. 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: There are practical and legal limitations on the auditor's ability 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.

➤ Auditor cannot force the management for providing necessary information. 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 and unscrupulous people and who may itself involved in fraud and may also engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may also produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents.

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.

18. RST Ltd., a mid-sized trading company, recently faced challenges in securing a bank loan due to doubts about the reliability of its financial statements. The management realized the importance of having audited accounts to build confidence among stakeholders. Elucidate the benefits and need of an audit.

Answer: The benefits and need of an audit are:

- Audited accounts **provide high quality information**. It gives confidence to users that the financial information is qualitative.
- Audit **safeguards the interests of the stakeholders**. It gives confidence to stakeholders that the financial information is qualitative and reliable.
- An audit **acts as a moral check on employees from committing frauds** for fear of being discovered by audit.
- Audited financial statements are **helpful to government authorities for determining tax liabilities**.
- Audited financial statements **can be relied upon by lenders, bankers for making their credit decisions** i.e. whether to lend or not to lend to a particular entity.
- An audit may also detect fraud or error or both.
- An audit **reviews existence and operations of various controls operating** in any entity. Hence, it is useful at pointing out deficiencies.

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

Answer: An assurance engagement involves the following **three parties**:

- Practitioner: 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.
- Responsible Party: A responsible party is the party **responsible for preparation of subject matter**.
- Intended Users: Intended users are the persons for whom an **assurance report is prepared**. These persons may use the report in making decisions.

20. KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement?

Answer: In the given case, CA T is appointed to provide KST Limited an assurance report on its financial statements prepared on the basis of historical financial information. The engagement involves gathering of sufficient appropriate evidence on the basis of which limited conclusion can be drawn up. It is a **limited assurance engagement** like **review**. Other two features of such type of engagement are: -

(1) It provides **lower level of assurance** than reasonable assurance engagement.

(2) It performs **fewer procedures** than reasonable assurance engagement.

21. 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: Raja & Co. can provide a **review report** in the given case. Review is a **limited assurance** engagement and involves **fewer procedures** and gathers **sufficient appropriate evidence** on the basis of which **limited conclusions** can be drawn up.

Hence Raja & Co. can provide a report as requested by management of Exotic Tours and Travels Limited. Such report would be in nature of “**Review**”.

Raja & Co. will be required to **obtain sufficient appropriate evidence** based on **limited procedures** performed.

22. 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: 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. Reasonable Assurance requires a high, but not an absolute assurance. In the given case, a Chartered Accountant is specifically asked to check accounts whether fraud exists. Therefore, it can be concluded that it is not a reasonable assurance engagement. It is in nature of investigation.

23. Kriti, a CA student, has joined articles in a reputed audit firm. She considers audit engagement to be an “assurance engagement”. Her understanding is that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form. However, her friend Somaya, does not agree with her. She is of the view that assurance engagements are not restricted to audit alone. Besides, Somaya also thinks that assurance engagements can also relate to matters other than historical financial information. Whose view appears to be correct? State with reasons.

Answer: Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements.

Assurance engagements provide assurance to users. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit.

There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving Prospective Financial Information and providing assurance on internal controls in an entity.

In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas is of the view that assurance engagements are not restricted to audit alone. Somaya is of the view that assurance engagements can also relate to matters other than historical financial information.

Therefore, it can be concluded that view of Somaya is correct.

24. Differentiate between Reasonable Assurance Engagement and Limited Assurance Engagement.

Answer:

REASONABLE ASSURANCE ENGAGEMENT	LIMITED ASSURANCE ENGAGEMENT
1. It provides high level of assurance .	1. It provides lower level of assurance than reasonable assurance engagement.
2. It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	2. It performs fewer procedures as compared to reasonable assurance engagement.
3. It draws reasonable conclusions on the basis of sufficient appropriate evidence.	3. It involves obtaining sufficient appropriate evidence to draw limited conclusions .
4. Example of reasonable assurance engagement is an Audit Engagement .	4. Example of limited assurance engagement is Review Engagement .

25. Give three examples of assurance engagements highlighting difference in nature of assurance provided by such engagements.

Answer: Examples of assurance engagements:

- a) Audit of Financial Statements: Audit of Financial Statements provides **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 on whether the financial statements are prepared, in all material respects, in accordance with an **applicable financial reporting framework**.
- b) Review of Financial Statements: Review provides **lower level of assurance** than audit. Further, review involves **fewer procedures** and gathers **sufficient appropriate evidence** on the basis of which **limited conclusions** can be drawn up.
- c) Examination of prospective financial information (PFI): In assurance reports involving PFI, practitioner obtains **sufficient appropriate evidence** to the effect that management's assumptions on which the PFI is based are **not unreasonable**, the PFI is **properly prepared** on the basis of the **assumptions** and it is **properly presented** and all **material assumptions** are adequately **disclosed**. Such type of assurance engagement provides a **moderate assurance**.

26. Rajul Ltd. engaged an external practitioner CA Rajul to provide assurance on its prospective financial information for the upcoming year, which includes projections for a new product line. The company projected a 15% increase in revenue, estimating total sales of Rs. 75 crore, driven by the expected launch of this new product. Mention the applicable Engagement and Quality Control Standard and the level of assurance that will be provided in the given situation. Also explain how Prospective Financial Information is different from Historical Financial Information.

Answer: In the given situation, Standards on Assurance Engagements will be applicable and such type of assurance engagement provides only a “moderate” level of assurance.

In assurance reports involving Prospective Financial Information (PFI), the practitioner obtains sufficient appropriate evidence to the effect that:

- management’s assumptions on which the PFI is based are not unreasonable;
- PFI is properly prepared on the basis of the assumptions; and
- PFI is properly presented and all material assumptions are adequately disclosed.

Key differences between PFI and Historical Financial Information

Historical Financial Information refers to the financial information of an entity about economic events, conditions or circumstances occurring in past periods. Prospective Financial Information refers to the financial information based on assumptions about events that may occur in the future and possible actions by an entity.

Historical Financial Information is rooted in past events which have already occurred whereas Prospective Financial Information is related to future events.

27. XYZ Ltd, a manufacturing company engaged in the production of various types of yarn, is planning to expand its operations into a new geographical market and also add new products. Company has prepared prospective financial information to be presented to potential investors and financial institutions to secure funding for the expansion. XYZ Ltd engages a firm of auditors to conduct an assurance engagement on this prospective financial information. During the engagement, the auditors reviewed the assumptions made by XYZ Ltd.'s management and issued a report. Explain the key differences between prospective financial information and historical financial information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information?

Answer: [Key differences between PFI and Historical Financial Information](#)

Historical Financial Information refers to the financial information of an entity about **economic events, conditions or circumstances** occurring in **past periods**. Prospective Financial Information (PFI) refers to the financial information based on **assumptions** about **events** that may occur in the **future** and **possible actions** by an entity.

Historical Financial Information is rooted in **past events** which have already occurred whereas PFI is related to **future events**.

Levels of Assurance provided in Assurance Engagement in PFI:

In assurance reports involving Prospective Financial Information (PFI), the practitioner obtains sufficient appropriate evidence to the effect that:

- management's assumptions on which the PFI is based are **not unreasonable**;
- PFI is properly prepared on the basis of the **assumptions**; and
- PFI is properly **presented** and all **material assumptions** are adequately **disclosed**.

28. Council of ICAI has issued various Engagement Standards under its authority. The purpose of issue of these standards is to establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services. Explain briefly, various types of Assurance Standards issued.

Answer: Types of Assurance Standards:

- Standards on Auditing (SAs): to be applied in the **audit** of historical financial information.
- Standards on Review Engagements (SREs): to be applied in the **review** of historical financial information.
- Standards on Assurance Engagements (SAEs): to be applied in **assurance engagements**, engagements dealing with subject matter **other than historical financial information**.

29. Why are Standards needed?

Answer: Standards are needed because of the following reasons:

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

30. 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: Standards on Auditing apply in **audit** of historical financial information which is a **reasonable** assurance engagement whereas Standards on Review Engagements apply in **review** of historical financial information which is a **limited** assurance engagement only.

Historical Financial Information refers to the financial information of an entity about **economic events, conditions or circumstances** occurring in **past periods**.

“Audit” and “Review” are two different terms. Audit is a **reasonable assurance engagement** and its objective is reduction in assurance engagement risk to an **acceptably low level** in the circumstances of the engagement. However, “review” is a **limited assurance engagement** and its objective is a reduction in assurance engagement risk to a level **that is acceptable** in the circumstances of the engagement.

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing ranging from overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit sampling, audit evidence and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are:-

- SA 230 Audit Documentation
- SA 500 Audit Evidence
- SA 700: Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are:

- SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- SRE 2410 Review of Interim Financial Information Performed by Independent Auditor of Entity

31. 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. Unable to obtain external confirmations from these debtors, he relied upon certain details and traced payments in bank accounts. 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: It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, he is required to ensure the following:

- document how alternative procedures performed achieve the purpose of required procedure
- document reason for departure unless it is clear.
- draw attention to such departures in his report.

CHAPTER 11: ETHICS AND TERMS OF AUDIT ENGAGEMENTS

1. Briefly outline how principles-based approach differs from rules-based approach to ethics.

Answer: Ethics may follow principles-based approach or rules-based approach. Principles-based approach to ethics requires **compliance with spirit of ethics**. It requires accountants to exercise **professional judgment** in every situation based upon their **professional knowledge, skill and expertise**. However, rules-based approach to ethics requires **strict follow – up of established rules**. It may lead to a **narrow outlook** and spirit of ethics may be **overlooked**. Rules- based approach is **rigid** as every practical situation may not be dealt with.

2. The auditors of a company have only relied upon management representation letter regarding treatment of certain tax matters under appeal by the company. The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditors in such a situation?

Answer: Professional skepticism refers to 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**. The auditor shall plan and perform an audit with professional skepticism.

In the given case, auditors have relied only upon management representation letter regarding treatment of certain tax matters under appeal by the company. No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors.

Therefore, it can be concluded that there is **lack of professional skepticism** on part of auditors.

3. How application of professional skepticism throughout audit is helpful in reducing audit risk?

Answer: Professional skepticism refers to 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**. It **reduces** the risks of **overlooking** unusual circumstances; **over generalizing** when drawing conclusions from audit observations and using **inappropriate assumptions** in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

4. 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. Explain giving examples.

Answer: 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. Professional skepticism includes being alert to, for example:

- Contradictory audit evidence;
- Questions on the reliability of documents.
- Conditions that may indicate possible fraud.
- Circumstances suggesting the need for additional audit procedures.

Maintaining professional skepticism throughout audit is necessary if auditor is to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

5. A Chartered accountant in practice issued a certificate showing original cost of plant and machinery installed in premises of a client for Rs. 9 crores to save some regulatory fees for his client. However, original cost of plant and machinery was Rs. 15 crore as per records of client. Which fundamental principle governing professional ethics is violated in this case?

Answer: Principle of Integrity requires that a professional accountant shall not knowingly be associated with reports, returns, communications or other information where he believes that the information contains a materially false or misleading statement or statement or information provided negligently or omits required information where such omission would be misleading.

In the given case, a false certificate is knowingly issued showing misstated original cost of machinery. Therefore, it can be concluded that the fundamental principle of integrity is violated.

6. CA H has been offered audit of Financial Statements of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit engagement letter to society's governing body and proceeded to conduct the audit. Does it constitute violation of fundamental principles governing professional ethics? State reasons for the same.

Answer: Principle of Professional Competence and Due Care requires an accountant to:

- attain and maintain professional knowledge and skill to that level so as to ensure that professional work is performed based on current technical & professional standards and relevant legislation; and
- act diligently and in accordance with applicable technical and professional standards.

In the given case, CA H failed to send audit engagement letter to society's governing body and proceeded to conduct the audit. Maintaining professional competence requires awareness of current technical and professional standards. Non-sending of engagement letter shows lack of such awareness on part of CA H. Therefore, it can be concluded that CA H has violated said fundamental principle governing professional ethics.

7. CA P is a professional accountant in service. In terms of employment and professional relationships with employer he has to be alert to the possibility of inadvertent disclosure of any information outside the employing organization. However, in view of disclosure required by law, CA P had to divulge the information and documents as evidence in course of legal proceedings. Whether CA P has violated any fundamental principle governing professional ethics in this case? Explain.

Answer: Principle of Confidentiality requires a professional accountant not to disclose the confidential information acquired during the course of professional work with the others unless required by law or regulation; permitted by client or employee; or there is a professional duty to disclose.

In the given case, CA P is a professional accountant in service and had to divulge the information and documents as evidence in the course of legal proceedings and same was required by law.

Therefore, it can be concluded that CA. P will not be held responsible for violation of fundamental principle of Confidentiality governing professional ethics.

8. CA P. Suryakantam has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit. He didn't even bother to reply to the letter despite reminders. Discuss which fundamental principle governing professional ethics is disregarded by him.

Answer: Principle of Professional Behavior requires an accountant to comply with relevant laws and regulations and avoid any conduct that might discredit the profession.

In the given case, ICAI has issued a letter to CA P. Suryakantam to certain matters concerning audit but he didn't even bother to reply to the letter despite reminders.

Therefore, it can be concluded that failure to reply to professional body smacks of lack of courtesy and professional responsibility.

9. "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, or to his own self-interest. It is not possible to define "independence" precisely since Independence is a condition of mind and personal character.

There are two interlinked perspectives of independence of auditors, one, independence of mind and two, independence in appearance.

➤ Independence of mind – It implies the state of mind that permits an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, exercise objectivity and professional skepticism.

➤ Independence in appearance – It implies the avoidance of facts and circumstances that are so significant that a reasonable third party would reasonably conclude that firm'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.

10. CA Sudhakar has been appointed as the auditor of AMRO Ltd. Before accepting the appointment, he learns that his cousin, who held shares in the company and recently passed away without children, named him as the nominee for these shares, which have substantial value. Although holding such shares through a distant relative does not violate legal provisions or affect his independence, this unexpected inheritance places him in a dilemma. Advise CA Sudhakar on how he should deal with this situation.

Answer: In the given case, CA Sudhakar has come to hold shares due to nomination made by his distant relative before accepting the appointment. Holding shares by CA Sudhakar involves **financial interest** in the company and is in nature of **self-interest threat**. Self – Interest threats occur when an auditing firm, its partner or associate could benefit from a **financial interest** in an audit client.

Hence, Holding of shares of the same company for which he is offered appointment as auditor constitutes **threat to his independence**. Therefore, it can be concluded that CA Sudhakar should take steps to **eliminate the threat** by **selling shares** immediately **before accepting** the appointment and in the **absence of same**, he should **not accept the appointment** as an auditor.

11. CA Tripad (engagement partner) is external auditor of Lap of Nature, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation?

Answer: In the given case, the firm is providing free hospitality to engagement team members including engagement partner. Due to free hospitality enjoyed by engagement team members, they may take a **sympathetic view** to issues which may have arisen during course of audit. In such circumstances, **fundamental principles governing professional ethics are violated**. Such acts of free hospitality are capable of **impairing objectivity** of auditor and is in nature of **familiarity threats**. Familiarity Threats occur when auditors form relationships with the client where they may end up being **too sympathetic to the client's interests**. Therefore, it can be concluded that **familiarity threats are created in above case**.

12. CA Sudhakar has been appointed as the auditor of AMRO Ltd. Before accepting the appointment, he learns that his cousin, who held shares in the company and recently passed away without children, named him as the nominee for these shares, which have substantial value. Although holding such shares through a distant relative does not violate legal provisions or affect his independence, this unexpected inheritance places him in a dilemma. Advise CA Sudhakar on how he should safeguard his independence.

Answer: Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to address the threats. Safeguards are actions that the professional accountant takes that effectively **reduce threats** to comply with the fundamental principles to an acceptable level.

To address the issue, the following guiding principles are to be applied:-

- Auditors should always be and **appears** to be independent of the entity so that the public can have confidence in the quality of audit.
- Before taking on any work, an auditor **must conscientiously** consider whether it involves **threats** to his independence.
- When such threats exist, the auditor should either **desist from the task** or eliminate the threat or at least put **safeguards** to reduce the threats to an acceptable level.
- If the auditor is **unable** to fully implement **credible** and adequate **safeguards**, then he **must not accept the work**.

13. CA X has been offered audit of financial statements of TDK Industries, a partnership firm. Prior to accepting proposed offer, he insists upon obtaining an agreement of management regarding acknowledgment of its responsibility of having a proper process in place to ensure that financial statements prepared are free from material misstatements. However, management is of the view that it is auditor's duty to detect material misstatements in financial statements and such an insistence by auditor is totally uncalled for. Whose view is proper? Also discuss reasons for arriving at your conclusion. What should be likely proper course of action for CA X in above situation?

Answer: As per SA 210 "Agreeing Terms of Audit Engagements", the objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- Establishing whether the preconditions for an audit are present; and
- Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance, of the terms of the audit engagement.

One of the preconditions for an audit is to obtain the agreement of management that it acknowledges and understands its responsibility:

- For the preparation of the financial statements as per applicable financial reporting framework;
- For exercising necessary internal control to enable the preparation of financial statements that are free from material misstatement.

In the given situation, CA X insisted to obtain agreement of management regarding acknowledgment of its responsibility for internal control to enable preparation of financial statements in accordance with SA 210. Design, implementation and maintenance of internal control to ensure preparation of financial statements that are free from material misstatements is management's responsibility. He is insisting on obtaining agreement of management regarding acknowledgment of its responsibility.

Therefore, it can be concluded that CA X's view is proper.

In case management does not provide such agreement acknowledging its responsibility, the auditor shall not accept proposed audit engagement unless required by law or regulation.

14. 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: As per SA 210 “Agreeing 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. In order to establish whether the preconditions for an audit are present, the auditor shall:

- a. Determine whether the financial reporting framework is acceptable; and
- b. Obtain the agreement of management that it acknowledges and understands its responsibility:
 - For the preparation of the financial statements as per applicable financial reporting framework;
 - For exercising necessary internal control to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - To provide the auditor with:
 - access to all information required for the purpose of audit;
 - additional information as requested by the auditor; and
 - unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

15. The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

Answer: It is necessary for management to give in writing to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. It is a necessary precondition for an audit in accordance with SA 210. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. The auditor shall not accept the proposed audit engagement:-

- If he determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable; or
- If the agreement of management is not obtained on matters relating to:
 - understanding of responsibility of management on preparation of financial statements,
 - internal controls for preparation of financial statements,
 - providing access to all information to auditor and unrestricted access to persons within the entity.

Therefore, it can be concluded that unless required by law or regulation to do so, such a refusal on the part of auditor is necessary as management is not willing to accept its responsibility for preparation of financial statements in accordance with applicable financial reporting framework.

16. CA H has been offered audit of F.S. of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit engagement letter to society's governing body and proceeded to conduct the audit. In absence of this letter, the governing body is of the view that purpose of such an audit is to provide absolute assurance against probable errors and frauds in the financial statements. Does it constitute violation of SA 210?

Answer: As per SA 210 "Agreeing Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with Management or Those charged with governance (TCWG). The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Such an agreement is known as Audit Engagement Letter.

Such a letter includes objective and scope of the audit of the financial statements. Absence of such a letter leads to misunderstanding between auditor and management.

In the given case, CA H failed to send audit engagement letter to society's governing body and proceeded to conduct the audit. Maintaining professional competence requires awareness of current technical and professional standards. Non-sending of engagement letter shows lack of such awareness on part of CA H. Therefore, it can be concluded that CA H has failed to follow requirements of SA 210.

17. The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Who gives engagement letter to whom and what is included in such a letter? OR Mr. J is an articled clerk with a big Chartered Accountants' firm. He is a part of the engagement team which is conducting the audit of a company for the first time. They are assigned with the work of preparing the draft audit engagement letter. Mr. J is not sure how to go about with this work. Explain what is Audit Engagement Letter and what are its contents? OR CA Paras has accepted audit of financial statements of an entity. According to the Standards on Auditing, the auditor is required to send an audit engagement letter to the entity. What are the key areas that should be included in the audit engagement letter? Under what circumstances is the auditor not required to record the terms of engagement in such a written agreement?

Answer: The auditor shall agree the terms of the audit engagement with Management or Those charged with governance (TCWG). The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Such an agreement is known as Audit Engagement Letter. The audit engagement letter is sent by the auditor to his client.

Audit Engagement Letter includes:

- The objective and scope of the audit of the financial statements;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of applicable FRF for preparation of financial statements; and
- Reference to expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

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

18. Chirag, as part of articulated training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report. He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

Answer: Engagement letter includes reference to expected form and content of audit report. It merely states that auditor would provide opinion in this form. However, engagement letter also includes statement that the form and content of report may need to be amended in the light of audit findings.

In the given case, Chirag was at a loss to understand how could an auditor include form and content of the report beforehand. Therefore, if auditor needs to give a modified opinion, he shall do so.

19. Deepa Ltd., initially requested an audit engagement for the financial year 2023-2024. However, midway through the audit process, the management claims that they are unable to provide complete supporting documentation for a significant portion of their receivables. As a result, the management asks the auditor to change the audit engagement to a review engagement, arguing that it would prevent the issuance of a qualified opinion. The auditor is now facing challenge in determining whether this change is justified or not. Comment in accordance with relevant SA.

Answer: As per SA 210 "Agreeing Terms of Audit Engagements", a request from the entity for the auditor to change the terms of the audit engagement may result from:

- a change in circumstances affecting the need for the service;
- a misunderstanding as to the nature of an audit as originally requested; or
- a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances.

The auditor considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement.

A request is considered as reasonable basis for requesting a change in the audit engagement if it appears that the change in circumstances that affects the entity's requirements or a misunderstanding as to the nature of the service originally requested.

A change may **not** be considered **reasonable** if it appears that the change relates to information that is **incorrect, incomplete** or otherwise **unsatisfactory**.

In the given case, Deepa Ltd. is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

Therefore, it can be concluded that Deepa Ltd.'s request for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion is **not reasonable**.

20. A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

Answer: On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be **revised** and whether there is a need to **remind** the entity of the **existing terms** of the audit engagement. 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:

- Any indication that the entity **misunderstands** the **objective** and **scope** of the audit.
- Any **revised** or **special** terms of the audit engagement.
- A recent change of **senior** management.
- A significant change in **ownership**.
- A significant change in **nature** or **size** of the entity's business.
- A change in **legal** or regulatory requirements.
- A change in **financial reporting framework** adopted in preparation of the financial statements.
- A change in **other** reporting requirements.

21. CA Puneet is appointed as an auditor of Kamla Limited for the F.Y. 2023-24. The management of Kamla Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and a few new products have been introduced by the company. Whether CA Puneet can agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in the terms of engagement?

Answer: The auditor may decide **not** to send a new audit engagement letter or other written agreement each period. However, a significant change in **nature** or **size** of the entity's business is one of the factors which may make it appropriate to revise the terms of the audit engagement.

In the given case, Kamla Limited has diversified its business, and few new products have also been introduced by the company which is indicative of significant change in nature or size of the entity's business.

Hence, it can be concluded that CA. Puneet can **agree to the request made by the management** to change the terms of the audit engagement. Therefore, the **request of Management** to change the terms of audit engagement is **appropriate**.

A request from the entity for the auditor to change the terms of the audit engagement may result from:

- a change in **circumstances** affecting the need for the service;
- a **misunderstanding** as to the nature of an audit as originally requested; or
- a **restriction** on the **scope** of the audit engagement, whether imposed by management or caused by other circumstances.

22. CA P is appointed as an auditor of XYZ Limited for the FY 2023-24. The management of XYZ Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and few new products have been introduced by the company. Can CA P agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in terms of engagement?

Answer: As per **SA 210 "Agreeing Terms of Audit Engagements"**, if, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a

lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so. So, in case of reasonable justification, auditor may accept the request made by the management.

A request from the entity for the auditor to change the terms of the audit engagement may result from:

- a change in circumstances affecting the need for the service;
- a misunderstanding as to the nature of an audit as originally requested; or
- a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances.

The auditor considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement. If the auditor concludes that there is reasonable justification to change the audit 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:

- The original audit engagement; or
- Any procedures that may have been performed in the original audit engagement.

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:

- Withdraw from the audit engagement where possible under applicable law or regulation; and
- Determine whether there is any obligation to report the circumstances to other parties such as TCWG, owners or regulators.

In the given case, auditor noticed that there is substantial change in management and also client has ventured into areas of business activity which were not present at time of accepting initial audit engagement.

Therefore, it can be concluded that Auditor may decide to send a new audit engagement letter.

23. “SA 220 is premised on the basis that the firm is subject to SQC 1”. What do you understand by given statement in context of audit quality?

Answer: Audit quality is **essential** to maintain confidence in the independent assurance provided by the auditors. It is the **responsibility of auditor** to maintain high audit quality. SQC 1 and SA 220 both deal with quality control. SQC 1 deals with **all engagements** including audits, reviews and other assurance and related service engagements, whereas, SA 220 applies to **audit engagements** only. Further, SQC 1 applies to **entire firm**. However, SA 220 applies to a **particular audit engagement**.

Based upon quality control system of firm established in accordance with requirements of SQC 1, quality control policies pertaining to audit engagements are decided by **engagement teams**. Engagement partner of a team is responsible for **quality control procedures** of a particular audit engagement in accordance with SA 220. Therefore, SA 220 is premised on the basis that the firm is subject to SQC 1.

24. The firm’s system of quality control should include policies and procedures addressing each element. Explain.

Answer: As per **SQC 1**, the firm’s system of quality control should include policies and procedures addressing each of the following elements:-

- **Leadership responsibilities for quality within the firm;**
- **Ethical requirements;**
- **Acceptance and continuance of client relationships and specific engagements;**
- **Human resources;**
- **Engagement performance;**
- **Monitoring.**

Quality control policies and procedures should be **documented** and **communicated** to the firm’s personnel.

25. SQC 1 requires assumption of leadership responsibilities for quality within firm. Are such leadership responsibilities required for audit engagements only? Who assumes such leadership responsibilities within firm? How it is important for audit quality?

Answer: SQC 1 requires firms to establish policies and procedures designed to **promote an internal culture** based on the recognition that quality is essential in performing engagements.

Such policies and procedures should require the firm's **chief executive officer** or the firm's **managing partners** to **assume ultimate responsibility** for the firm's system of quality control.

Further, **persons assigned** operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have **sufficient** and appropriate **experience, ability** and the necessary **authority** to assume that responsibility.

26. How does SQC 1 ensure that independence in engagements is not breached by an audit firm?

Answer: As per **SQC 1**, the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel **maintain independence** where required by the Code.

Such policies and procedures should enable the firm to:

- **Communicate** its independence requirements to its personnel;
- **Identify** and evaluate circumstances and relationships that create threats to independence and **take appropriate action** to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement.

There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm **promptly notify firm** all breaches of independence to firm for appropriate action.

The firm should obtain **written confirmation** from all firm personnel as to compliance with independence requirement.

27. CA Arpita has joined a mid-sized CA firm recently. She finds that partners remain too busy and the firm is proposing to accept audit work in areas in which it has no experience or capabilities. The firm is proposing to accept audit of some entities engaged in emerging “fin-tech” sector. Such audits may be requiring extensive use of technology and data analytics. However, the said firm has no such capabilities and trained personnel. Discuss, whether, firm should accept such audits with reason.

Answer: SQC 1 requires that before accepting an engagement, competence (including capabilities, time and resources) to perform engagement have to be considered. In the given case, the proposed engagements involve use of technology and data analytics. The firm has no prior experience of audits in emerging “fintech” sector. The firm does not have trained personnel to carry out these audits. Therefore, it can be concluded that CA Arpita should not accept the offer.

28. ABC & Associates, an audit firm, has been approached by a prospective company client that has been in business for about 10 years to conduct an audit of its financial statements. Before accepting the audit engagement, the firm wants to assess the integrity of prospective client. With regard to the assessment of integrity, which matters should be considered by the audit firm? OR MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only selected clients to adhere to Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to integrity of a client.

Answer: As per SQC 1, the firm should obtain such information as it considers 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.

If there is any conflict of interest between firm and client, it should be properly resolved before accepting engagement.

With regard to the integrity of a client, matters that the firm considers include, for example:

- The **nature of the client's operations**, including its business practices.
- Indications of an **inappropriate limitation** in the scope of work.
- Indications that the client might be involved in **money laundering or other criminal activities**.
- Whether client is aggressively concerned with **maintaining the firm's fees as low** as possible.
- The **reasons for the proposed appointment** of firm and non-reappointment of the previous firm.
- The **identity and business reputation** of the client's principal owners, key management, related parties and those charged with governance.

29. AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years.

XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates wishes to withdraw from the engagement and client relationship on the grounds that had this information been obtained earlier, it would not have accepted the engagement. Discuss the issues that need to be addressed before withdrawing from the engagement.

Answer: As per **SQC 1**, the firm should establish policies and procedures for the **acceptance and continuance** of client relationships and specific engagements that before accepting an engagement, **competence** (including **capabilities, time and resources**) to perform engagement have to be considered.

In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates wish to withdraw from the engagement and client relationship on the grounds that this information was not obtained earlier. Where firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, firm should consider:

- The **professional and legal responsibilities** to report to persons who made appointment or to regulatory authorities; and
- The **possibility of withdrawing** from engagement.

30. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm.

Answer: As per SQC 1, firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards & regulatory and legal requirements, and to enable firm or engagement partner (s) to issue reports that are appropriate. Such policies and procedures address following personnel issues recruitment, performance evaluation, capabilities, competence, career development, promotion, compensation and estimation of personal needs.

31. SQC 1 dwells upon engagement quality control review (EQCR) as part of system of quality control in a firm. Why is such a review required? For which type of engagements EQCR is mandatory? What should be approach of firm for engagements for which EQCR is not mandatory?

Answer: Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued. Engagement quality control review (EQCR) is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

32. SA 220 describes responsibilities of engagement partner. Explain.

Answer: SA 220 describes responsibilities of engagement partner in relation to following matters:-

- (A) Leadership responsibilities for quality on audits
- (B) Relevant ethical requirements
- (C) Acceptance and continuance of client relationships and audit engagements
- (D) Assignment of engagement teams
- (E) Engagement performance (F) Monitoring

33. An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

Answer: As per SA 220 “Quality Control for an Audit of Financial Statements”, Engagement Partner shall take leadership responsibility for overall quality on each audit engagement to which that partner is assigned and should emphasize following to the engagement Team (ET):

➤ The importance to audit quality of:-

- (i) Performing work that complies with professional standards & regulatory & legal requirements;
- (ii) Complying with the firm’s quality control policies and procedures as applicable;
- (iii) Issuing auditor’s reports that are appropriate in the circumstances; and
- (iv) The ET’s ability to raise concerns without fear of reprisals.

➤ The fact that quality is essential in performing audit engagements.

34. CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services.

While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him?

Answer: Integrity of principal owners, key management and those charged with governance has to be considered before accepting an audit engagement in accordance with SA 220. In this regard, SA 220 states requirements on lines of SQC 1.

SQC 1 clearly states that in cases where there are indications that the client might be involved in money laundering or other criminal activities, appointment should not be accepted.

In the given case, there have been raids of NIA on suspected links with terror outfits which is a criminal activity. Further, raids by Enforcement Directorate also point towards money laundering.

Therefore, it can be concluded that proposed offer should not be accepted by CA PK Nair.

35. 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: As per SA 220 “Quality Control for an Audit of Financial Statements”, the information which assists the auditor in accepting and continuing of relationship with the client may include the following:

- Integrity of principal owners, key management and TCWG;
- Competency and capabilities including time and resources of engagement team;
- Compliance with relevant ethical requirements; and
- Significant matters arisen during current or previous audit engagement and their implications.

36. What are the responsibilities of Engagement Partner as per SA 220?

Answer: As per SA 220 “Quality Control for an Audit of Financial Statements”, Engagement partner has the responsibility for the following:

- Direction, supervision and performance of audit engagement as per professional standards and regulatory and legal requirements.
- Auditor’s report being appropriate in circumstances.
- Review of audit documentation before issue of audit report.
- Ensuring that sufficient appropriate audit evidence has been obtained to support the conclusions reached.
- Undertaking appropriate consultation on difficult matters.

37. CA M is the engagement partner of the firm M/s Y2Z LLP and he is auditing the financial statements of a listed entity ABC Ltd. The audit firm has determined that an engagement quality control review is required for this assignment. Discuss the responsibilities of CA M as an engagement partner for engagement quality control review as per SA-220.

Answer: As per SA 220 “Quality Control for an Audit of Financial Statements”, for audits of financial statements of **listed entities**, the engagement partner shall:

- Determine that an engagement quality control reviewer has been **appointed**.
- Discuss **significant matters** including those identified during engagement quality control review with engagement quality control reviewer.
- **Not date** the auditor’s report **until** the **completion** of the engagement quality control **review**.

If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the **firm’s policies and procedures** for dealing with and resolving differences of opinion.

38. The engagement partner should document certain matters pertaining to an audit engagement. Explain those matters.

Answer: As per SA 220 “Quality Control for an Audit of Financial Statements”, the engagement partner should document following matters pertaining to an audit engagement:-

- **Issues** identified with respect to compliance with relevant **ethical requirements** and how they were resolved.
- Conclusions on compliance with **independence** requirements and any relevant **discussions** with the firm that support these conclusions.
- Conclusions reached regarding the **acceptance** and **continuance** of client relationships and audit engagements.
- The **nature**, **scope** and **conclusions** resulting from consultations undertaken during the course of the audit engagement.

CHAPTER 2: AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

1. 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. Analyze and advise explaining the benefits of adequate planning.

Answer: As per SA 300 “Planning an audit of financial statements”, planning an audit involves establishing audit strategy for the engagement and developing audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:-

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence and proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and review of their work.
- Assisting in coordination of work done by others such as experts.

2. CA E is auditor of LM Ltd. Before commencing with current year's audit, he initiated planning for the audit. Planning includes the need to consider certain matters, prior to the identification and assessment of the risk of material misstatements. Enumerate such matters.

Answer: Planning includes the need to consider certain matters, prior to the identification and assessment of the risk of material misstatements, such as:

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

3. MG & Co, a firm of auditors, having a standing of 30 years is appointed as a statutory auditor of company engaged in manufacturing of defence equipment. Due to opening of defense sector by government to private players in recent times, many new companies have entered the fray to manufacture sophisticated defense equipment. Considering technical and complex nature of operations, the auditors recognize that involvement of experts in the audit is required. Does consideration for involvement of experts by auditors fall in the domain of planning audit?

Answer: As per SA 300 “Planning an audit of financial statements”, planning an audit involves developing an overall plan for expected scope and conduct of audit and developing an audit programme showing nature, timing and extent of audit procedures. While planning an audit, auditor would have to consider whether involvement of experts is necessary.

In the given case, company is involved in technical and complex operations. Therefore, while planning an audit, auditors would have to consider whether involvement of expert is necessary.

Therefore, it can be concluded that consideration for involvement of experts by auditors falls within domain of planning.

4. CA Kartik is planning for audit of a company engaged in manufacturing of cosmetics. Considering nature of operations of the company, he had planned to include testing of controls of the company over purchases, sales and inventories. One fine day, he reaches the corporate office and asks for manuals and required documentation to ensure surprise element in testing. He had never shared with management his intention to carry out above procedures. Is approach of CA Kartik proper?

Answer: Auditor may decide to discuss elements of planning with the entity's management to facilitate the **conduct** and **management** of the audit engagement **without compromising effectiveness** of audit. In the given case, CA Kartik has reached office of the company without sharing with management his intention to test the controls. Sharing details of visit to test controls **does not compromise effectiveness of audit**. It is for the **better facilitation** and **conduct** of audit. Therefore, it can be concluded that **approach of CA Kartik is not proper**.

5. Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assist an auditor?

Answer: Preliminary engagement activities include following activities:-

- Performing procedures regarding the **continuance of the client relationship**;
- Evaluating **compliance with ethical requirements**, including independence;
- Establishing an **understanding of terms of engagement**.

Performing preliminary engagement activities assists the auditor in **identifying and evaluating events or circumstances** that may affect auditor's ability to plan and perform audit engagement.

6. CA N, engagement partner of LPS & Associates, is planning for audit of a large company. As part of preliminary engagement activities being performed in this regard, he wants to ensure that compliance with independence requirements is adhered. How shall he form a conclusion that audit firm complies with independence requirements?

Answer: As a part of preliminary engagement activities, the engagement partner shall form a conclusion on compliance with independence requirements. In doing so, the engagement partner shall:-

- Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence;
- Evaluate information on identified breaches, if any, to determine whether they create a threat to independence for the audit engagement; and
- 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. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

In the given case, as part of preliminary engagement activities being performed CA N wants to ensure that compliance with independence requirements is adhered while planning for audit of LPS & Associates. Therefore, it can be concluded that CA N should perform the above.

7. EFG Ltd. has appointed M/s. MN & Co., Chartered Accountants, as the statutory auditors for the year 2024-25. CA N, the engagement partner, completed his risk assessment procedure. However, he is concerned about the management of human resources to be employed to conduct the audit. For this purpose, he wants to establish an overall audit strategy for setting the scope, timing and direction of the audit. Describe how the process of establishment of overall audit strategy will assist him in managing deployment of his human resources for various audit areas.

Answer: The auditor shall establish an overall audit strategy that 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:

- Helping the auditor in **deploying appropriate resources** 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.
- Helping the auditor in allocating the **appropriate amount of resources** to specific audit areas such as the number of team members assigned to observe the inventory count at material locations or the extent of review of other auditors' work in the case of group audits.
- Helping the auditor in determining the **timing of deploying** these resources such as whether at an interim audit stage or at key cut-off dates.
- Helping the auditor in **managing, directing and supervising** these resources such as when team briefing and debriefing meetings are expected to be held and whether to complete engagement quality control reviews.

8. 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”, auditor shall establish an overall audit strategy that sets scope, timing and direction of the audit, and guides development of audit plan. In establishing overall audit strategy, auditor shall:

- Identify characteristics of engagement that define its scope;
- Ascertain reporting objectives of engagement to plan timing of audit and nature of communications required;
- Consider factors that are significant in directing engagement team efforts;
- Consider results of preliminary engagement activities; and
- Ascertain nature, timing and extent of resources necessary to perform engagement.

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

Answer: It is important for auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy. There are many characteristics of engagement defining its scope. Some of characteristics are as under:-

- Applicable financial reporting framework applicable to the entity.
- Nature of business segments to be audited including the need for specialized knowledge.
- Industry specific reporting requirements required by industry regulators.
- Expected use of audit evidence obtained in previous audits.

10. The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Give three instances to explain.

Answer: The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under:-

- The entity's **timetable for reporting** such as at interim and final stages.
- **Organization of meetings** with management to discuss nature, timing and extent of audit work.
- Discussion with management regarding **expected type and timing** of reports to be issued.
- Discussion with management regarding **expected communications** throughout the engagement.
- **Expected nature and timing of communications** among engagement team members including the nature and timing of team meetings and timing of the review of work performed.

11. B Ltd. is a company manufacturing bed-sheets and pillow covers. They have appointed M/s C & Co., Chartered Accountants, as their auditors. The auditor is establishing audit strategy with his team members. As the work progressed, they came to know that the company has diversified its business and now they are also planning to manufacture wooden furniture. The auditor, in his professional judgement, considers this to be a significant factor in directing the engagement team's efforts. Give examples of factors that in auditor's professional judgment are significant in directing the engagement team's efforts.

Answer: The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of **transactions, account balances** and **disclosures** help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under:-

- **Volume of transactions** which may determine whether it is more efficient for the auditor to rely on internal control.
- **Significant industry developments** such as changes in industry regulations and new reporting requirements.
- **Significant changes in the financial reporting framework** such as changes in accounting standards.
- Other **significant relevant developments** such as changes in the legal environment affecting the entity.

12. CA Shubhendu is statutory auditor of a social media company. Due to change in information technology regulations by government, it has become mandatory for such companies to constitute “grievance redressal mechanism” for users of social media platform of the company. Failure to comply with regulations can potentially lead to civil and criminal liabilities against the company. Is above factor to be considered by auditor while framing 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 guides the development of the audit plan. Changes in laws and regulations affecting the company is a factor to be considered while establishing overall audit strategy. In the given case, there has been change in information technology regulations applicable to the company. Noncompliance of the same can have implications in form of civil and criminal liabilities. Therefore, it can be concluded that matter concerning changes in laws and regulations is to be considered by auditor while establishing overall audit strategy.

13. CA Mary, while planning audit of a company, feels that she would inquire from in – house legal counsel of the company status of pending litigation matters against the company to identify and assess risks of material misstatements. Considering above description, are you able to identify said procedures? Where these identified procedures are included in planning?

Answer: As per SA 300 “Planning an audit of financial statements”, auditor shall develop audit plan that shall include description of:

- Nature, timing and extent (NTE) of planned Risk Assessment Procedures;
- NTE of planned Further Audit Procedures at assertion level; and
- Other Planned Audit Procedures required to be carried out.

In the given case, auditor would like to inquire from in – house legal counsel of the company as to status of pending litigation matters to identify and assess risk of material misstatement.

Therefore, it can be concluded that Planned Risk Assessment Procedures are included in audit plan in accordance with SA 300.

14. AP & Co., Chartered Accountants, are appointed as statutory auditor of Heavy Industries Limited, a listed company engaged in manufacturing of electric vehicles, for the F.Y. 2023-24. As per the recent guideline issued by the regulatory authority, every listed company is required to maintain the digital database of all those personnel who could access the books of the company to avoid Insider Trading. In case of non-compliance, hefty fines may be imposed on the company. CA P is the engagement partner from auditor firm for the audit of Heavy Industries Limited. During planning, CA P planned that he would inquire from in-house IT Head of the company about the maintenance of the digital database to identify and assess risk of non-compliance with regulatory guidelines. In light of above facts, explain:

a. Whether CA P is required to consider about maintenance of digital database while framing audit strategy?

b. Whether the procedures planned by CA P are in line with SA-300?

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 guides the development of the audit plan. The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Examples of such matters include significant industry developments such as changes in industry regulations and new reporting requirements and other significant relevant developments such as changes in the legal environment affecting the entity. In the given case, CA P is the engagement partner for the audit of Heavy Industries Limited and planned that he would inquire from in-house IT Head of the company about maintenance of the digital database to identify and assess the risk of non-compliance with regulatory guidelines. Therefore, it can be concluded that CA P is required to consider about the maintenance of digital database while framing audit strategy.

Further, auditor shall develop audit plan that shall include description of:

- Nature, timing and extent (NTE) of planned Risk Assessment Procedures;
- NTE of planned Further Audit Procedures at assertion level; and
- Other Planned Audit Procedures required to be carried out.

Procedures planned by CA P is Risk assessment Procedure and is in line with SA-300.

15. The engagement partner, of a firm of auditors, is explaining to his audit team, undergoing practical training, the inter relationship between audit strategy and audit plan. Discuss the points which the engagement partner will explain to his team in this regard.

Answer: Relationship between Audit Strategy and Audit Plan

- Audit strategy sets overall approach to audit whereas audit plan addresses various matters identified in overall audit strategy.
- Audit strategy determines scope, timing and direction of audit. Audit plan describes how strategy is to be implemented.
- **Audit plan is more detailed than overall audit strategy** that includes the nature, timing and extent of audit procedures to be performed.
- Once overall audit strategy has been established, audit plan can be developed to address various matters identified in overall audit strategy.
- Establishment of overall audit strategy and 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.

16. W, the auditor of SKM Ltd. asks its finance and audit head to prepare audit strategy for conducting audit of SKM Ltd. W also insists him to draw detailed audit procedures. On the request of auditor W completes audit strategy as well as audit procedures as prepared by finance head of the company. Subsequently, auditor realizes that effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment.

Answer: Overall audit strategy and audit plan remain **auditor's responsibility**. It is **auditor** who is **responsible** for establishing **overall audit strategy** and **developing audit plan**. However, auditor may **discuss elements of planning** with entity's **management without compromising effectiveness of audit**. In the given case, on the request of auditor audit strategy as well as audit procedures are prepared by finance head of the company. Therefore, it can be concluded that **Approach of W was wrong** and he should **have prepared overall audit strategy** and **detailed audit procedures**.

17. Plans should be further developed and revised as necessary during the course of the audit. 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
- audit evidence obtained from the results of audit procedures.

The auditor may need to modify the overall audit strategy and audit plan and resulting planned nature, timing and extent of further audit procedures.

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 on detailed checking may contradict the audit evidence obtained through testing internal controls.

18. CA D is planning an audit of a listed company. List specific documentation requirements in accordance with SA 300 in relation to planning such an audit. How such planning documentation is useful?

Answer: 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.

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.

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.

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.

19. APR & Associates, a Chartered Accountant firm, are appointed as the auditors of Time Ltd. and Bakes Ltd. The volume and nature of business of both the companies are entirely different. CA R is the engagement partner for Bakes Ltd. CA P is the engagement partner for Time Ltd. CA R formulates an Audit Programme for conducting the audit of Bakes Ltd. He suggests CA P to use the same audit programme for Time Ltd. But CA P is of the opinion that this audit programme will not be useful for the audit of Time Ltd. Is CA P correct in emphasizing for a different Audit Programme for Time Ltd.?

Answer: Evolving audit programme applicable to all business entities under all Circumstances is **not practical**. This is due to:

- Varying **nature, size and legal form** of Business entities.
- Work **suitable to one business may not be suitable to another**.
- **Efficiency and operation of Internal Controls and exact nature of services** to be rendered by auditor differs from assignment to assignment.

Hence, it is required to develop an audit programme that specify in detail, nature of work to be performed in a particular engagement. In the given case, CA P is of the opinion that audit programme of Bakes Ltd. will not be useful for the audit of Time Ltd. Therefore, it can be concluded that **CA. P is correct in emphasizing for a different audit programme for Time Ltd.**

20. M/s TP & Co., a firm of Chartered Accountants, has been conducting audit of KSR Ltd. since last 4 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? Guide them.

Answer: During Initial stage, auditor should frame a programme, having regard to:

- **nature, size and composition of business;**
- **dependability of Internal control;**
- **scope of work.**

Such programme may be considered as a **Standard Programme**. As experience is gained & information is collected, **programme may be suitably altered**, for relevant matters. If any work originally covered in audit programme, appears to be **unnecessary**, it may be **dropped**. Hence, **assistants** engaged in audit should be encouraged to keep an **open mind** beyond the programme given to them. Any **significant matter**, noticed by them, should be **informed to Senior** persons in firm.

In the given case, the assistants of M/s TP & Co. are conducting the audit of KSR Ltd. on the basis of the standard audit programme handed over to them by the senior member.

Therefore, it can be concluded that **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.

21. M/s. PP & Co, a firm of Chartered Accountants, has been auditing the books of accounts of KALI Ltd. for the past 3 years. The company has recently made some major changes in its business policies. While planning to start the audit for the 4th year i.e. for financial year 2024-25, the audit manager of the firm, as per the routine practice, handed over the previous years' audit programme as it is to the audit team with the instructions to adhere unfailingly to the said audit programme. Evaluate the decision of the audit manager with reference to the use of audit programme.

Answer: Auditor shall **review audit programme periodically** to assess whether same continues to be adequate for obtaining requisite knowledge & evidences about transactions.

Utility of audit programme can be maintained by keeping programme under periodic review so that **inadequacies or redundancies may be identified** and audit programme may be updated.

If periodic review is not done, auditor may not be able to identify Changes in business policies of client and audit work performed on basis of **obsolete audit programme**, will **not be considered effective and efficient** and hence **auditor may have face consequences**.

In the given situation, Ms. PP & Co., a firm of Chartered Accountants has been auditing the books of accounts of KALI Ltd. for the past 3 years and the Company has recently made major changes in its business policies, therefore, it is very essential to review the audit programme.

Therefore, it can be concluded that contention of the audit manager to adhere with the instructions of following the same audit programme as per routine practice is **not correct**.

22. 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**

XYZ & associates are appointed as the statutory auditors of Fisco Ltd. for the FY 2022-23. While constructing the audit programme, the engagement partner, CA X, should keep in mind various points.

List such points. **OR** While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. Explain stating clearly the points to be kept in mind while developing an audit programme.

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

- Stay within **scope and limitation** of assignment.
- Prepare **written audit programme** containing procedures needed to implement plan.
- Determine **evidence reasonably** available and identify best evidence for deriving the necessary satisfaction.
- Apply only those procedures which are **useful** in accomplishing verification purpose.
- **Include audit objectives** for each area of audit and sufficient details which serve as a set of instructions for assistants in proper execution of the work.
- Consider **all possibilities of error**.
- Coordinate **procedures to be applied** to related items.

23. Sanjana is of the view that there exist some disadvantages in the use of audit programmes but most of these can be removed by following some concrete steps. Do you agree with her perspective? Comment.

Answer: The view of Sanjana is **appropriate**. Some disadvantages are there in the use of audit programmes but most of these can be removed by following some concrete steps. The disadvantages are:

- **Work may become mechanical** and particular parts of the programme may be carried out without any understanding of object of such parts.
- Programme often tends to become **rigid and inflexible**; business may change in its operation of conduct, but old programme may still be carried on.
- **Inefficient assistants may take shelter behind the programme** i.e. defend deficiencies in their work on ground that no instruction in matter is contained therein.
- Hard & fast audit programme may **kill initiative of efficient & enterprising assistants**.

All these disadvantages may be eliminated by:

- **imaginative supervision of work** carried on by the assistants;
- **receptive attitude of auditor** as regards the assistants;
- **encouraging assistants** to observe matters objectively and bring **significant matters** to notice of supervisor/principal.

CHAPTER 6: AUDIT DOCUMENTATION

1. What is meant by audit documentation? What are objectives of an independent auditor in accordance with SA 230?

Answer: SA 230 “Audit Documentation” defines the term audit documentation as to record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached. Audit documentation commonly known as working papers. The objective of the auditor is to prepare documentation that provides:

- A sufficient and appropriate record of the basis for the auditor’s report; and
- Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

2. Explain the nature of audit documentation.

Answer: As per SA 230 “Audit Documentation”, audit documentation provides:

- evidence of the auditor’s basis for a conclusion about the achievement of overall objectives; and
- evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

3. CA M is the engagement partner of S Ltd. He has instructed his audit team to maintain proper audit documentation. The audit team members are not sure about the purpose for which the documentation should be made. Explain the various purposes of audit documentation with reference to SA 230.

Answer: As per SA 230 “Audit Documentation”, the following are the purpose of Audit documentation:

- Assisting the engagement team (ET) to plan and perform the audit.
- Assisting members of ET to direct and supervise audit work & discharge their review responsibilities.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

4. A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company. Explain whether Audit Documentation has any relation with regard to planning the audit of a company.

Answer: Audit Documentation helps in **planning the audit** of a company in a **proper manner** and also helps in **conducting the audit** of that company in a **more effective way**.

5. While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor should record.

Answer: In documenting nature, timing and extent of audit procedures performed, **auditor shall record:**

- The identifying **characteristics of the specific items** or matters tested.
- **Who performed the audit work** and the **date** such work was completed; and
- **Who reviewed** the audit work performed and the date and **extent of such review**.

6. During the course of audit of a company, an issue arose relating to treatment of interest costs of company on its restructured loans taken from a bank. This important matter was discussed with CFO of the company and was properly resolved. Is it necessary for the auditor to include in its working papers?

Answer: The auditor shall **document discussions of significant matters** with management, those charged with governance, and others, including the **nature of the significant matters** discussed and **when** and **with whom** the **discussions** took place. In the given case, an important matter regarding treatment of interest costs of company on its restructured loans taken from a bank directly impacting profits of the company was discussed. Therefore, it can be concluded that although issue was resolved, it is necessary to **document** the same by including **detail** of the **person** with whom discussions took place along with **date**.

7. CA Piku has prepared audit documentation of an entity describing nature, timing and extent of audit procedures performed during the course of audit. In documenting nature, time and extent of audit procedures performed, which matters shall be recorded? He is also of the view that such documentation alone as described above meets requirements of Standards on Auditing. Comment upon validity of his views.

Answer: In documenting nature, timing and extent of audit procedures performed, auditor shall record:

- The identifying characteristics of the specific items or matters tested.
- Who performed the audit work and the date such work was completed; and
- Who reviewed the audit work performed and the date and extent of such review.

Auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand:

- The nature, timing and extent of the audit procedures performed.
- The results of the audit procedures performed and the audit evidence obtained and
- Significant matters arising during the audit and the conclusions reached thereon and significant professional judgments made in reaching those conclusions.

Therefore, all above matters shall be recorded to meet requirements of SA 230. Documenting nature, time and extent of audit procedures performed alone does not meet the requirements of SA 230. Therefore, CA Piku's views are not valid.

8. One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of the entity. State six other factors in this respect.

Answer: One of the factors affecting the form, content and extent of audit documentation relates to **size** and **complexity** of audit. Other factors are:

- The **nature** of the **audit procedures** to be performed.
- The identified **risks** of material misstatement.
- The significance of the **audit evidence** obtained.
- The nature and extent of **exceptions** identified.
- 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.
- The audit **methodology** and **tools** used.

9. Define Audit Documentation. Also give some examples.

Answer: **SA 230 “Audit Documentation”** defines the term audit documentation as to record of **audit procedures performed**, relevant **audit evidence** obtained and **conclusions** the auditor reached. Audit documentation commonly known as working papers. Audit documentation may be recorded on **paper or on electronic or other media**. Examples of audit documentation include:

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

10. CA Sonali Morarka has completed audit of a listed company. The audit report dated 15th July, 2022 has been issued. However, audit working papers including record of discussions with management, details of audit procedures performed to obtain audit evidence and conclusions reached by her have not been properly assembled. More than six months have elapsed after issue of audit report. Subsequently, she has received a letter from regulator in connection with audit of the company requesting her to share copy of audit file. The letter has woken up her from deep slumber. She hurriedly assembled audit file and inserted some more papers which were necessary. However, she put current date on these inserted papers and the copy of audit file was sent to regulator. Discuss, the issues involved, in context of “audit documentation”.

Answer: An appropriate time limit within which to complete the assembly of the final audit file is ordinarily **not more than 60 days after date of auditor’s report**. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance **quality** of audit and facilitates **effective review** and **evaluation** of audit **evidence** obtained and **conclusions** reached before auditor’s report is finalized. Documentation prepared **after** the **audit work** has been performed is likely to be **less accurate** than documentation prepared at the time such work is performed.

In the given case, even after passage of more than six months, she has not assembled audit file. Besides, she has put in some papers with current date which is not permissible at all.

Therefore, it can be concluded that part of audit documentation has been prepared afterwards putting a **question mark on quality of audit**.

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

Answer: Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

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

12. Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her.

Answer: SA 230 "Audit Documentation" requires that the auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance quality of audit and facilitates effective review and evaluation of audit evidence obtained and conclusions reached before auditor's report is finalized.

SQC 1, however, requires auditor to complete assembly of final audit file in ordinarily not more than 60 days after date of auditor's report. Completion of assembly of final audit file after the date of auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

Therefore, auditor shall prepare documentation on a timely basis. However, for completion of assembly of final audit file which is an administrative process, time period of 60 days after the date of auditor's report has been required in SQC 1.

13. CA B, an auditor, after the completion of busy audit season, was occupied in assembling of final audit files of one of his client. First of all, he started preparing various documents of that client and then kept those documents in various folders. He was preparing documents as well as audit file in paper form because he believed that it is mandatory. He could complete documentation as well as assembling of final audit file of that client after three months from the date of audit report. Generally, he retains audit file of the clients for 4 years from the date of audit report. Check the validity of the action of CA B.

Answer: Audit documentation may be recorded on paper or on electronic or other media. Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. Hence the views of CA B that audit documentation should be maintained mandatorily in paper form is not correct.

The auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance quality of audit and facilitates effective review and evaluation of audit evidence obtained and conclusions reached before auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed. Completing the audit Documentation by CA B not on timely basis is not proper.

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after date of auditor's report. In the given case, CA B after completion of audit season is completing the audit file as well as assembling of final audit files of his client after three months of the date of audit report which is not valid as per SQC 1.

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 7 years from the date of the auditor's report or if later, the date of the group auditor's report. He retains audit file of the client for 4 years from the date of audit report is also non-compliance of SQC 1.

14. CA N, statutory auditor of Rock Limited, is in the process of final assembly of audit file. Under what circumstances, a statutory auditor can make changes to audit documentation during final assembly process of audit file? Give a few examples of such changes.

Answer: Changes may be made to audit documentation during final assembly process if they are administrative in nature. Examples of such changes include:

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

15. CA N, statutory auditor of QST Limited, appointed for a term of 5 years has completed audit for the first financial year ending on 31st March 2024. In compliance with requirements of professional standards, an audit file has been assembled. After about a period of six months from date of issue of audit report, he gets a call from CFO of the company to share complete audit file so that financial reporting of company can be improved upon in coming periods. Is it mandatory for statutory auditors to share audit files with client? What are the requirements for making audit documentation available to clients?

Answer: SQC 1 provides that audit documentation is the property of the auditor unless otherwise specified by law or regulation. In the given case, CA N gets a call from the CFO of QST Limited to share complete audit file. Therefore, it is not mandatory for CA N to share audit file with client.

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.

16. CA N, statutory auditor of QST Limited, appointed for a term of 5 years has completed audit for the first financial year ending on 31st March 2024. In compliance with requirements of professional standards, an audit file has been assembled. After about a period of six months from date of issue of audit report, he gets a call from CFO of the company to share complete audit file so that financial reporting of company can be improved upon in coming periods. Is it mandatory for statutory auditors to share audit files with client? What are the requirements for making audit documentation available to clients?

Answer: SQC 1 provides that unless otherwise specified by law or regulation, audit documentation is the **property of the auditor**. Therefore, it is **not mandatory** for CA N to share audit file with client.

Auditor may at his **discretion**, make portions of or extracts from audit documentation available to **clients**, provided:

- Such disclosure does not **undermine validity** of work performed; or
- In case of assurance engagements, **independence** of auditor or of his personnel.

17. Discussing meaning of completion memorandum, elaborate upon its importance.

Answer: Completion memorandum is a **summary** that describes the **significant matters identified** during the audit and **how they were addressed**. Such a summary may **facilitate effective and efficient review and inspection** of audit documentation, particularly for **large and complex audits**.

It helps the auditor to consider **significant matters**. It also helps the auditor to consider whether he is able to achieve the objectives of **relevant individual SAs** that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

18. A director of Very Different Limited was of the view that Audit Documentation of a company is the property of that company. Comment on the contention of the director regarding the audit documentation of the company.

Answer: SQC 1 provides that unless otherwise specified by law or regulation, audit documentation is the **property of the auditor**. Therefore, Audit Documentation of a company is **not the property of the company** rather Audit Documentation is the **property of Auditor of that company**.

19. M/s Samar Amar & Associates are the statutory auditors of Ganga Ltd. for FY 2020-21. CA Samar is the engagement partner for such assignment. While discussing with the engagement team, CA Samar briefed his team that “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 requires firms to establish policies and procedures for the retention of engagement documentation.” Explain.

Answer: The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling final audit file ordinarily **not more than 60 days after date of auditor’s report**.

Completion of assembly of final audit file **after the date of 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 be made to audit documentation during final assembly process if they are administrative in nature. Examples of such changes include:

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

After assembly, auditor shall **not delete or discard** audit documentation before end of its retention period, i.e., ordinarily **no shorter than 7 years from the date of the auditor’s report** or if later, the **date of the group auditor’s report**.

20. 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. Explain stating clearly the examples of significant matters.

Answer: As per SA 230 “Audit Documentation”, judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks.
- Results of audit procedures indicating:
 - that financial statements could be materially misstated, or
 - a need to revise auditor’s previous assessment of risks of material misstatement and auditor’s responses to those risks.
- Circumstances that cause significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to audit opinion or inclusion of Emphasis of Matter paragraph in 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 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).

21. Give some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment where the matters and judgments are significant.

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

- Rationale for auditor's conclusion when a requirement provides that auditor shall consider certain information that is **significant** in particular engagement.
- Basis for auditor's conclusion on reasonableness of areas of subjective **judgments** (for example, reasonableness of significant accounting estimates).
- Basis for auditor's conclusions about **authenticity** of document in case of any doubt (for example, doubt on reliability of confirmation requests).