

#Ace Audit



CA Intermediate AUDITING & ETHICS **THE ULTIMATE** **REVISION GUIDE**

MAY & ²⁰²⁵SEPT



Crack Auditing in Your First Attempt with My Proven Revision Book! 📖💡

Looking to ace your CA Intermediate Auditing and Ethics exam? 🚀 This is the exact revision book I used to crack the audit paper in my first attempt! 🔥

- ✓ Comprehensive, concise, and clear
- ✓ Highlights the Key Words
- ✓ Draw attention to frequently asked questions
- ✓ Packed with AI generative EXAM LEVEL case studies
- ✓ Each SA's well-articulated
- ✓ Key concepts, tips, and shortcuts
- ✓ Perfect for quick revisions and last-minute preparation
- ✓ Packed with essential ethics guidelines and auditing practices

Get your hands on the book that made my journey easier – and get ready to conquer the exam with confidence!



Grab your copy today and start revising smarter, not harder!



Tables of contents

Particulars	Page no.
Chapter 1	4
Chapter 2	20
Chapter 6	43
Chapter 11	60
Chapter 4 – SA 501	84
SA 505	94
SA 510	101
SA 550	107
SA 610	116
SA 500	129
Chapter 7 – SA 560	147
SA 570	159
SA 580	171
SA 260	181
SA 265	194
Chapter 8 – SA 700	205
SA 701	216
SA 706	219
SA 705	224
SA 710	226
SA 600	227
SA 299	229

Nature, objective & scope of audit

ORIGIN OF AUDITING

- ✚ The word "audit" comes from the Latin word "**audire**", meaning "**to hear**". In medieval times, auditors would hear the accounts being read out to check if employees were not careless or negligent.

Note: Preparation & presentation of F/S of an entity is the responsibility of management of that entity. Auditor is only liable to express opinion on the financial statements in the form of written audit report.

Meaning & Nature of Auditing

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

Nature - *Independent Audit must be independent. The auditor must be free from any external influence to form an unbiased opinion.

* Nature of Financial Information Auditing applies to both profit-oriented (businesses) and non-profit organizations (NGOs, charitable trusts).

* To Express Opinion on the financial statements. Auditing provides assurance and builds confidence among users that the financial statements are reliable and credible.

* Purpose of an audit is to **enhance confidence in the users** of financial statements on whether the financial statements comply with an applicable reporting framework.

SA 200 (Overall **objectives** of the independent auditor & the conduct of the audit)

Reasonable Assurance

The auditor must obtain reasonable assurance that the financial statements are free from material misstatement (due to fraud or error), enabling the auditor to form an opinion on whether the statements are prepared in accordance with AFRFW (Applicable Financial Reporting Framework)

Reporting on Findings

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

Note: Reasonable Assurance is **different** from absolute Assurance

Reasonable Assurance – **high** level Assurance

absolute Assurance – **complete** Assurance

Scope

 **Coverage of All** Aspects of Entity

 **Reliability and Sufficiency** of Financial Information

 **Proper Disclosure** of Financial Information

Scope of Audit DO NOT Include

- + Responsibility of prep & presentation of F/S
- + Duties outside the scope of competence of auditor
- + Authentication of documents
- + Investigation

Inherent Limitations of an Audit

- + Nature of Financial Reporting
- + Nature of Audit Procedures
- + Audit is Not an Investigation
- + Timeliness and Relevance of Information
- + Future Events

Meaning of Engagement

Engagement refers to a formal agreement between the auditor and client. It contains the audit services to be provided and is documented in an engagement letter.

Benefits of Audit

- + High quality info's
- + For shareholders, their interest is safeguarded by an audit
- + Moral check on employees, discouraging fraud due to the fear of being discovered
- + Help government authorities determine accurate tax liabilities.
- + Highlights any deficiencies in the systems.

Is Audit- Mandatory or Voluntary?

Audit is not always compulsory. Many entities choose to voluntarily audit their accounts for the benefits of the audit process, including internal rules that require audits. Certain entities, like companies, are legally required to get their accounts audited under law.

Who Appoints the Auditor?

User of the F/S

Definition of Assurance Engagement

An assurance engagement is where a practitioner expresses a conclusion to enhance the confidence of intended users (other than the responsible party) about the evaluation of a subject matter against criteria.

Elements of an Assurance Engagement

- ✚ A 3-Party Relationship
- ✚ Appropriate Subject Matter
- ✚ Suitable Criteria
- ✚ Sufficient Appropriate Evidence
- ✚ Written Assurance Report in Appropriate Form

Meaning of Review and Difference between Audit and Review

- Audit provides reasonable assurance, whereas review provides limited assurance, which is a lower level of assurance.

- Review involves fewer procedures and gathers sufficient and appropriate evidence to form limited conclusions
- Both audit and review are related to financial statements based on historical financial information

Historical financial information and Prospective Financial Statements

- ✚ Historical financial information - Types of Assurance Engagements
- ✚ Prospective financial information refers to financial data based on assumptions about future events and actions. It can be presented as a forecast, projection, or a combination of both.
- ✚ **Note:**
 - ❖ Historical financial information reflects financial details of past events, conditions, or circumstances.
 - ❖ Prospective financial information is based on assumptions about future events and actions of the entity.

Differences

- ✓ Historical information is rooted in the past and represents actual events.
- ✓ Prospective information focuses on the future, based on assumptions about what might occur.

Engagement and Quality Control Standards

- ✚ [Standards on Auditing](#) apply to the audit of financial statements by an independent auditor. They set high-quality benchmarks for conducting audits of historical financial information.
- ✚ [Standards on Review Engagements](#) apply to the review of financial statements. A review provides limited assurance, which is lower than that of an audit, as it involves fewer procedures. Although providing limited assurance, a review also requires obtaining sufficient appropriate evidence. For example, when reviewing interim financial information.
- ✚ [Standards on Assurance Engagements](#) apply to engagements dealing with subject matters other than historical financial information. These do not include the audit or review of historical financial information, may involve examination of prospective financial information.
- ✚ [Standards on Related Services](#) apply to engagements that involve performing agreed-upon procedures regarding financial information.
- ✚ [Standards on Quality Control](#): SQC 1 requires auditors to establish a quality control system to ensure compliance with professional standards, regulatory & legal requirements, and that reports are appropriate.

Need for EQC Standards

- ✓ Ensure audits are conducted against established benchmarks, aligned with global practices.

- ✓ Improve the quality of financial reporting, aiding diligent decision-making.
- ✓ Promote uniformity in audits of financial statements.
- ✓ Equip professional accountants with necessary knowledge and skills.
- ✓ Ensure audit quality.

Duties in Relation to Engagement and Quality Control Standards:

1. Professional accountants must follow Standards in their engagements. If a specific procedure in the Standards is ineffective, they must document alternative procedures and their purpose.
2. They must also document the reason for departure unless it's clear, and draw attention to these departures in their report.
3. Disclosure alone does not absolve the accountant from complying with applicable Standards.

BASIC LEVEL



Case Study 1: Understanding the Auditor's Role

XYZ Ltd., a newly formed public company, has appointed Mr. Ravi, a Chartered Accountant, as its auditor. The management believes that the auditor is responsible for preparing the financial statements and detecting all frauds and errors in the company. Mr. Ravi wants to clarify his actual role and responsibilities as per auditing standards.

Question: Advise Mr. Ravi on how to explain the **nature and objective** of an audit and clarify the **scope** of an auditor's responsibility to the management of XYZ Ltd.

Suggested Answer:

Mr. Ravi should explain the following:

- **Nature of Audit:** Audit is an independent examination of financial information of an entity, whether profit-oriented or not, irrespective of size or legal form.
- **Objective of Audit:** The **primary objective** is to **express an opinion** on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- **Scope of Auditor's Responsibility:**
 - Auditor is **not responsible for preparation** of financial statements. This is the duty of **management**.
 - The auditor provides **reasonable assurance**, not absolute assurance.
 - Detection of **material misstatements**, whether due to **fraud or error**, is a part of the auditor's responsibility, but audit does **not guarantee detection of all frauds**.

This will align with the principles outlined in **SA 200 - Overall Objectives of the Independent Auditor**.

✓ Case Study 2: Misconception about Scope

During the annual general meeting, shareholders of Alpha Ltd. raised concerns that the auditor did not uncover certain internal mismanagement issues. They questioned the **scope** of audit and believed the audit should have reported such matters.

Question: What should be the auditor's response regarding the **scope and limitations** of audit in such a situation?

Suggested Answer:

The auditor should respond:

- Audit is designed to provide **reasonable assurance** that the financial statements are **free from material misstatements**, not to uncover **every act of internal inefficiency or mismanagement**.
- The scope is defined by:
 - **Relevant laws and regulations**
 - **Terms of engagement**
 - **Applicable auditing standards**
- Unless internal mismanagement has a **material impact** on the financial statements, it is **not the primary focus** of audit procedures.

This aligns with the concept of **professional skepticism** and **risk-based approach** followed by auditors.

✓ Case Study 3: Audit vs. Investigation

A client, Beta Industries, was under the impression that statutory audit and investigation are the same. They expected the auditor to deeply examine every transaction and suspected fraud during the year.

Question: Differentiate between **audit and investigation** and explain the **nature** and **scope** of an audit in this context.

Suggested Answer:

An auditor should explain:

Basis	Audit	Investigation
Objective	To give opinion on true and fair view	To establish specific facts or suspected fraud
Scope	Defined by auditing standards and engagement	As per specific instructions of the client
Approach	Test check and sampling	In-depth examination
Nature	Recurring process (annual)	Non-recurring, specific purpose

Hence, the **audit is not meant to detect all frauds**, unless they result in **material misstatement** in the financial statements.

INTERMEDIATE LEVEL

■ Case Study 1: Scope of Audit vs. Responsibility of Management

MNO Ltd. is a private company that manufactures consumer goods. During the audit, the auditor, CA Divya, noticed that inventory records were not properly maintained. The management argued that it was the auditor's responsibility to maintain those records and ensure compliance. They blamed the auditor for their internal lapses.

Question: Evaluate the situation in light of the scope of audit and explain who is responsible for maintaining accounting records and internal control systems.

Suggested Answer:

CA Divya should clarify:

- **As per SA 200**, the responsibility for:
 - **Maintaining accounting records**
 - Designing and implementing **internal controls** lies solely with the **management and those charged with governance**.
- The **auditor's role** is to:
 - **Examine financial statements** prepared by management.
 - Provide an **independent opinion** on whether they give a **true and fair view**.

- The **scope of audit** does **not include maintaining or designing internal control systems**.

Hence, the management's claim is incorrect.

Case Study 2: Reasonable Assurance and Limitations of Audit

During the audit of ABC Ltd., a fraud committed by a mid-level employee went undetected. The Board was unhappy and accused the auditor of professional negligence. The auditor contended that audit provides only **reasonable assurance**.

Question: Discuss the concept of **reasonable assurance** and explain why audit may fail to detect certain frauds or errors.

Suggested Answer:

Audit provides **reasonable**, not absolute, assurance due to:

1. Inherent Limitations of Audit:

- Use of **judgment** in audit procedures.
- Use of **sampling techniques**.
- Possibility of **collusion** to conceal fraud.

2. Nature of Evidence:

- Audit evidence is **persuasive**, not conclusive.

3. Time and Cost Constraints:

- Not every transaction is checked; only **material items** are tested.

As per **SA 240**, auditors are responsible to design procedures to detect **material misstatements due to fraud**, but cannot guarantee detection of all frauds.

Hence, the auditor cannot be held negligent unless professional standards were clearly violated.

Case Study 3: Independence and Objectivity

PQR Ltd. appointed Mr. Sharma, a retired employee of the company, as their statutory auditor. During the course of audit, Mr. Sharma did not report several weaknesses in internal controls due to his past loyalty to the management.

Question: Evaluate the auditor's behavior in light of **auditor's independence and objectivity**. Is the audit valid?

Suggested Answer:

The audit suffers from a **lack of independence**:

- As per the **Code of Ethics** and **SA 200**, an auditor must be **independent in mind and appearance**.
- Mr. Sharma being a **former employee** poses a **threat to independence**.
- His failure to report control weaknesses shows lack of **professional skepticism**.

Therefore, the audit may be considered **compromised** and **non-compliant** with professional standards. The appointment may also be

questioned under **Section 141 of the Companies Act, 2013** regarding disqualification of auditors.

EXAM LEVEL

◆ Case Study 1: Auditor's Duty vs. Management Pressure

Zeta Manufacturing Ltd., a closely held company, is under pressure from investors to show growth. The management asks the auditor to overlook some inventory overstatements and promises to rectify them next year. The auditor is also offered a long-term consultancy contract if the report is "clean."

Question: Analyse the ethical and professional dilemmas faced by the auditor. How should the auditor respond in light of the **nature and objective of audit**?

Suggested Answer:

The auditor is facing both:

- **Self-interest threat:** Due to promised consultancy engagement.
- **Advocacy threat:** If auditor supports management's misstated figures.

As per the **Fundamental Principles of Ethics** and **SA 200**:

- The **objective of audit** is to **express an independent opinion** on whether financial statements are free from **material misstatements**.
- The auditor **must not compromise integrity** for future gain.

Action:

- Refuse to overlook misstatements.
- Communicate findings to those charged with governance.
- If management doesn't correct the overstatement, issue a **qualified or adverse opinion** depending on materiality.

This situation tests independence, objectivity, and professional behavior — core to audit quality.

 Case Study 2: Nature of Audit vs. Assurance Services

Delta Solutions LLP offers assurance services like certification of CSR expenditure, due diligence for mergers, and forensic reviews. A client believes all such services are part of statutory audit.

Question: Clarify the difference between **audit and other assurance services**. How does this distinction impact the auditor's responsibilities?

Suggested Answer:

Audit and **assurance services** both provide confidence to users, but they differ in nature and scope:

Criteria	Audit	Assurance Services
Objective	Opinion on financial statements	Depends on engagement (e.g. CSR, internal control)

Criteria	Audit	Assurance Services
Scope	Defined by statutes and SA	Agreed-upon terms or standards
Users	Primarily shareholders and regulators	Management, investors, lenders, etc.

As per **SA 200**:

- **Nature of audit** is specific — to express an opinion on whether financial statements present a **true and fair view**.
- Assurance engagements are broader and governed by **SAE (Standards on Assurance Engagements)**.

Conclusion:

Statutory audit is **not interchangeable** with other assurance services. Each has a defined purpose and separate scope.

Audit strategy, planning & programme

Benefits of Planning Activities

- ✚ Appropriate attention to important areas
- ✚ Identify and resolve potential problems
- ✚ Selection of team members
- ✚ Direction & supervision of team & review of work
- ✚ Coordination with other auditors & experts

Nature of Audit planning

1. Planning is **not a discrete phase** [specific] but a continual and iterative process.
2. It begins after the completion of the previous audit and continues until the completion of the current audit engagement.
3. The audit plan should be **reviewed periodically** to ensure it covers newly identified areas.

Considerations in Planning

- ✚ Application of analytical procedures as risk assessment procedure.
- ✚ Understanding the legal and regulatory framework applicable to the entity and its compliance.
- ✚ Determination of materiality as per SA 320.
- ✚ Assessment of the need for expert's assistance.
- ✚ Performance of risk assessment procedures to identify and assess.

Involvement of Various Members in Planning Process

- ✓ The auditor is responsible for establishing the overall audit strategy and developing the audit plan. The engagement partner and key engagement team members must be involved in planning the audit and discussions among team members.
- ✓ Their involvement enhances the effectiveness and efficiency of the planning process through their experience and insight.

Discussion with Entity's Management

- a. The auditor may discuss planning elements with the entity's management to facilitate audit engagement.
- b. Ensure that the discussions do not compromise the effectiveness of the audit.
- c. Matters related to surprise checks should not be included in discussions with the client.

Elements of Planning

Preliminary Engagement Activities

Performing procedures related to acceptance and continuation of client relationship (SA220 & SQC1 - Acceptance and Continuation of Client Relationship - Integrity of principal owners and key management)

Compliance with ethical requirements including independence (SA220&SQC1)

- ✚ [Independence means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him]
- ✚ The engagement partner shall remain alert for evidence of non-compliance with ethical requirements.
- ✚ In case of Non compliances with ethical requirements, the engagement partner takes appropriate actions.
- ✚ Engagement partner form conclusion on compliance with independence by:
 - ✓ Obtaining information to identify threats to independence.
 - ✓ Evaluate identified breaches of firm independence policies
 - ✓ Take appropriate action to eliminate the threat or reduce them to acceptable level by applying safeguards to address threats. [Withdraw if cannot be eliminated]
 - ✓ Promptly report to the firm in case of unresolved matters to the firm.

Establishing understanding of terms of engagement (SA210)

The auditor sends an engagement letter before starting the audit to avoid misunderstandings. Ensure there is no confusion with the client regarding the terms of engagement.

Note: Performing preliminary engagement activities assists the auditor in identify & evaluate the circumstances or event that may affect the Auditor ability to plan & perform audit engagement.

Planning Activities

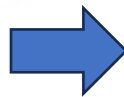
a. Establishing the overall audit strategy

- ✚ Sets the scope, timing, and direction of the audit and guides the development of the detailed audit plan.
- ✚ overall audit strategy assists the auditor to determine:
 - ❖ Where to deploy
 - ❖ How much to deploy
 - ❖ When to deploy
 - ❖ How deploy can be managed

Note: Read the Factors to consider while establishing Overall Audit strategy in depth (asked in many attempts)

b. Developing an audit plan (address various matters identified in overall audit strategy)

It includes – NTE
procedure



Planned Risk assessment

(nature, timing & extent)
procedure

Planned further audit
procedure

Relationship Between Overall Audit Strategy and Audit Plan

- ✚ Audit Strategy sets the broad overall approach to the audit, whereas the Audit Plan addresses specific matters identified in the strategy.

- ✚ Establishing the Audit Strategy and developing the Audit Plan are not discrete or sequential but are inter-related since changes in one affecting the other.
- ✚ Planning for audit procedures occurs throughout the audit as the plan develops and adapts to engagement needs.

Changes to Audit Plan [Planning Decisions] during the audit

- ✚ The auditor shall update and change the overall audit strategy and audit plan as and when necessary.
- ✚ Unexpected events, Changes in conditions, new information discovered during the audit process may lead to modify the overall audit strategy and audit plan.

Planning, Supervision and Review of Work of Engagement Team Members

The auditor shall plan NTE of direction, supervision and review of Engagement Team work and its NTE may vary depending on the factors -

1. Size and complexity of the entity.
2. Specific audit areas.
3. Assessed risks of material misstatement.
4. Capabilities and competence of individual team members performing audit tasks.

Documentation of Overall Audit Strategy and Audit Plan

Purpose of Documentation

- ✚ Acts as a record of key decisions regarding audit planning.
- ✚ Facilitates communication with the engagement team on significant matters.
- ✚ Records the planned nature, timing, and extent of risk assessment and audit procedures.
- ✚ Helps in review and approval of audit procedures before performance.

Documentation Includes

- ✚ Overall Audit Strategy.
- ✚ Audit Plans.
- ✚ Significant Changes to the overall strategy or audit plan with reasons for changes.

Record of Significant Changes

- ✚ Explains why the significant changes were made.
- ✚ Reflects the final strategy and audit plan adopted.
- ✚ Shows appropriate response to changes during the audit.

Audit Programme (performing audit procedure / Application of detailed audit plan)

- ✚ Evolving One Audit Programme is Not practicable for All Businesses - Nature, size, and composition of businesses vary.
- ✚ Assistants Keep an Open Mind for Changes

- Additions: As experience is gained, the programme may be altered to include relevant situations initially left out.
- Deletions: Work deemed unnecessary or irrelevant may be dropped.
- Assistants engaged in the audit are encouraged to - maintain an open mind beyond the given programme.
- Note and report significant matters to seniors or partners of the audit firm.

✚ Periodic Review of Audit Programme – Review the audit programme throughout the audit process to keep it up-to-date.

✚ Constructing Audit Programme – steps

1. Stay within scope & limitation of assignment.
2. Prepare a written audit programme to perform the audit plan.
3. Determine the evidence reasonably available & identify best evidence.
4. Include only relevant steps for specific verification purposes.
5. Specify audit objectives and detailed instructions for assistants.
6. Anticipate all possible errors.
7. Coordinate procedures for related items.

Audit Programme is Designed to provide Audit Evidence

- * Audit Evidence may be defined as the information used by auditor in arriving at the conclusions on which the auditor's opinion is based.
- * After obtained the evidence, the auditor shall rank the evidence by performing multiple procedures.

Advantages of Audit Programme

- ✚ Provides assistants with a clear set of instructions for the work to be done.
- ✚ Offers a total perspective of the audit, especially for major audits.
- ✚ Enables selection of assistants based on capabilities when work is well-planned and segregated.
- ✚ Reduces the risk of ignoring records, ensuring that work proceeds in a systematic manner.
- ✚ Assistants accept responsibility by signing the programme, enabling traceability of work performed.
- ✚ Assists the principal in monitoring progress of audits by examining completed sections of the programme.
- ✚ Serves as a guide for subsequent year audits.
- ✚ Acts as evidence of due diligence in the event of charge against auditor, aiding in defence against charges of negligence.

Disadvantages

- ✚ Work may become mechanical, with assistants lacking an understanding of the audit's objectives.

- ✚ Programmes may become rigid and inflexible, failing to adapt to changes in business operations.
- ✚ Changes in staff or internal controls may necessitate alterations to the programme.
- ✚ Inefficient assistants might defend their work's deficiencies by blaming the absence of specific instructions.
- ✚ Rigid programmes may kill the initiative among efficient and enterprising assistants.

All these disadvantages can be eliminated

- ✚ Receptive Attitude - Foster a receptive environment for assistants to raise concerns and share observations.
- ✚ Encourage assistants to observe objectively and report significant matters to supervisors.

BASIC LEVEL

Case Study 1: Audit Strategy

You are appointed as the auditor of *Glow Max Industries Ltd.*, a company that manufactures LED lighting products. The company recently expanded its business to exports and introduced a new product line. As part of the preliminary discussions, management informs you that they've shifted part of their manufacturing to a new plant and are using a new inventory management system.

Question:

As an auditor, what factors will you consider while developing an

overall audit strategy, and how will these factors influence your audit approach?

Suggested Answer:

In developing the **overall audit strategy**, the auditor will consider:

1. Business Changes:

- Expansion to exports may introduce **foreign currency risks** and **new compliance requirements**.
- New product line may result in **valuation complexities** for inventory.

2. New Inventory System:

- The auditor must evaluate whether the **internal controls** around the new system are reliable.
- If not, more **substantive procedures** may be required instead of relying on controls.

3. New Manufacturing Plant:

- Risk of misstatement in **asset capitalization** and **depreciation**.
- May require **site visits** and review of fixed asset register.

4. Audit Team Competence & Resources:

- Need for a team member with knowledge of **export regulations** or **foreign exchange accounting**.

5. Timeline & Reporting Deadlines:

- Planning the audit calendar considering statutory deadlines and new audit areas.

Conclusion:

These considerations will guide the nature, timing, and extent of audit procedures, selection of team members, and development of the audit plan.

Case Study 2: Audit Planning

You are auditing *True Health Pharma Ltd.*, a medium-sized pharmaceutical company. During audit planning, you observe that sales for the current year have increased significantly due to the pandemic-related surge in demand. However, there is a large increase in receivables, with some overdue beyond 120 days.

Question:

As an auditor, how will this observation influence your **audit planning**? What steps will you include in the audit plan?

Suggested Answer:

The audit plan should be influenced in the following ways:

1. Risk Assessment:

- Rapid sales growth may lead to **revenue recognition risks**.
- High receivables may indicate **collection issues or misstatements**.

2. Materiality:

- Reassess **materiality levels**, especially for revenue and receivables.

3. Planned Procedures:

- Detailed testing of **cut-off procedures** and **credit policies**.
- **Aging analysis** of receivables and review of subsequent collections.

4. Increased Focus on Estimates:

- Examine **provision for doubtful debts**.
- Review assumptions and compare them with historical trends.

5. Analytical Procedures:

- Compare sales growth with industry trends to detect anomalies.

Conclusion:

The audit plan will need to allocate **more time** and **resources** for receivables and revenue areas, and include tailored procedures to address identified risks.

Case Study 3: Audit Programme

You are auditing *EcoSmart Appliances Ltd.*, a company that sells energy-efficient home appliances through online platforms and physical stores. You are drafting the audit programme for **inventory and cost of goods sold (COGS)**.

Question:

What specific procedures would you include in the **audit programme** for inventory and COGS, and why?

Suggested Answer:

The audit programme should include the following procedures:

1. Inventory:

- **Physical verification:** Attend stock counts at both warehouses and showrooms.
- **Cut-off testing:** Check that inventory movements around year-end are recorded in the correct period.
- **Valuation testing:** Verify that inventory is valued at **cost or NRV**, whichever is lower.
- **Obsolete stock review:** Identify slow-moving items and ensure adequate provisions are made.

2. COGS:

- **Recalculate COGS:** Verify using formula:
$$\text{Opening Stock} + \text{Purchases} - \text{Closing Stock} = \text{COGS}$$
- **Vouching purchase invoices and freight charges** to ensure correct costs are included.
- **Analytical review:** Compare gross profit margins with previous years and industry averages.

Conclusion:

The audit programme ensures that inventory and COGS are **accurately recorded and fairly presented**, helping in identifying valuation and classification issues.

INTERMEDIATE LEVEL

Case Study 1: Audit Strategy

You are appointed as the auditor of *SpeedBuild Infra Ltd.*, a construction company engaged in multiple government contracts. The company operates in different states and follows a percentage-of-completion method for revenue recognition. There have been recent changes in GST rules for the construction industry.

Question:

What key elements will you consider while formulating the **audit strategy** for this client? How will you tailor your strategy considering the industry-specific risks?

Suggested Answer:

Key Elements to Consider in Audit Strategy:

1. Industry-Specific Risks:

- Construction contracts have **long durations**, involve **estimates**, and have **complex revenue recognition**.
- Change in GST rules adds **regulatory compliance risks**.

2. Revenue Recognition under Percentage-of-Completion:

- High risk of **misstatement** due to estimation of work completed, cost-to-complete, etc.
- Strategy must include assessing **management's assumptions and judgments**.

3. Multi-location Operations:

- Strategy should include **site-specific audit procedures**, especially where high-value projects are underway.
- Coordination between teams across locations may be needed.

4. Internal Control Systems:

- Evaluate if **project-level budgeting, cost tracking, and invoicing** systems are reliable.
- If not, strategy will lean towards more **substantive procedures**.

5. Specialist Involvement:

- May consider involving a **technical expert** to evaluate progress certificates or project costing accuracy.

Tailoring the Strategy:

- The strategy will have a **risk-based approach**, focusing on revenue and compliance.
- **Time and resources** will be allocated heavily to estimation areas and locations with complex contracts.

- **Frequent communication with the client** about changes in laws and accounting treatment is planned.

Case Study 2: Audit Planning

You are planning the audit of *FreshHarvest Agro Pvt. Ltd.*, which exports perishable goods to the Middle East. During preliminary inquiries, you learn that the company uses third-party cold storage facilities and has recently changed its export documentation and billing process.

Question:

As the auditor, what specific aspects would you include in your **audit plan** to address the business risks and ensure a reliable audit?

Suggested Answer:

Key Inclusions in Audit Plan:

1. Understanding New Billing & Documentation Processes:

- Evaluate if the changes have affected **revenue cut-off** or **recognition timing**.
- Plan walkthroughs and controls testing for the new system.

2. Third-Party Cold Storage Risk:

- Plan to obtain **external confirmations** from third-party storage providers.
- Assess if any **significant inventory losses** or damages have occurred.

3. Valuation of Inventory (Perishables):

- Plan detailed procedures for **valuation and provisioning** for perishables nearing expiry.
- Include **site visits**, review of **storage temperature records**, and sample checks.

4. Export Transactions:

- Plan to verify **shipping documents, customs clearance, and foreign currency transactions**.
- Analytical procedures to compare with prior years and gross margins.

5. Internal Controls and Risk Assessment:

- Focus on controls over **export billing, exchange rate fluctuations, and freight charges**.

Conclusion:

The plan will focus on **inventory risk, documentation changes, and export-related compliance**, with testing designed accordingly.

 **Case Study 3: Audit Programme** - You are auditing *DigitalNest Edutech Ltd.*, a company offering online courses and certifications. The company earns revenue from course subscriptions, partnerships with universities, and digital advertisements. You are preparing the audit programme for **revenue and related receivables**.

Question:

What specific audit procedures will you include in your **audit programme** for verifying revenue and receivables, and why?

Suggested Answer:**Audit Procedures for Revenue:****1. Subscription Revenue:**

- **Recalculate deferred revenue** for unexpired subscriptions.
- Test sample transactions for correct **period recognition**.

2. University Partnerships:

- Review **agreements/MOUs** to understand revenue-sharing terms.
- Match revenue with **course enrollments and actual usage**.

3. Advertisement Revenue:

- Verify **contracts with advertisers**, rate per click/view.
- Test with platform analytics to validate number of impressions/clicks.

4. Cut-off Testing:

- Examine transactions around year-end to ensure correct period recognition.

5. Receivables Testing:

- Send **external confirmations** to universities and ad clients.

- Perform **aging analysis** and assess **allowance for doubtful debts**.

6. Analytical Review:

- Compare revenue growth across revenue streams.
- Investigate significant variations with expected trends.

Conclusion:

The audit programme is designed to test **accuracy, occurrence, and completeness** of revenue and ensure receivables are **recoverable and fairly stated**.

EXAM LEVEL

◆ Case Study 1: Audit Strategy (Exam-Level)

You are appointed as the statutory auditor of *SwiftMove Logistics Ltd.*, a logistics company offering warehousing and fleet transport services across India. The company has recently expanded its services to include same-day delivery for e-commerce clients. You are in the process of finalizing your **overall audit strategy**.

Question:

Identify and explain **FOUR key considerations** you would include in your overall audit strategy, considering the changes in business operations.

Also, mention **how these considerations will influence your audit plan**.

Suggested Answer:

Key Considerations in Audit Strategy:

1. Business Expansion to Same-Day Delivery:

- May involve changes in revenue recognition policy, possibly shifting from delivery-based to contract-based milestones.
- **Influence:** Increased focus on new revenue streams and testing whether the revenue is recognized properly as per Ind AS/AS.

2. Internal Control Environment:

- Assess whether control systems are in place for new delivery models (e.g., GPS tracking, delivery confirmations).
- **Influence:** Strategy may shift from control reliance to substantive testing if systems are weak.

3. Multiple Warehousing Locations:

- Involves inventory holding risk, especially in transit.
- **Influence:** Auditor may plan physical verification of inventories or rely on third-party confirmations.

4. Complex Contracts with E-Commerce Clients:

- Risk of misstatement in terms of obligations, penalties, and discounts.

- **Influence:** Audit plan will include review of major contracts, terms, and timing of revenue recognition.

◆ Case Study 2: Audit Planning (Exam-Level)

You are auditing *Aristo Media Ltd.*, a media production company. The company earns income through film production, music licensing, and online streaming. During audit planning, you notice that the company has reported an increase in intangible assets under development and capitalized significant advertisement expenses.

Question:

As an auditor, how will you respond to these observations in your **audit planning process**? Mention at least **four audit planning steps** you would take, with brief reasoning.

Suggested Answer:

1. Risk Assessment of Intangibles:

- Capitalization of costs like script development or licensing fees involves significant judgment.
- **Planning Step:** Obtain schedules of intangible assets under development and review capitalization criteria.

2. Testing Capitalized Advertisement Costs:

- Advertising is generally treated as an expense unless it meets specific recognition conditions.
- **Planning Step:** Verify if costs meet AS-26/Ind AS 38 criteria. If not, plan to reclassify during audit.

3. Understanding Internal Controls:

- Check controls over approvals for capitalization and cost classification.
- **Planning Step:** Perform walkthroughs to understand approval hierarchies and authorization.

4. Planning Materiality & Resources:

- Capitalized costs could be material; may affect profit significantly.
- **Planning Step:** Determine revised materiality and assign team members with experience in IP-based industries.

◆ Case Study 3: Audit Programme (Exam-Level)

Scenario:

You are preparing the audit programme for *GreenLeaf Organics Ltd.*, a company involved in organic farming and direct-to-consumer sales. The company operates via an e-commerce portal, mobile app, and retail stores. You are responsible for verifying **Sales and Receipts**.

Question:

Draft **FOUR specific audit procedures** you would include in your **audit programme** for sales and receipts, addressing **risks of overstatement or fictitious sales**.

Suggested Answer:

1. Test of Controls over E-Commerce Portal:

- Verify that all orders are automatically recorded through the portal and matched with payment gateways.
- Helps in checking **completeness and accuracy** of online sales.

2. Sample Vouching of Sales Transactions:

- Select sample invoices and match with dispatch records, customer acknowledgments, and receipts.
- Prevents **fictitious sales or revenue overstatement**.

3. Cut-Off Testing:

- Review transactions near year-end to ensure sales are recorded in the correct period.
- Helps detect **early recognition of revenue**.

4. Reconciliation of Payment Gateway Receipts:

- Match portal sales with bank credits and third-party payment settlements.
- Ensures **existence and accuracy of cash receipts**.

AUDIT DOCUMENTATION

Meaning

Audit Documentation refers to the record of:

- ✚ Audit procedures **performed**.
- ✚ Relevant audit **evidence obtained**.
- ✚ **Conclusions reached** by the auditor.

Also known as “working papers” or “work papers”.

Objective of the Auditor

The auditor’s objective is to prepare documentation that provides:

- ✚ A **sufficient and appropriate** record supporting the basis for the auditor’s report.
- ✚ Evidence that the audit **was planned and performed** in accordance with:

✓ Standards on Auditing.

✓ Applicable legal and regulatory requirements.

Nature of Audit Documentation

- Evidence for Conclusions:** Evidence of the auditor’s basis for conclusions about achieving the overall audit objectives.
- Evidence for Compliance with SAs:** Evidence that the audit was planned and performed as per SAs and applicable legal and regulatory requirements.

Purpose of Audit Documentation

- ✚ Assists the engagement team to plan and perform the audit.
- ✚ Helps team members to direct, supervise and review the audit work effectively.
- ✚ Ensures the engagement team is accountable for its work.
- ✚ Retains a record of matters important for future audits.
- ✚ Enables quality control reviews and inspections as per SQC 1.
- ✚ Facilitates external inspections as per applicable legal or regulatory requirements.

Form, Content and Extent of Documentation

The auditor must prepare audit documentation so that an experienced auditor with no prior connection with the audit, to understand:

- ✚ The nature, timing, and extent of the audit procedures performed.
- ✚ The results of procedures and the audit evidence obtained.
- ✚ Significant matters, conclusions reached, and professional judgments made.

In documenting the Nature, Timing, and Extent (NTE) of audit procedures, the auditor must record:

- ✚ The identifying characteristics of specific items tested.
- ✚ Who performed the work and the date of completion.
- ✚ Who reviewed the work, including the date and extent of the review.

Document **discussions of significant matters**, including:

- ✚ The **nature** of the matters discussed.
- ✚ **When and with whom** the discussions occurred.

If **information inconsistent** with the final conclusion is identified, document **how the inconsistency was addressed**.

Factors Affecting Documentation - The form, content, and extent of documentation **depend on**:

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

Audit Documentation **can be recorded** on paper, electronic media, or other forms.

Examples include:

- ✚ **Audit programmes** outlining planned procedures.
- ✚ **Analyses** of financial information.
- ✚ **Memoranda** regarding significant issues.
- ✚ **Summaries** of key significant matters.

- ✚ Confirmation letters and letters of representation.
- ✚ Checklists used for audit procedures.
- ✚ Correspondence (including emails) concerning significant matters.

The auditor **may include copies** of entity records as part of audit documentation. Examples:

- ✚ Significant contracts and agreements.
- ✚ Audit documentation does not replace the entity's accounting records.

The auditor **need not include**:

- ✚ Superseded drafts of working papers or financial statements.
- ✚ Notes showing incomplete or preliminary thinking.
- ✚ Previous versions corrected for typographical errors or other minor corrections.
- ✚ Duplicate copies of documents.

Audit File

An audit file is **one or more folders** or storage media (physical or electronic) containing the audit documentation for a specific engagement.

Timely Preparation of Documentation

- ✚ The auditor must prepare audit documentation on a **timely basis**.

- ✚ Timely preparation **enhances audit quality** and supports effective review and evaluation before finalizing the auditor's report.
- ✚ Documentation **prepared after the work is done** is likely to be **less accurate** than when prepared during the audit.

Assembly of Final Audit File

Timely Basis: The final audit file must be assembled and completed timely after the auditor's report date.

SQC 1 Requirement: SQC 1 requires firms to **establish policies** and procedures for timely completion of the audit file assembly.

Audits - 60 Days Limit: The time limit to complete the final audit file is usually **no more than 60 days** after the auditor's report date.

Administrative Process: The final file assembly is an administrative process and **does not involve new audit procedures** or conclusions. Changes are only administrative, such as:

- Deleting or discarding superseded documentation.
- Sorting, collating, and cross-referencing working papers.
- Signing off on checklists related to file assembly process.
- Documenting audit evidence obtained, discussed, and agreed upon before the auditor's report date.

Retention of Documentation

- ✚ After the final audit file is assembled, the auditor **shall not delete** or discard documentation before the retention period ends.
- ✚ SQC 1 requires firms to have policies for the **retention of** audit documentation.
- ✚ The retention period for audit files is typically **no shorter than 7 years** from the auditor's report date or the group auditor's report date, whichever is later.

Audit Summary Memorandum Content

Purpose of Summary (Completion Memorandum) The auditor may prepare a summary (also called a **completion memorandum**) as part of the audit **documentation that describes**:

- The **significant matters** identified during the audit.
- How those significant matters were addressed.**

Benefits of Summary

- ✓ A summary can help in the **effective and efficient review** and inspection of audit documentation, especially for **large and complex** audits.
- ✓ It also helps the auditor in considering and **addressing the significant matters.**

Achievement of SA Objectives

- ✓ The summary may **help** the auditor to evaluate **whether any individual SA objective** that has **not been achieved.**

- ✓ This is important to ensure the auditor achieves the overall objectives of the audit.

Ownership of Documentation

As per SQC 1, audit documentation is **the property of the auditor**, unless stated otherwise by law or regulation.

The auditor may **at his discretion** share portions or extracts of documentation with clients, provided it **does not**:

- ✓ Undermine the validity of the work performed.
- ✓ Affect the auditor's independence in assurance engagements.

BASIC LEVEL



Case Study 1: Misplaced Supporting Document

Question: You are assisting in the audit of XYZ Pvt Ltd. While reviewing the audit documentation related to purchases, you find that the invoice supporting a major purchase transaction is missing from the file. The audit senior says it was verified earlier, but it's not in the current working papers. What should you do, and what is the implication on audit documentation?

Suggested Answer:

You should immediately bring the missing document to the attention of the audit senior. According to SA 230 (Audit Documentation), audit working papers should be complete and should contain sufficient

appropriate audit evidence to support the auditor's conclusions. In this case, the missing invoice should either be re-obtained from the client or, if already verified, details of the verification should be properly recorded, including the person who verified it and when. An explanatory note should be added if the document cannot be re-obtained. Absence of such documentation may lead to questions on audit quality and compliance.



Case Study 2: Use of Tick Marks Without Legend

Question: During the review of the audit file of ABC Ltd., you notice that several tick marks (✓, v, #, *) have been used in working papers for vouching and verification, but there is no legend or explanation provided for their meaning. What is the issue here, and how should it be resolved?

Suggested Answer:

This is a deficiency in audit documentation. As per SA 230, documentation should be understandable to an experienced auditor having no previous connection with the audit. Tick marks used in working papers must be explained in a legend or key to ensure clarity. The audit team should be instructed to prepare a proper tick mark legend and ensure all symbols used in working papers are defined. This ensures that anyone reviewing the file can understand the nature and extent of procedures performed.

Case Study 3: Post-Dated Adjustment in Working Papers

Question: While finalizing the audit documentation for PQR Ltd., you observe that a journal entry dated after the audit report date has been inserted into the working papers. There is no explanation or sign-off. Is this acceptable? What steps should be taken?

Suggested Answer:

No, this is not acceptable. According to SA 230, audit documentation must not be altered after the audit file has been finalized (within 60 days of the report date). Any additions must be clearly documented as **subsequent changes**, with the date of addition, the reason, and the person making the change. In this case, you should verify whether the change was authorized and made before the documentation completion date. If it was made later, it should be properly documented in accordance with SA 230. Unauthorized post-dated changes may affect the integrity of the audit documentation.

INTERMEDIATE LEVEL

Case Study 1: Conflict Between Team Members' Documentation

Question: During the audit of LMN Ltd., the audit manager finds two conflicting conclusions in the audit working papers related to revenue recognition. One set of working papers prepared by the audit assistant indicates sufficient evidence of revenue recognition as per Ind AS 115, while a review note by the audit senior on another page mentions

concerns about improper cut-off. Both documents are signed and dated, but the final conclusion in the audit report is silent on any issue.

As a team member reviewing this file, how should this inconsistency be handled? What are the implications under SA 230?

Suggested Answer:

Such inconsistencies in audit documentation can compromise the quality and credibility of the audit. SA 230 requires that audit documentation should clearly reflect who performed the work, the conclusions drawn, and whether those conclusions are supported by sufficient appropriate audit evidence.

Here, the following actions should be taken:

- **Investigate the inconsistency** by discussing with both the assistant and the senior to understand why their conclusions differ.
- **Evaluate which conclusion is appropriate** based on available evidence.
- **Update the working papers** with a final conclusion that is justified by evidence, clearly stating why one conclusion was accepted over the other.
- **Document the resolution** of the inconsistency, along with the reviewer's notes.

Failing to resolve such differences may indicate inadequate supervision and review, which is a violation of auditing standards.

■ Case Study 2: Confidential Information in Audit File

Question: While reviewing audit documentation of a listed company, QRS Ltd., you find detailed working papers related to a pending acquisition deal disclosed to the audit team under strict confidentiality. These documents are not yet public, but they are stored in the general audit file, accessible to all staff in the firm.

Is this appropriate? How should such sensitive information be documented according to professional standards?

Suggested Answer:

No, it is not appropriate to store confidential or sensitive client information in a general access area of the audit file. As per SA 230 and the Code of Ethics, auditors are obligated to maintain client confidentiality and ensure that sensitive data is safeguarded.

The correct approach:

- Store such confidential documentation in a **restricted-access folder** or file, with access limited to senior personnel involved in that specific audit.
- Document the nature of the information, the reason for restricted access, and who has reviewed it.
- Reference this restricted file in the general audit file (e.g., "Refer Confidential Folder A1 for acquisition-related documents").

This ensures both compliance with documentation requirements and protection of client confidentiality.

■ Case Study 3: Use of Oral Explanation as Audit Evidence

Question: During the audit of XYZ & Co., you identify an unusual loan transaction. The client CFO orally explains that the loan is a short-term arrangement between group companies and will be reversed within a month. There is no agreement, board resolution, or email trail. The audit assistant documents this oral explanation in the working paper and concludes that no further action is needed.

Is this documentation sufficient? What should be the auditor's approach here?

Suggested Answer:

No, this is not sufficient. As per SA 230, oral explanations **alone** do not constitute adequate audit documentation, although they may be used to clarify or support other written evidence. SA 500 also requires audit evidence to be **sufficient and appropriate**—which generally means **written documentation** for material transactions.

The correct approach:

- Request and obtain written confirmation or supporting documents—such as a **loan agreement, board resolution**, or at least **email communication**.
- If the client cannot provide it, the matter should be **escalated to the audit senior/partner** for a risk-based evaluation.
- Document the client explanation, but also record the **limitation of audit evidence** and consider the impact on the audit opinion (e.g., potential **emphasis of matter** or **qualification**).

Relying solely on oral explanations without corroborating evidence may result in **audit failure or disciplinary action**.

EXAM LEVEL

◆ Case Study 1: Late Alteration of Audit File

Question: The audit of DEF Ltd. was completed, and the audit report was signed on 15th May 2024. While conducting an internal quality review on 20th July 2024, it was found that a team member had added a new working paper (dated 18th July) related to impairment testing of goodwill, without marking it as a post-completion addition. The file was finalized and archived by 10th July 2024.

Analyse the situation from the perspective of SA 230. What are the auditor's responsibilities in such a case, and how should the situation be handled?

Suggested Answer:

Violation of SA 230:

- As per SA 230, audit documentation **must be completed within 60 days** from the date of the auditor's report (i.e., by 14th July 2024 in this case).
- After finalization, **no audit documentation can be deleted or altered**, only **additions with proper explanation** (including date, person responsible, and reason for addition) are permitted.

- The new working paper dated **18th July** was added **after finalization (10th July)** and **without proper marking** as a subsequent addition, violating the standard.

Responsibilities:

- The engagement partner should investigate and determine whether this was an isolated mistake or deliberate.
- The working paper must now be marked clearly as **post-completion documentation**, with a proper note explaining:
 - Why it was added,
 - The person responsible,
 - The date of addition, and
 - Whether it affects the audit opinion.
- If it indicates a **previous audit deficiency**, a **reassessment** of the audit opinion may be necessary.

Conclusion: This situation reflects **non-compliance** and potentially a **breach of ethical standards** if done intentionally.

Case Study 2: Third-Party Working Papers in Audit File

Question: During the audit of MNO Ltd., the audit team engaged an external valuation expert to assess the fair value of investment properties. The expert provided a detailed report with their conclusion and assumptions. The report was filed directly into the audit documentation without any further auditor commentary or analysis.

As per SA 230 and other relevant SAs, evaluate whether the audit documentation is sufficient and appropriate. What additional steps should the audit team have taken?

Suggested Answer:

Assessment under SA 230 and SA 500 (Audit Evidence):

- Merely placing an expert's report in the file **does not constitute sufficient documentation**.
- The auditor must **evaluate the competence, capabilities, and objectivity** of the expert (SA 500).
- The auditor must also:
 - **Understand the assumptions and methods** used by the expert,
 - **Assess the relevance and reasonableness** of those assumptions,
 - **Document how reliance was placed** on the expert's work,
 - And draw **independent conclusions** on whether the valuation supports the financial statement assertions.

Deficiency:

- No documentation of the auditor's **evaluation process**, judgment, or conclusion about the expert's work.
- Absence of commentary implies **blind reliance**, which is against the principle of **professional skepticism**.

Correct Approach:

- Prepare a memo summarizing:
 - Credentials of the expert,
 - Summary of the work performed,
 - Key assumptions reviewed,
 - Auditor's conclusion on reasonableness,
 - How the report supports audit opinion.

Conclusion: Without such documentation, the file is **incomplete**, and audit quality may be questioned.

Case Study 3: Undocumented Reliance on Internal Controls

Question: You are reviewing the audit documentation of a large manufacturing company, GHI Ltd. The audit team has placed significant reliance on the client's automated controls in the ERP system for inventory valuation. The working papers mention walkthrough procedures and observations but do not contain any evidence of testing the controls or system access logs. The audit report expresses an unmodified opinion.

You are assigned to assess whether the audit documentation complies with SA 230. What deficiencies do you identify, and what should have been done differently?

Suggested Answer:

Deficiencies Identified:

- **Lack of evidence of control testing:** Reliance on controls must be supported by **tests of controls**, as per SA 330. Merely performing walkthroughs or observations is **not sufficient** evidence.
- **Absence of documentation on the effectiveness of controls:** SA 230 requires that audit documentation must enable an experienced auditor to understand the **nature, timing, and extent** of procedures performed and conclusions reached.
- **No documentation of access control or IT environment:** For automated controls, reliance should be supported by **IT general controls (ITGCs)** evaluation.

Correct Approach:

- Document results of **control testing**, including sample size, results, and conclusion on effectiveness.
- Include supporting documentation such as **screenshots, system logs, or test reports**.
- If such testing was not performed, reliance on controls is **not justified**, and the auditor should have obtained **substantive evidence** instead.

Conclusion: The current documentation is insufficient and may result in **quality control issues** or **peer review findings**.

Ethics & terms

Definition of Ethics

- ✚ Ethics refers to **moral principles** that govern a **person's behaviour** or actions. It is the branch of knowledge that deals with moral principles.
- ✚ Ethics **comes from within an individual** and must be inculcated into their habit and temperament. It should be strong enough to resist selfish motives or temptations.
- ✚ Ethics is a **state of mind** that aligns actions with moral principles. It imposes obligations on individuals and is considered the science of morals in human conduct.

Need for Professional Ethics

1. Purpose of Assurance Engagements (to enhance the confidence of intended users)
2. Basis of Professional Ethics (place public good above personal gain, earning respect and honour)
3. Adherence to Ethics (how strictly professionals follow ethical standards through self-discipline)
4. Public Interest
5. Role of Chartered Accountants (CAs) (whether in practice or service, must adhere to ethical behaviours and follow the fundamental principles of ethics)

6. ICAI's Ethical Standards (requires members to comply with ethical principles)
7. Code of Ethics for CAs (follow the Code of Ethics in both practice and service)
8. Disciplinary Actions for Deviations.

Principles Based Approach Vs Rules Based Approach to Ethics

Principles-Based Approach

- In a principles-based approach, accountants must **comply with the spirit of ethics**. It requires the **use of professional judgment in every situation** based on knowledge, skill, and expertise to evaluate and reach conclusions.

Rules-Based Approach

- In a rules-based approach, accountants strictly **follow established rules**. This can be narrow in outlook and may overlook the spirit of ethics. It is also rigid, as **not all practical situations** can be handled by rules alone.

Observe the Spirit of the code

It is essential to follow the spirit of the code rather than just the letter of the rules to ensure ethical compliance in all situations.

Fundamental Principles of Professional Ethics (many times asked)

Integrity - straightforward, honest, fair dealing, truth, not knowingly rely on the false/misleading information.

Objectivity – Avoid while undue influence exists.

Professional Competence and Due Care – Complete knowledge& skill

Note: Accountants must attain & maintain the professional knowledge and skills at the level required to ensure that a client receives competent professional service.

Confidentiality – not to disclose information and not to share with 3rd parties.

Note: Confidential information may be disclosed only when: i. Required by law. ii. Permitted by law and authorized by the client or employer. iii. There is a professional duty or right to disclose when not prohibited by law.

Professional Behaviour – Avoid impairs act with integrity, objectivity & good reputation.

Independence of Auditors

✚ **Independence of mind** – without being affected by influences that compromise professional judgement.

✚ **Independence of appearance**

Note: Independence is dependent on the state of mind & character of a person & is a very subjective matter.

Threats to Independence (many times asked)

A. Self-Interest

Threats Occurs when the auditing firm or any partner benefits from a **financial interest** in the audit client.

Examples:

- ✚ Direct financial interest or materially significant indirect financial interest in the client.
- ✚ Loan or guarantee to/from the client.
- ✚ Dependence on client fees, risking loss of the engagement.
- ✚ Close business relationship with the client.
- ✚ Potential employment with the client.
- ✚ Contingent fees for audit engagement.

B. Self-Review

Threats occurs when an auditor **reviews their own judgement** or conclusion from a previous audit or non-audit engagement.

Examples:

- When an auditor or team member was recently a director or senior officer of the company.
- When auditors perform services that are also subject to audit.

Note: Non-audit services include management services, internal audit, investment advisory, IT system design, etc.

C. Advocacy

Threats occurs when the auditor promotes a client's opinion to the point where **objectivity** may be perceived as compromised.

Examples:

- When an auditor deals with shares or securities of the audited company.
- When the auditor acts as the client's advocate in litigation or third-party disputes. In these situations, the auditor may be perceived as championing the client's cause, undermining objectivity.

D. Familiarity

Threat occurs when auditors become **too close to the client**, where they end up being too **sympathetic** to clients' interests.

Examples:

- Close family member working in senior position of the client.
- Former partner of the audit firm being a director or senior employee of the client.
- Long-standing relationships between specific auditors and client counterparts.
- Accepting significant gifts or hospitality from the client.

E. Intimidation

Threat occurs when auditors **are deterred from acting** objectively and with professional skepticism.

Examples:

- Threats of replacement due to disagreements on accounting principles.
- Pressure to reduce audit work to lower fees.
- Threats of litigation.

Safeguards to Independence

- ✚ Before accepting work, an auditor must assess whether it involves a threat to their independence.
- ✚ If threats to independence exist, the auditor should either withdraw from the task or take precautions to reduce the threats to acceptable level. Document the safeguard steps taken for evidence.
- ✚ If the auditor unable to apply credible safeguards to address threats, they must decline the work.

Professional Skepticism

It is an attitude of a questioning mind, being alert to unusual situations, and critical assessment of audit evidence.

Professional skepticism involves being alert to:

- ✚ Audit evidence that contradicts other evidence.
- ✚ Information questioning the reliability of documents or responses.
- ✚ Conditions indicating possible fraud. d. Need for additional audit procedures then required as per SA.

Maintaining skepticism reduces risks of:

- ✚ Overlooking unusual circumstances.
- ✚ Over-generalizing when drawing conclusions from audit observations.
- ✚ Making inappropriate decisions regarding audit procedures (nature, timing, extent).

SA 210 Agreeing the Terms of Audit Engagement

Scope

SA 210 deals with the auditor's responsibilities **in agreeing to the terms** of the audit engagement with management and, when applicable, those charged with governance. This **includes establishing preconditions** for the audit.

Objective

The auditor's objective is **to accept** or continue an audit engagement **only when:**

- The **preconditions** for the audit **are present**.
- There is a **clear and mutual understanding** between the auditor and management (and, where appropriate, those charged with governance) about the terms of the audit engagement.

Preconditions for an Audit

As per SA 210, preconditions include:

- ✓ Management **using an acceptable financial reporting framework** for the financial statements.
- ✓ **Agreement** by management and, where applicable, governance, **on the premise** of the audit.

Auditor's Responsibilities

The auditor must:

- a. **Determine** if the financial reporting framework **is acceptable**.
- b. Obtain **management's agreement** on:
 - i. Responsibility for **preparing** the financial statements in line with the framework, including fair representation.
 - ii. Responsibility for necessary **internal controls** to prevent material misstatement (fraud or error).
 - iii. Providing the auditor with:
 - ✓ **Access to all relevant information** (records, documents).
 - ✓ **Additional information** requested by the auditor.
 - ✓ **Unrestricted access** to necessary persons within the entity.

If Preconditions Are Not Present

If preconditions are missing, the auditor must:

- ✓ **Discuss** with management.
- ✓ Reject the audit engagement unless required by law or regulation, if:
 - a. The financial reporting framework is **unacceptable**.
 - b. Management **does not agree on their responsibilities** regarding financial statement preparation, internal controls, or access to information and people.

Limitation on Scope

If management or those charged with governance **impose a limitation that affects the auditor's ability** to form an opinion (e.g., leading to a disclaimer of opinion), the auditor **should not accept** such an engagement, unless required by law or regulation.

Change In Terms of Engagement as Per SA 210

The terms of the engagement may **change due to**:

1. **Change in circumstances**.
2. **Misunderstanding** of the terms originally agreed services.
3. A **restriction on the scope** of the engagement imposed by management or circumstances.

Acceptance of Change in Terms

The auditor **may accept** a change if:

1. If There is **reasonable justification** and the work complies with SAs.
2. The auditor and management **must agree and record the new terms in a new engagement** letter.

Note: To avoid confusion, The new report shall **not refer to the original engagement** and procedures in the original engagement.

3. Non-Acceptance of Change - The auditor **will not accept** changes if there is **no reasonable justification** for the modification of terms.

If the auditor cannot agree to the change or management doesn't allow continuing the original engagement:

1. The auditor **must withdraw** from the audit.
2. The auditor must **assess if there is any obligation to report** the circumstances to other parties (e.g., governance, owners, regulators).

✚ A **recurring audit** occurs when the previous year's auditor is reappointed for the current year.

The new engagement letter should be issued in recurring audits if:

- ✓ The entity **misunderstands** the objective or scope of the audit.
- ✓ There are **revised** terms of engagement.
- ✓ There is a **change** in **legal** or regulatory requirements.
- ✓ There is a **change** in the **financial reporting framework**.

- ✓ There is a **change in audit reporting requirements**.
- ✓ There is a **recent change in top management**.
- ✓ There is a **significant change in the nature** or size of the entity's business.

Audit Quality

Both SQC 1 and SA 220 deal with quality control:

- ✓ SQC 1 **applies to all types** of engagements (audits, reviews, other assurance services and related services) & applies to the entire firm
- ✓ SA 220 applies **only to specific** audit engagements.

Elements of the System of Quality Control - SQC 1

The firm's quality control system should address the following elements:

1. **Leadership responsibilities** for quality within the firm. (to promote an internal culture based on the recognition that quality is essential in performing engagements)
2. **Ethical requirements**. (Annually, the firm should obtain written confirmation of compliance with its policies & procedures on independence from all firm personnel)
3. **Acceptance and Continuance of client relationship**. (Before accepting or continuing an engagement, the firm must gather vital information about the client to assess:

- ✚ Integrity of the client.

- ✚ Competence, capabilities, time and resources of the firm to perform the engagement.
- ✚ Compliance with ethical requirements.

Note: The firm should document how issues are resolved when deciding to accept or continue a client relationship.

4. **Human resources.** (policies & procedures designed to provide reasonable assurance that the firm has sufficient personnel with capabilities, competence, and ethical principles to perform engagements in compliance with standards)

5. **Engagement performance.** (Consultation should take place in difficult or contentious matters with individuals inside or outside the firm. External consultation may be sought from other firms, professional bodies, or regulatory bodies for advisory services. Significant judgments should be reviewed by the engagement quality reviewer before the report is issued. The review does not reduce the responsibility of the engagement partner)

Note: Engagement quality control review is mandatory for all listed entities.

6. **Monitoring.** (Quality control policies must be documented and communicated to all personnel in the firm. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters)

SA 220 Quality Control for an Audit of Financial Statements

1. Leadership responsibility for quality on audits
 - ✚ Performing work that comply with professional standards and regulatory/legal requirements.
 - ✚ Comply with the firm's quality control policies.
 - ✚ Ensure the audit report is appropriate.
 - ✚ Encourage the team to raise concerns without fear of reprisal.
2. Relevant ethical requirements (same as SQC 1)
3. Acceptance and continuance of client relationships (same as SQC 1)
4. Assignment of engagement teams (same as SQC 1)
5. Engagement performance (same as SQC 1)
6. Monitoring

The engagement partner should document:

1. Ethical **issues identified** and their resolution.
2. **Compliance** with Independence related conclusions and relevant discussions.
3. **Conclusions reached** on Acceptance/continuance of client relationships.
4. **Consultation details**, including scope and conclusions.

BASIC LEVEL



Case Study 1: Client Insists on Removing Clause from Engagement Letter

Question: You are assisting in the audit of Alpha Ltd. While drafting the audit engagement letter, the client requests to **remove the clause** that mentions the auditor's right to access all financial records and explanations. The client says, "We trust you, so there is no need for this."

Should the auditor agree to this? What does this imply in terms of audit ethics and SA 210?

Suggested Answer:

No, the auditor **must not agree** to remove this clause. According to **SA 210**, one of the **preconditions for an audit** is that management must acknowledge and accept their responsibility to provide:

- Access to all relevant information,
- Unrestricted access to persons within the entity, and
- Additional information as requested.

Implication:

Removing such a clause would **limit the scope of the audit**, impair auditor independence, and violate the **fundamental principle of integrity**. The auditor should either:

- Explain the necessity of the clause, or

- Decline the engagement if the client refuses, as per ethical guidelines.

Case Study 2: Audit Fee Linked to Loan Sanction

Question: Beta Ltd., a start-up company, offers an audit assignment to your firm and proposes:

“We will pay your audit fee only if we successfully obtain a bank loan based on the audited financial statements.”

Can you accept this audit engagement as per the Code of Ethics?

Suggested Answer:

No, the auditor **cannot accept** an audit engagement where the **fee is contingent upon an outcome**, such as obtaining a loan.

Reason:

- The **Code of Ethics** prohibits acceptance of **contingent fees** in statutory audits because it **compromises independence** and may create **self-interest threats**.
- The auditor might be influenced (or appear to be influenced) to **modify audit procedures or opinion** to achieve the desired client result.

Conclusion:

This engagement must be declined or the terms renegotiated with a **fixed, non-contingent fee structure** to maintain professional ethics.

✓ Case Study 3: Previous Auditor Not Communicated

Question: You have been approached by Gamma Ltd. to conduct their statutory audit for the current year. Upon inquiry, you find out that another CA firm audited them last year. However, Gamma Ltd. asks you to begin work immediately and **not to contact the previous auditor**, citing “unpleasant history.”

What should you do?

Suggested Answer:

As per the **Code of Ethics (Part A - Professional Appointment)**:

- Before accepting the audit, the **incoming auditor must communicate** with the previous auditor to:
 - Understand the reasons for the change,
 - Inquire if there are any **professional reasons** not to accept the engagement.

Action:

- You must **refuse to begin work** until you have:
 - **Proper communication** with the previous auditor (preferably in writing),
 - Obtained **No Objection** and ensured that there are no ethical concerns.

Ignoring this requirement would be **unethical** and may attract disciplinary action.

INTERMEDIATE LEVEL

Case Study 1: Audit Engagement Without Signed Engagement Letter

Question: You are reviewing the audit file of a mid-sized company, Delta Technologies Ltd. The audit team began audit procedures based on verbal confirmation from the client's CFO, as the engagement letter was delayed due to "internal approvals." The audit report has been signed and issued, but still no signed engagement letter is on record.

Evaluate this situation in light of **SA 210**. What risks are involved, and what should the auditor have done differently?

Suggested Answer:

Issue:

- As per **SA 210**, the auditor must obtain a **written agreement** in the form of an engagement letter **before** commencing the audit.
- Starting an audit based only on **verbal assurance** violates this requirement.

Risks Involved:

- Lack of clarity on **scope of services, auditor responsibilities, and management responsibilities**.
- In case of a dispute or regulatory inquiry, there is **no legal protection** for the auditor.

- May lead to a **disciplinary issue** under the **Code of Ethics** for professional negligence.

Correct Approach:

- Auditor should have **insisted on a signed engagement letter** before starting work.
- In exceptional cases, if the audit had to begin early, there should have been at least **email confirmation** of the agreed terms, followed by a formal letter **before finalizing the report**.

Case Study 2: Close Relationship With Company Director

Question: You are a partner in a CA firm appointed as the statutory auditor of Omega Constructions Ltd. During the engagement, it is discovered that your brother-in-law has recently been appointed as the CFO of the company. You are not in close contact with him personally, but he is now part of the management.

Is your independence impaired? What should you do under the **Code of Ethics**?

Suggested Answer:

Yes, your **independence is impaired** under the **Code of Ethics**, specifically under **Section 290 – Independence for Audit and Review Engagements**.

Why:

- **Close family members** include brother-in-law (depending on the definition used by ICAI and IFAC, interpreted broadly).

- Since the brother-in-law holds a **key managerial position (CFO)**, there is a **threat to independence**, even if personal contact is minimal.

Required Action:

- You must **disclose** the relationship to the firm's ethics committee (if applicable) or the engagement partner.
- The firm must evaluate whether **safeguards** (such as removing you from the engagement) can reduce the threat to an acceptable level.
- If not, the firm must **resign from the engagement** or **replace the engagement partner** to comply with ethical standards.

Case Study 3: Client Insists on Excluding a Subsidiary from Scope

Question: Theta Group appoints you as their statutory auditor. In the engagement discussion, the Group CEO insists that one of their subsidiaries—Theta Asia Pte Ltd (based in Singapore)—should be **excluded from the audit scope** due to "local confidentiality concerns." You're told to only audit the Indian operations.

Can you accept such a limitation as part of the terms of audit engagement under SA 210? How should you proceed?

Suggested Answer:

No, you should not accept an engagement with a **limitation on scope** that prevents you from obtaining sufficient appropriate audit evidence for **consolidated financial statements**.

As per SA 210:

- The auditor should **not accept an audit engagement** if **management imposes a scope limitation** that could result in a disclaimer of opinion **before the audit even begins**.

Implications:

- Accepting such an engagement risk issuing an **inappropriate audit opinion**.
- It also violates the principle of **professional competence and due care** under the **Code of Ethics**.

Correct Approach:

- Explain to the client that if the subsidiary is **material to the group**, it **must be audited** (either by you or a component auditor).
- If management refuses, you should **decline the engagement** or **issue a modified opinion** due to scope limitation if the audit is forced to proceed.

EXAM LEVEL

◆ Case Study 1: Pressure to Sign Backdated Engagement Letter

Question:

You are the audit manager in a firm appointed to audit the financial statements of **Zephyr Ltd.** for FY 2024–25. Due to internal delays, the engagement letter was finalized and signed on **30th June 2025**, after

substantial audit work was already completed. The client now insists that you **backdate** the engagement letter to **1st April 2024**, citing “internal documentation protocols” and says, “It’s just a formality—everything was verbally agreed.”

As an audit professional, how should you respond? What are the implications under SA 210 and the Code of Ethics?

Suggested Answer:

Backdating an engagement letter is unethical and potentially illegal.

As per **SA 210**, the **engagement letter must be signed before commencement** of audit work to clearly establish:

- Responsibilities of both auditor and management,
- Scope and objectives of audit,
- Basis for audit fee, etc.

Implications under the Code of Ethics:

- Backdating constitutes **false documentation**, violating the principles of **integrity and professional behaviour**.
- It may result in **disciplinary action**, and could impact legal proceedings if audit evidence is questioned later.

Correct Action:

- You must refuse to backdate the letter.

- Instead, document the **actual date of signing** and prepare a separate **memo explaining when the work began**, what was agreed verbally, and why the engagement was formalized late.
- Consider issuing a **modified audit opinion** if scope or risk was affected due to the delayed agreement.

◆ Case Study 2: Familiarity Threat Due to Long Association

Question:

You are a partner who has been conducting the statutory audit of **Nova Textiles Ltd.**, a listed company, for the last **10 consecutive years**. While preparing for the next audit cycle, the internal quality reviewer raises concerns about **long association** and potential **familiarity threats**. You argue that you know the client well and your efficiency helps reduce time and cost.

As per the Code of Ethics and relevant SAs, what should be your response? Can you continue as the engagement partner?

Suggested Answer:

Under the **Code of Ethics (Revised by ICAI and aligned with IFAC guidelines)**:

- For **listed entities**, **rotation of audit partner** is mandatory after a **prescribed number of years** (usually **7 years** for engagement partners).

- Continuing beyond this period without rotation creates a **familiarity threat**, which may impair independence **in appearance** and **in fact**.

Therefore:

- You must **step down as engagement partner** for Nova Textiles Ltd. and ensure that a **cooling-off period** (typically 5 years) is followed.
- Your argument regarding efficiency does not override ethical obligations. Independence is **not just about objectivity**, but also about being perceived as objective.
- Your firm may continue as auditor if audit partner rotation is implemented in compliance with **Companies Act, 2013** and **ethical standards**.

◆ Case Study 3: Conflict Between Client's Legal Advice and Auditor's Judgment

Question:

You are auditing **Epsilon Pharmaceuticals Pvt. Ltd.**. The company has a significant pending litigation regarding a patent infringement suit. The management has obtained a legal opinion stating that the chance of losing the case is “remote,” so no provision is made.

However, during your review, you come across an internal email where the company's legal counsel mentions that a recent hearing went **unfavourably**, and the court appears to be leaning toward the plaintiff. Management insists that you rely only on the formal legal opinion.

How should you proceed? Can you solely rely on the legal opinion under SA 210 or the Code of Ethics?

Suggested Answer:

As an auditor, your responsibility is to **exercise professional skepticism** and obtain **sufficient appropriate audit evidence**, as per **SA 500** and **SA 210**.

Key Points:

- You cannot **blindly rely** on formal legal opinions if **contrary evidence** exists (e.g., internal emails).
- The auditor has an obligation under the **Code of Ethics** to demonstrate **objectivity**, even when evidence conflicts with management assertions.

Your action should be:

- Reassess the **audit evidence** in light of the internal email.
- **Seek a revised legal opinion** or **direct clarification** from the in-house legal counsel.
- Consider whether a **provision or disclosure** under AS/Ind AS is now required.
- If management refuses to update their assessment and suppresses evidence, evaluate the impact on the audit opinion—this may lead to a **modified opinion** (qualified or adverse), and even **reporting under CARO or fraud clauses**.

State reasons for the differences

If alternative
is NOT Possible



MODIFY OPINION
(As per SA 705)

Physical verification Date



On the Date of Financial Statements



Other than Financial
Statements date



State reason for
SIGNIFICANT difference
between perpetual
inventory records &
actual inventory count.

CA updates

To planned for attendance at physical verification consider the following:

- ✚ Nature of Inventory
- ✚ Stae of completion
- ✚ Risk related to inventories

- ✚ Internal control of inventory
- ✚ Location of inventory
- ✚ Timing of physical verification
- ✚ Assistance of auditor's expert

NOTE: The matter of **inconvenience** to the auditor, is **not sufficient** to support the decision by the auditor **that attendance is impracticable**.

Further, the auditor cannot omit the audit procedure on the basis of the matter of **difficulty, time or cost involved** is **not** in itself is **valid**.

When the inventory lying at the 3rd party's control (only such inventory is material to financial statement)

The auditor shall do –

- ✚ Request confirmation from 3rd party regarding the quantity & conditions of inventory.
- ✚ Perform inspection (if possible) or perform other audit procedure.

Other audit procedure include –

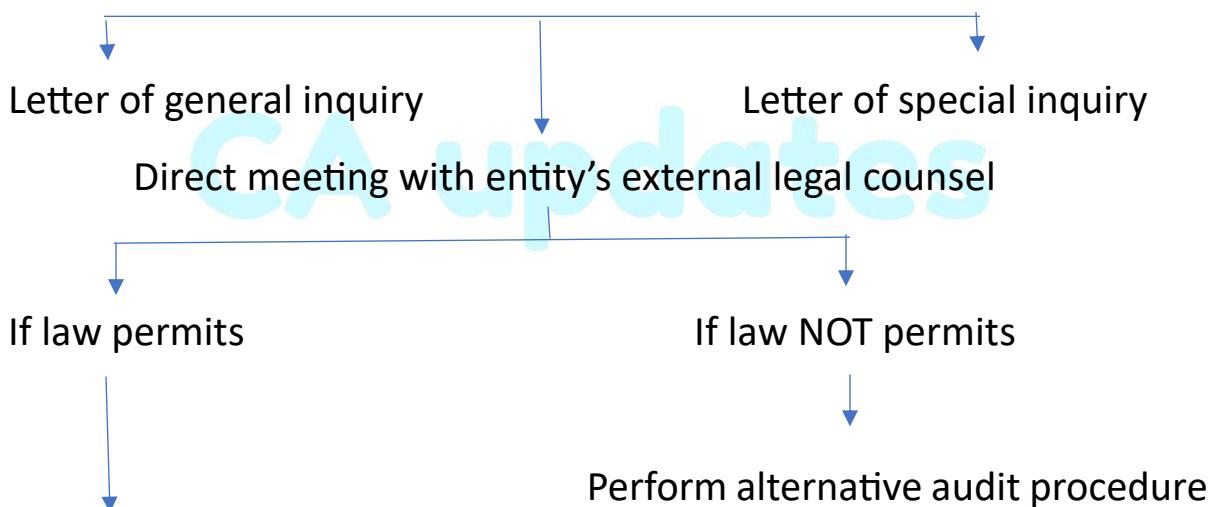
- ✓ Inspecting documentation.
- ✓ Requesting confirmation if inventory pledged as collateral to other party.
- ✓ Attending or arranging other auditor to attend 3rd parties physical count (if practicable).
- ✓ Obtaining another auditor report regarding 3rd party's internal control is adequate to ensure that inventories are properly counted & safeguarded.

Litigation and claims

To determine whether risk of MMS (Material Mis Statement) exist,

- ✚ Inquiry with Management & TCWG (Those Charged With Governance) & in-house legal counsel.
- ✚ Read the minutes of meeting between entity & External legal counsel.
- ✚ Review legal expenses account.

If risk of MMS exists, obtain Confirmation from entity's external legal counsel



It performed only in case of

- ✚ High risk involved.
- ✚ Disagreement between entity & external legal counsel.
- ✚ Matter is complex.

MODIFY OPINION

- ✚ If Management **did NOT provide permission** to make the direct meeting with external legal counsel (adverse opinion).
- ✚ External legal counsel **refuses to respond** (adverse opinion).
- ✚ **Unable to obtain** sufficient appropriate audit evidence by performing alternative audit procedure (Disclaimer of opinion).

Letter of special inquiry includes-

- ✚ List of litigation & claims,
- ✚ Management's assessment of the outcome of each of identified litigation & claims and its estimate of the financial implications,
- ✚ Request the entity's external legal counsel to confirm the reasonableness of the management's assessment and
- ✚ Further provide the auditor with information if the list is considered as incomplete or incorrect by the entity's external legal counsel.

Segment Information

Obtain sufficient appropriate audit evidence regarding presentation & Disclosure of segment information –

- ✚ **Understand the method** used by management to determine segment information.
- ✚ **Evaluate** whether the **method used in accordance** with applicable financial reporting framework.
- ✚ **Testing the application** of such method.

BASIC LEVEL

✓ Case Study: Physical Inventory Observation at Multiple Locations

You are assisting in the audit of **Crystal Traders**, a company dealing in consumer electronics. The company has three warehouses located in Mumbai, Delhi, and Hyderabad. The inventory count is scheduled for the **same day** at all three locations.

Your audit team has limited resources and can only be present at **one location**. Management assures you that they will share the count sheets and videos from the other two locations.

As per **SA 501**, how should the auditor handle this situation? Is it sufficient to rely only on management's representation and video recordings?

Suggested Answer

No, it is not sufficient to rely solely on **management representations** and **video recordings** for physical inventory verification.

Under **SA 501 – Audit Evidence – Specific Considerations for Selected Items**, when inventory is **material to the financial statements**, the auditor is required to:

- **Attend the physical inventory count** (unless impracticable),
- Evaluate **management's instructions and procedures**,
- Observe the **counting process**,
- Perform **test counts**, and

- Inspect inventory.

In this case:

- Since all three locations are conducting inventory on the same day, and the auditor cannot attend all, they should:
 - Attend the count at **one location**,
 - Consider using a **component or branch auditor** or engage a **qualified third party** to attend at the other two locations, OR
 - Perform **alternative procedures** (e.g., post-year-end purchases/sales, stock reconciliation) to gain sufficient appropriate audit evidence.

Conclusion:

- Management's assurance and video are **not a substitute** for physical attendance unless attending is **impracticable**, in which case the auditor must **document reasons** and **perform alternative procedures**.
- The auditor should assess **materiality and risk** before concluding on the sufficiency of the evidence.

INTERMEDIATE LEVEL



Case Study: Litigation and Claims Disclosure Discrepancy

You are auditing **Silverpoint Ltd.**, a company involved in real estate development. During the audit, you notice from Board Meeting

minutes that the company is facing a **dispute with a regulatory authority** for alleged violations in one of its projects. Management claims the issue is minor and has not disclosed it in the financial statements, stating:

“Our lawyer has verbally told us there’s nothing to worry about.”

However, when you review emails between the company and its legal advisor, you find that the lawyer had actually advised that the matter was still **under active review** by the tribunal, and there is a **reasonable chance of penalty or adverse order**.

As per **SA 501**, what should the auditor do in this situation regarding litigation and claims?

Suggested Answer :

As per **SA 501**, the auditor must obtain **sufficient appropriate audit evidence** regarding litigation and claims. Verbal representations or inconsistent evidence are **not sufficient**.

In this case:

- The email contradicts management’s claim, indicating a **reasonable chance of penalty**.
- Auditor should request a **written legal confirmation** directly from the company’s legal counsel.
- Evaluate whether a **provision or disclosure** is required under Ind AS/AS.

- If management refuses to provide sufficient evidence or appropriate disclosure, consider issuing a **modified opinion**.
- All findings and judgments must be **properly documented**.

EXAM LEVEL



Case Study: Physical Inventory and Suspected Manipulation

Question: You are the audit manager for the statutory audit of **Trio Components Pvt. Ltd.**, a manufacturer of automobile spare parts. The inventory is material to the financial statements and is held at the company's factory warehouse.

During the physical inventory observation, you notice:

- Several high-value items are sealed in boxes and **not opened for counting**, despite your team requesting to verify the contents.
- The warehouse manager insists:

"These boxes were packed just before the count and are from a new consignment. We haven't opened them either, but the value is as per the invoice inside."

- On further inquiry, you find the **GRNs (Goods Receipt Notes)** for the consignment are **dated two days after the year-end**, although management claims these were physically received before year-end.
- The purchase invoice is dated **March 31st**, but delivery challan is dated **April 2nd**.

Management insists that these items were part of closing inventory and should be included.

As per **SA 501**, what are your responsibilities as an auditor in this situation? What audit risks arise, and what course of action should you take?

Suggested Answer:

As per **SA 501**, the auditor must obtain **sufficient appropriate audit evidence** through **inspection and observation** of physical inventory.

In this case:

- Refusal to open sealed boxes creates a **scope limitation**.
- GRNs and delivery challans dated **after year-end** indicate the goods were **not received** as of the balance sheet date.
- Inclusion in inventory may lead to **overstatement** and a **material misstatement** of stock.

Audit Action:

- Insist on physical verification.
- Perform **cut-off testing** using GRNs and invoices.
- If access remains restricted or management disagrees, report to **TCWG**.
- If unresolved and material, issue a **qualified/adverse opinion**.

SA – 505 (External Confirmations)

Scope & objective

To design the audit procedure to obtain appropriate audit evidence.

Why we need SA 505? - more reliable audit evidence is obtained

- from **independent** sources outside entity.
- **directly collected** by the auditor.
- when it exists in **documentary form**.

Definition - Audit evidence obtained as a direct written response to the auditor from a third party in paper form or by electronic or other medium.

Imp Definition of other terms

POSITIVE CONFIRMATION REQUEST (PCR) – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees.

NOTE: There is a **risk** in PCR, that confirming party may respond without verifying that information is correct.

The auditor may **reduce the risk** by using “Blank confirmation request” which is the type of positive confirmation request, in this request auditor **do not state the amount and ask the confirming party to fill the blank**.

But the blank confirmation request may **result in lower response rates**.

NEGATIVE CONFIRMATION REQUEST (NCR) - A request that the confirming party respond directly to the auditor only if the confirming party disagrees.

It shall be used in limited cases, they are-

- ✚ where **low risk** of MMS involved,
- ✚ Where **low expected exception** rate,
- ✚ Auditor is **not aware** of circumstances that receipt of NCR (negative confirmation request) to **disregard such requests**.

NOTE: there is a risk in NCR that confirming party more likely to respond when the information in the request is not in their favour.

NON-RESPONSE – A failure of the confirming party to respond to a positive confirmation request, or a confirmation request returned undelivered.

EXCEPTION – A response that indicates a difference between information provided by the confirming party and information requested to be confirmed.

Audit procedure to be adopted to obtain audit evidence –

- ✚ Determining the **information to be confirmed**,
- ✚ Selecting **the propiate confirming party** (auditor believes that the party is knowledgeable about the information to be confirmed),
- ✚ Designing the **confirmation requests**,
 - Design of a confirmation request (it directly affects response rate and reliability).

- Factors to be considered by auditor when designing confirmation requests-
 - Assertion (whether to get evidence for existence or valuation or payment).
 - Specific identified risk of MMS.
 - Management authorizing the confirming party to respond directly to the auditor.
 - Mode of communication.
 - Layout & presentation of confirmation requests.
- Determination of properly addressed requests.

✚ Sending the requests including follow ups requests.

If management refuses to allow the auditor to send request to the confirming party

- ✚ Inquiry into reasons for refusal,
- ✚ Implication of such refusal and
- ✚ Perform alternative audit procedure.

MODIFY OPINION

- ✚ If management's reason for refusal is unreasonable (qualified opinion).
- ✚ Unable to obtain audit evidence by performing the alternative audit procedure (Disclaimer of opinion).

While evaluating the obtained audit evidence, Auditor categorizes the obtained audit evidence -

- + Indicating agreement or provided further information without exception.
- + Indicating agreement is deemed unreliable.
- + Non response.
- + Response indicating the exception rate.

BASIC LEVEL

✓ Case Study: Customer Confirmation Refusal

Question: You are auditing **GreenTech Traders**, a company engaged in wholesale distribution. While confirming balances of trade receivables, one of the major customers, **M/s Arjun Enterprises**, refuses to respond to your external confirmation request, stating that they “do not share financial information with third parties.”

Management tells you not to worry and assures that the balance is correct and fully recoverable.

As per **SA 505**, how should you deal with this situation?

Suggested Answer:

According to **SA 505 – External Confirmations**, when a confirmation request is **not responded to**, the auditor must:

1. **Perform alternative procedures** to obtain sufficient appropriate audit evidence. This may include:
 - Examining **subsequent receipts** from the customer,
 - Reviewing **sales invoices, delivery challans, and correspondence.**

2. The auditor **cannot rely solely on management's representation** that the balance is correct.
3. If **alternative procedures do not provide sufficient evidence**, the auditor must assess whether it leads to a **material misstatement** or **scope limitation**, and modify the opinion if required.

Conclusion:

The auditor must apply **alternative audit procedures** and cannot rely only on management's assurance. A non-response doesn't automatically imply misstatement, but it requires careful follow-up and documentation.

INTERMEDIATE LEVEL



Case Study: Discrepancy in Debtor Confirmation Response

Question: You are auditing **Alpha Components Ltd.**, which shows a closing balance of ₹15 lakhs receivable from **M/s Zen Electric Pvt. Ltd.** in its books. You send an external confirmation request to Zen Electric.

In their response, Zen confirms a balance of only ₹10 lakhs and notes that a **₹5 lakh credit note** was issued to Alpha Components for returned goods, which, according to them, was not accounted for in Alpha's books.

On inquiry, Alpha's management states that the credit note was **received after the year-end** and hence not considered.

As an auditor, how would you deal with this situation in light of **SA 505 – External Confirmations**?

Suggested Answer:

As per **SA 505**, when there is a **discrepancy in confirmation**, the auditor must **investigate the difference** and perform **further audit procedures**.

In this case:

- Check whether the ₹5 lakh credit note relates to **goods returned before year-end**.
- If yes, Alpha's debtor balance is **overstated** and must be adjusted.
- If returns were after year-end, the balance may be correct, but ensure proper **cut-off** and **disclosure**.
- Auditor cannot rely solely on management's explanation—must verify with supporting documents.

EXAM LEVEL



Case Study: Confirmation Denial and Suspicious Discrepancy

You are auditing the financial statements of **Beta Textiles Ltd.** for the year ending 31st March 2025. The company has shown a bank balance of **₹2.20 crores** with **Bank of Capital India**.

As part of your audit procedures, you send a **bank balance confirmation** to the said bank. The bank replies, stating that the

balance is only ₹1.75 crores, and mentions that ₹45 lakhs is under **lien** against a **corporate guarantee** given by the company for its subsidiary.

Management responds by saying that the difference is due to a **temporary bank posting error** and insists that you rely on the company's internal ledger. They also **refuse permission to re-confirm with the bank**, citing the sensitivity of group-level financial arrangements.

Required:

As per **SA 505**, explain your responsibilities as an auditor in this case.

How should you deal with:

- (a) The discrepancy in the bank confirmation, and
- (b) Management's refusal to allow further confirmation?

Suggested Answer:

(a) Discrepancy in Bank Confirmation:

- SA 505 requires the auditor to obtain **reliable audit evidence** from **external confirmations** and to investigate any discrepancies.
- The difference of ₹45 lakhs is **material** and must be evaluated by:
 - Inspecting **bank statements, corporate guarantee documents, and related agreements**.
 - Assessing whether the **lien** affects the **presentation and disclosure** in the financial statements (e.g., classification as restricted cash or contingent liability).

(b) Refusal for Further Confirmation:

- Management's refusal to allow further confirmation may be a **scope limitation**.
- Auditor should:
 - Document all communications,
 - Report the matter to **Those Charged With Governance (TCWG)**,
 - Consider the risk of **management override of controls**,
 - Reassess the **reliability of other management representations**,
 - If unresolved, consider a **modified audit opinion** (qualified/disclaimer) due to **inability to obtain sufficient appropriate evidence**.

Conclusion: Auditor must exercise **professional skepticism**, and cannot rely solely on internal records. Discrepancies in external confirmations, especially involving **liens and guarantees**, require full investigation and may impact the **audit report**.

SA – 510 (Initial Audit Engagements-Opening Balances)

Objective – Whether

- ✚ Opening balances contains **misstatements that materially affect** current year financial statement and

- ✚ Accounting policies are **applied consistently** which are reflected in the opening balances or if there is **any change** in the accounting policies are **properly accounted** for and adequately **presented and disclosed of** in accordance with applicable financial reporting frame work.

NOTE: If auditor concludes, based on the audit evidence obtained regarding the opening balances, that **misstatements are exist**, then **communicate TCWG**.

MODIFY OPINION

- ✚ Unable to obtain audit evidence regard opening balances (Disclaimer of opinion).
- ✚ Opening balances contain misstatement that affect the current year financial statement & effect of such is not properly accounted for & not adequately presented and disclosed of (qualified opinion).
- ✚ Accounting policies not consistently applied or change in the accounting policies are not properly accounted for & not adequately presented and disclosed of (qualified opinion).

BASIC LEVEL

Case Study: Doubt Over Opening Inventory Figures

You have been appointed as the statutory auditor of **Nova Traders Pvt. Ltd.** for the financial year 2024–25. This is your **first year** of audit engagement. The closing inventory as on 31st

March 2024 (i.e., the **opening inventory** for the current year) is shown as **₹48 lakhs** in the books.

However, the previous year was **audited by another auditor**, and you were **not present at the previous year-end inventory count**. Management has only provided you with the audit report and stock summary from the prior year. No further detailed working papers are available.

Required:

As per **SA 510**, what audit procedures should you perform with respect to the **opening balance of inventory**? Also, state your responsibility if you are **unable to obtain sufficient audit evidence** regarding the opening inventory.

Suggested Answer :

Audit Procedures as per SA 510:

As this is an **initial audit engagement**, SA 510 requires the auditor to obtain **sufficient appropriate audit evidence** regarding the **opening balances**, including inventory.

The following procedures should be performed:

1. **Read the prior year's audited financial statements** and auditor's report.
2. **Evaluate whether the opening balances contain misstatements** that materially affect the current period's financial statements.
3. **Perform analytical procedures** and **review documentation** available (e.g., stock summary, GRNs, sales post-year-end) to assess the reasonableness of opening inventory.

4. If available, **verify subsequent movements** in inventory (e.g., sales/consumption) to confirm the existence and valuation.
5. **Inquire with management** and obtain representations regarding how the opening balance was arrived at.

Responsibility if Sufficient Evidence Cannot Be Obtained:

- If sufficient appropriate audit evidence **cannot be obtained**, and the impact is **material but not pervasive**, the auditor should issue a **qualified opinion**.
- If the effect is **material and pervasive**, a **disclaimer of opinion** may be required.

Conclusion:

Under SA 510, the auditor must take steps to verify the **accuracy and completeness of opening balances**. If evidence is not obtainable, a **modified opinion** must be considered, depending on the **materiality and pervasiveness** of the matter.

INTERMEDIATE LEVEL

Case Study: Opening Balance of Fixed Assets with Disputed Ownership

You are appointed as the statutory auditor for the first time of **Taurus Engineering Ltd.** for the financial year 2024–25.

During your audit, you observe that the opening balance of **Plant and Machinery** includes an asset worth ₹1.2 crore, claimed to be acquired in March 2024. However:

- There is **no purchase invoice** or **delivery document** available.

- The fixed asset register contains the asset, but no depreciation has been charged.
- The previous auditor's working papers are **not accessible**, and management claims the asset was delivered late but recorded based on a proforma invoice.

Required: What are your responsibilities as an auditor under **SA 510** with respect to this opening balance? What actions should you take if you are unable to obtain sufficient audit evidence?

Suggested Answer:

As per **SA 510**, the auditor must verify whether opening balances:

- **Contain misstatements** that materially affect the current period, and
- Have been **correctly brought forward** and appropriately accounted.

In this case:

- Perform procedures such as **physical inspection, review of capex approvals, and vendor communication** to verify the existence and ownership of the asset.
- If sufficient appropriate audit evidence is **not obtainable**, evaluate whether the item materially affects current year financials (e.g., depreciation, asset base).
- If material, issue a **qualified opinion**; if **material and pervasive**, issue a **disclaimer of opinion**.

EXAM LEVEL

✓ Case Study: Suspected Overstatement in Opening Receivables

You are appointed as the new statutory auditor of **Zeon Pharmaceuticals Ltd.** for FY 2024–25. On reviewing the opening balances, you find that **trade receivables** as on 31st March 2024 include an amount of **₹3.8 crores** from **M/s Healtro Labs**, shown as outstanding for over 10 months.

On inquiry, management claims that the debtor is disputing only a part of the balance and that collection is expected soon. However:

- No cash has been received till the date of audit (Jan 2025).
- There are **legal notices** exchanged between the parties regarding quality issues.
- No provision was made in the previous year.
- Previous auditor's working papers and confirmation procedures are **not available**.

Required:

In accordance with **SA 510**, explain your responsibilities as the incoming auditor. How should you respond if sufficient appropriate audit evidence cannot be obtained regarding the recoverability of this balance?

Suggested Answer:

As per **SA 510**, the auditor must obtain sufficient appropriate audit evidence about **opening balances**, including their **correctness, classification, and impact on current period**.

In this case:

- Perform procedures such as:
 - **Review correspondence**, legal proceedings, and **customer communication**.
 - **Send external confirmation** to M/s Healtro Labs.
 - Examine **subsequent receipts**, if any, and consider the **reasonableness of management's assumptions**.
- Since the balance is material and possibly **not recoverable**, it may affect current year's **provision for doubtful debts** and **true and fair view**.
- If **sufficient evidence is not available**, and the impact is **material**, issue a **qualified opinion**.
- If the matter is **material and pervasive**, issue a **disclaimer of opinion**.

SA – 550 (Related parties)

Scope

- ✚ Auditor responsibility **to identify the nature of transaction** with related parties or transactions outside the scope of entity.
- ✚ Moreover, assess whether the related party relationship & transactions **affect the financial statement**.

How an auditor identifies whether existence of related party relationship & transaction – Inspect

- ✚ Entity income tax returns.
- ✚ Information supplied by entity to regulatory authorities.

- ✚ Shareholders register to identify the principal shareholders.
- ✚ Records of entity's investments and those of its pension plans.
- ✚ Life insurance policies acquired by entity.
- ✚ Internal auditor's report.

Nature of related party relationship & transactions – Examples (very imp, many times asked)

- ✚ Related parties may operate through an **extensive and complex** range of relationship & structure, with a **corresponding increase** in the complexity of related party transaction.
- ✚ **Information system** may be **ineffective** at identifying or summarising the transaction between entity and its related parties.
- ✚ Related parties' transactions may **not be conducted** in the **course** of the business terms & conditions.

Understanding entity's related party relationship & transactions

- ✚ Identity of related parties including **any changes** from prior period,
- ✚ **Nature of transactions** between them and
- ✚ If any transaction they entered, identify the **type & purpose** of the transaction.

Understanding entity's internal control regarding related parties

- ✚ Whether **properly accounted for and disclose** of.

- ✚ Whether TCWG **authorise & approve** the transactions **with related parties**.
- ✚ Whether TCWG **authorise & approve** the transactions **outside the scope of entity**.

BASIC LEVEL

Case Study: Undisclosed Transactions with a Family-Owned Entity

You are auditing **Zenia Fashions Pvt. Ltd.** for the year ending 31st March 2025.

During your audit, you notice multiple high-value purchases of fabric from **Aura Textiles**, a vendor not listed in the previous year's supplier records. The transactions appear frequent and significant. On inquiry, the purchase manager casually mentions that **Aura Textiles is owned by the managing director's cousin**, but this relationship was **not disclosed** in the related party list provided by management.

Required:

What are your responsibilities as an auditor under **SA 550 – Related Parties** in this situation?

Suggested Answer :

As per **SA 550**, the auditor is responsible for:

- **Identifying and assessing the risks of material misstatement** associated with related party relationships and transactions.

- Performing **inquiries with management** and **TCWG** regarding the existence of related parties.
- Evaluating whether the related party was **properly identified, accounted for, and disclosed** in accordance with the financial reporting framework.

In this case:

- The relationship with Aura Textiles was **not disclosed**, despite being a related party.
- The auditor should:
 - **Verify the nature of relationship** (through ROC records, declarations, etc.).
 - **Assess completeness** of management's related party list.
 - **Perform further procedures** to evaluate whether transactions were conducted at **arm's length**.
 - **Discuss the non-disclosure** with management and obtain **written representations**.
- If management **refuses to disclose** a known related party, consider its impact on the **audit report**, and whether it indicates **fraud risk** under SA 240.

Conclusion:

The auditor must **remain alert** to undisclosed related parties and, if such parties are identified, perform **appropriate audit**

procedures to ensure **fair presentation and compliance** with applicable disclosure requirements.

INTERMEDIATE LEVEL

Case Study: Loan to Related Entity Not Disclosed in Financials

You are the auditor of **Vistara Solutions Ltd.**, a software development company.

While reviewing the bank statements, you notice a transfer of **₹50 lakhs** to **Synergy Analytics LLP**, which is not recorded in the books as a loan or advance. On inquiry, the CFO mentions this was a **temporary funding support** to a “friendly vendor.” However, on deeper investigation, you discover that the **CEO of Vistara Solutions is also a partner in Synergy Analytics LLP.**

This transaction was **not disclosed** in the related party register, and no formal loan agreement or board approval is available. It also does not appear in the notes to accounts under related party transactions.

Required:

As per **SA 550**, what should be your responsibilities and audit procedures in this case? What reporting implications may arise if the matter remains unresolved?

Suggested Answer:

Under **SA 550**, the auditor's responsibilities include:

- **Identifying related party relationships and transactions**, even when not disclosed by management.
- **Assessing the business rationale** behind such transactions and evaluating whether they were conducted at **arm's length**.
- Performing **inquiries**, reviewing **minutes**, and **examining bank transactions** to detect undisclosed related parties.

In this case:

- The CEO's connection to Synergy Analytics makes it a **related party**, and the ₹50 lakh transfer is a **related party transaction**.
- The auditor must:
 - **Discuss the issue with management and TCWG**, seeking explanation and disclosure.
 - **Request written representations** from management acknowledging the relationship.
 - **Verify if board approval was required** and whether disclosure in financials is mandatory under applicable accounting standards (e.g., AS 18 or Ind AS 24).

If management **refuses to disclose** the transaction or provide audit evidence:

- It may result in a **material misstatement due to non-disclosure**.

- The auditor should consider issuing a **qualified opinion or adverse opinion**, depending on **materiality and pervasiveness** of the misstatement.

EXAM LEVEL

✓ Case Study: Layered Related Party Dealings and Intentional Non-Disclosure

You are auditing the financial statements of **Deltronix Systems Ltd.**, an electronics equipment manufacturer, for the year ending 31st March 2025.

During the audit, you observe that Deltronix has paid unusually high service charges (₹3.2 crores) to a consultancy firm named **NeuroEdge Solutions Pvt. Ltd.** for “strategic business advisory.” No prior-year transactions exist with this entity.

On further investigation:

- You discover that **NeuroEdge is owned by the spouse of the Chairman of Deltronix**, but this relationship has **not been disclosed** in the related party register.
- There are no formal contracts or detailed scope of services available for the payments made.
- When questioned, management dismisses the relationship as **“non-influential and irrelevant to business reporting.”**

- Your request for external confirmation from NeuroEdge remains unanswered, and management is unwilling to provide further documentation.

Required:

As per **SA 550**, what are your responsibilities as an auditor in this situation?

How should you deal with management's refusal and the potential implications on your audit opinion?

Suggested Answer:

Responsibilities under SA 550:

- The auditor must perform **risk assessment procedures** to identify **related party relationships and transactions**, whether disclosed or not.
- The auditor should remain **alert to fraud risk factors**, especially in cases involving **unusual transactions** with entities having close connections to key management.

In this case:

1. The payment to NeuroEdge appears to be a **related party transaction** due to the spouse's ownership, and its **non-disclosure violates SA 550** and accounting standards (AS 18 / Ind AS 24).
2. Auditor should:
 - Discuss the matter with **Those Charged With Governance (TCWG)**.

- Evaluate the **substance over form** of the relationship.
- Consider the lack of documentation and non-cooperation as a **limitation on audit evidence**.
- Assess if this situation involves **intentional concealment**, potentially indicating **fraud**.

If management refuses to disclose or provide sufficient evidence:

- The auditor may consider this a **material misstatement by omission** and/or a **limitation on scope**.
- The impact is likely **material and pervasive**, given the amount and intent.
- The auditor should consider issuing an:
 - **Adverse Opinion** (if financials are misleading due to non-disclosure), or
 - **Disclaimer of Opinion** (if scope limitation is severe and evidence is insufficient).

Conclusion:

The auditor must maintain **professional skepticism** and ensure related party transactions are **identified, evaluated, and disclosed**. Failure by management to cooperate or disclose can lead to a **modified audit opinion**, possibly an **adverse or disclaimer**, depending on the significance and intent.

SA – 610 (Using the work of Internal Auditors)

Definition of Internal Audit Function - It is a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

Ways in which the external auditor may make use of the Internal Audit Function for purposes of the audit.

- ✚ To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud.
- ✚ If law permits, the external auditor, after appropriate evaluation, may decide to use the internal audit function work during the period of audit in partial substitution for audit evidence which is supposed to be obtained directly by the external auditor.
- ✚ If law permits, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor (referred to as "direct assistance").

Note: External Auditor's Responsibility for the audit

The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by using the work of the internal audit function or internal

auditors to provide direct assistance on the engagement. If the external auditor **decides to use** the work of the internal audit function or internal auditors to provide direct assistance on the engagement, **such decision is external auditors whole responsibility**. If any misstatements due to fraud or error **involved in the internal audit function**, the **whole responsibility** for such misstatements has **to bear by the external auditors**.

Moreover, **nothing in this SA requires** the external auditor to use the work of the internal audit function **to modify** the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it **remains a decision of the external auditor** in establishing the overall audit strategy.

Before using-evaluate the Internal Audit Function

The external auditor shall evaluate the following to determine whether the work of the internal audit function can be used for purposes of the audit:

- ✚ The extent to which the organization's support the **objectivity** of the internal auditors;
- ✚ The level of **competence** of the internal audit function; and
- ✚ Whether the internal audit function applies a **systematic and disciplined approach, including quality control**.

Factors that may affect the external auditor's evaluation in relation to Objectivity-

- Whether the organizational status of the internal audit function, supports **the ability of the function to be free from bias, conflict of interest or undue influence of others** to override professional judgments.
- Whether those charged with governance **oversee employment decisions** related to the internal audit function.
- Whether there are **any constraints or restrictions** placed on the internal audit function **by management or those charged with governance**.
- Whether the internal audit function is **free of any conflicting responsibilities**

Factors that may affect the external auditor's determination in relation to competence-

- Whether the internal audit function is **adequately and appropriately resourced** relative to the size of the entity and the nature of its operations.
- Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
- Whether the internal auditors have **adequate technical training and proficiency in auditing**.
- Whether the internal auditors possess the required

knowledge relating to the entity's financial reporting and the applicable financial reporting framework.

Objectivity and competence may be viewed as a continuum.

An organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function. Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors.

Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach-

- The existence, adequacy and use of documented internal audit procedures or guidance
- Whether the internal audit function has appropriate quality control policies and procedures.

Circumstances in which the external auditor shall plan to use less of the work of the Internal audit function and perform more of the work directly-If

- ✚ The **more judgment** is involved in:
 - ✓ Planning and performing relevant audit procedures; and
 - ✓ Evaluating the audit evidence gathered;
- ✚ The **higher the assessed risk** of material misstatement at the assertion level;
- ✚ Internal audit function's organizational status and relevant policies and procedures are **less adequately supporting the objectivity** of the internal auditors; and
- ✚ The **lower the level of competence** of the internal audit function.

Circumstances When Work of the Internal Audit Function Cannot Be Used- If

- ✚ The function's organizational status and relevant policies and procedures **do not adequately support the objectivity** of internal auditors;
- ✚ The function **lacks sufficient competence**; or
- ✚ The function does **not apply a systematic and disciplined approach**, including quality control.

Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used

Its relevance to the external auditor's overall audit strategy and audit plan.

Examples of work of the internal audit function that can be used by the external auditor include the following:

1. Testing of the **operating effectiveness** of controls.
2. Substantive procedures involving **limited judgment**.
3. **Observations** of inventory counts.
4. **Tracing transactions** through the information system relevant to financial reporting.
5. Testing of **compliance with regulatory requirements**.

Using the Work of the Internal Audit Function

- ✚ Discuss the planned use of its work with the internal audit function as a basis for **coordinating** their respective activities.
- ✚ **Read the reports** of the internal audit function relating to the work of the function that the external auditor plans to use **to obtain an understanding of the nature and extent of audit procedures it performed and the related findings**.
- ✚ **Perform sufficient audit procedures** on the body of work of the internal audit function **as a whole** that the external auditor plans to use **to determine its adequacy for purposes of the audit**.

Coordination between the external auditor and the internal audit function is effective when, for example;

- ✚ **Discussions** take place **at appropriate intervals** throughout the period.

- ✚ The external auditor informs the internal audit function of significant matters that may affect the function.
- ✚ The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

The external auditor shall not use internal auditors (direct assistance) to perform following procedures that:

- ✚ Involve making significant judgments in the audit;
- ✚ Relate to higher assessed risks of material misstatement;
- ✚ Relate to work with in which the internal auditors have been involved before becoming the direct assistance; or
- ✚ Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

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

- ✚ There are significant threats to the objectivity of the internal

auditor; or

- ✚ The internal auditor lacks sufficient competence.

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

- ✚ Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
- ✚ Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

BASIC LEVEL

Case Study: Reviewing Internal Audit of Cash Handling

You are appointed as the statutory auditor of **Indigo Retail Pvt. Ltd.** for FY 2024–25.

The company has a well-established **internal audit department**, and during your planning, you find that internal auditors have recently completed a **detailed review of cash handling procedures** across all retail

outlets.

Management suggests that you can **rely on the internal audit report** to reduce your audit procedures in that area.

Required:

As per **SA 610 – Using the Work of Internal Auditors**, what steps should you take before relying on the internal auditor's work in this case?

Suggested Answer :

As per **SA 610**, before relying on the internal auditor's work, the external auditor must:

1. **Evaluate the objectivity** of the internal audit function (e.g., independence from management).
2. Assess their **technical competence** (qualifications, experience).
3. Ensure their work is carried out with **due professional care**.
4. Review the **scope, timing, and results** of their work.
5. Determine if their work is **adequate and relevant** to the external audit objectives.

In this case, the auditor should **review the internal audit documentation**, perform **limited re-performance**, and ensure **sufficient audit evidence** is obtained before

placing reliance and reducing own procedures.

INTERMEDIATE LEVEL

✓ Case Study: Relying on Internal Auditor's Risk Testing

You are the statutory auditor of **Avon Chemicals Ltd.**, a company with operations in multiple cities. The company's **internal audit department** has conducted a detailed **risk assessment of inventory controls**, including surprise stock audits and reconciliation procedures.

During your audit planning, you learn that the internal audit team has:

- Tested inventory controls at 8 out of 12 locations.
- Identified **significant internal control weaknesses** in 2 locations.
- Submitted their report directly to the CFO, but not to the audit committee.

Management urges you to **rely on the internal audit work** to avoid duplication of efforts.

Required:

As per **SA 610**, how should you assess whether and to what extent the internal auditor's work can be used in your audit? What factors would influence your decision?

Suggested Answer :

Under **SA 610**, the external auditor must **evaluate the extent to which internal audit work can be used** by considering:

1. **Objectivity**: Since reports are submitted only to the CFO (and not TCWG or audit committee), independence may be **compromised**.
2. **Competence**: Assess qualifications and experience of the internal auditors.
3. **Systematic & Disciplined Approach**: Verify whether internal audit followed a structured audit methodology (e.g., documentation, risk-based approach).

Additionally, the external auditor must:

- **Re-perform a sample of procedures** and verify internal auditor's conclusions, especially for the 2 locations with weaknesses.
- Consider performing **additional audit procedures** in areas of high risk.
- Document the **extent of reliance** and basis for that reliance.

If the internal audit is **not sufficiently objective or competent**, the external auditor **cannot rely** and must perform independent testing.

EXAM LEVEL



Case Study: Internal Audit Involvement in Complex Area

You are auditing **Trinity Technologies Ltd.**, a company engaged in manufacturing electronic components, for the year ending 31st March 2025.

During the audit, you come across the following scenario:

- The internal audit function has performed **detailed testing of warranty provisions**, including estimation techniques and historical trend analysis.
- You find that the **internal auditor used a complex actuarial model**, relying on past product return data, to assist management in estimating the warranty liability.
- The internal auditor reports to the **CFO** and sits in quarterly meetings where provisions are discussed and finalized.
- You also note that the internal auditor has been involved in **developing the estimation methodology** and has reviewed its own work.

Management informs you that since the internal audit has already covered this area, you can skip detailed audit procedures.

Required:

As per **SA 610** and other relevant SAs, critically evaluate whether you can use the work of the internal auditor in this situation. What steps must you take before deciding to rely on their work?

Suggested Answer:

Under **SA 610**, the external auditor may use the work of internal auditors if they are:

- **Objective** (free from bias or influence),
- **Competent** (qualified and experienced), and
- Follow a **systematic and disciplined approach**.

In this case:

1. **Objectivity is impaired:** Internal auditor reports to CFO and participates in management decision-making, especially in estimating warranty provisions.
2. **Self-review threat:** The internal auditor developed the estimation model and is now reviewing the same – this creates a conflict.
3. The area involves **significant judgment and estimation uncertainty**, where **SA 610** advises **against using internal auditor's work** if the area is highly judgmental or subjective.
4. Under **SA 540 (Estimates)**, the auditor should

evaluate management's assumptions independently.

Hence:

- You **should not rely** on internal auditor's work in this case.
- Perform **independent audit procedures** to assess the warranty provision, including testing assumptions, data, and methodology.
- Document the reasons for **not using the internal auditor's work** and communicate concerns, if any, with **Those Charged with Governance**.

SA – 500 (Audit Evidence)

Meaning

- ✚ Audit evidence is Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based
- ✚ It includes both information contained in the accounting records underlying the financial statements and other information.

Sufficient appropriate audit evidence

The auditor has to **obtain sufficient appropriate** audit evidence **to draw reasonable conclusions** on financial statements.

Note: Sufficiency and Appropriateness are interrelated

Sufficiency is the measure of the **quantity of audit evidence**.

- The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required).

Auditor's judgement as to sufficiency may be affected by the factors such as (Many times asked)

Materiality

Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.

Risk of material misstatement

It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components

- Inherent risk
- Control risk

Less evidence would be required in case assertions that have a lower risk of material misstatement and if assertions have a higher risk of material misstatement, more evidence required.

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

Appropriateness is the measure of the **quality of audit evidence**; that is, **its relevance and its reliability**.

Relevance and Reliability of audit evidence

✚ **Relevance** deals with the **logical connection** with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing.

✚ **Reliability** refers to the **degree** to which the evidence can **be trusted to be true, accurate & unbiased**. Reliable evidence provides **assurance to the auditor** that the information it provides is **credible & can be rely upon to form conclusion**.

The following generalizations about the reliability of audit evidence may be useful -

- Increased when it is **obtained from independent sources** outside the entity.
- Increased when the **related controls**, including those over its preparation and maintenance, imposed by

the entity are **effective**.

- Audit evidence **obtained directly by the auditor** is more reliable than audit evidence obtained indirectly.
- Audit evidence **in documentary form**, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.
- Audit evidence obtained **as original documents** is more reliable than audit evidence obtained as photocopies.

Source of audit evidence

- ✚ Some audit evidence is **obtained by performing audit procedures to test** the accounting records.
- ✚ More assurance is **ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature** than from items of audit evidence considered individually.

Audit procedures for obtaining audit evidence

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

- ✚ Risk assessment procedures (It means the audit procedures performed to obtain an **understanding of the entity** and its **environment to identify and assess the risks**

of material misstatement, at the financial statement and assertion levels.); and

+ **Further audit procedures**, which comprise:

- **Tests of controls**, when required by the SAs or when the auditor has chosen to do so. (**Test of controls** may be defined as an audit procedure **designed to evaluate the operating effectiveness of controls** in preventing, or detecting and correcting, material misstatements at the assertion level.); and
- **Substantive procedures**, including tests of details and substantive analytical procedures (Substantive procedures are **designed to detect material misstatements** at the assertion level.)

Audit procedures to obtain audit evidence can include:

- + **Inspection** - **examining records or documents**, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
- + **Observation** - consists of **looking at a process** or procedure being **performed by others**.
- + **External Confirmation** - audit evidence **obtained by the auditor** as a **direct written response** to the auditor **from a third party (the confirming party)**, in paper form, or by electronic or other medium
- + **Recalculation** - consists of **checking the mathematical accuracy of documents or records**. Recalculation may be performed manually or electronically.
- + **Reperformance** - involves the **auditor's independent execution**

of procedures or controls that were originally performed as part of the entity's internal control.

+ **Analytical Procedures** - consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

+ **Inquiry** - consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.

- Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.
- Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

The following points are also relevant in respect of audit procedures for auditor's consideration:

In case the same auditor is holding the audit office for both previous and current year, Audit evidence obtained from previous audits may, in certain circumstances, provide appropriate audit evidence where the auditor performs audit procedures to establish its continuing relevance.

Nature and Timing of the Audit Procedures

- ✚ Nature – Permanent form (shall not be changed or deleted)
- ✚ Time – Can be retrieved, whenever necessary.

Assertions - refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

Classes of transactions and events

- Occurrence
- Completeness
- Accuracy
- Cut-off
- Classification

Account balances at the period end

- Existence
- Rights and obligations
- Completeness
- Valuation and allocation

Presentation and disclosure

- Occurrence and rights and obligations
- Completeness
- Classification and understandability
- Accuracy and valuation

Note:

- ✚ The assertions are **generally implied and not specifically spelt out**, though some explicit assertions are also found in the financial statements.
- ✚ Every financial statement **contains an overall representation** in addition to the specific assertions so far discussed. Each financial statement purports to present something as a whole in addition to its component details. For example, an income statement purports to present “the results of operations” a balance sheet purports to present “financial position”. **The auditor’s opinion is typically directed to these overall representations.**

An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity.

Advantages of Audit trail-

- ✚ Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
- ✚ Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use.
- ✚ Audit trails help to enhance internal controls and data security.
- ✚ Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not.
- ✚ It aids in verification whether a transaction was indeed performed by a person authorized to do it. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

Disadvantages of Audit trail-

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

Selecting Items for Testing to Obtain Audit Evidence

When designing tests of controls and tests of details, the auditor shall determine the means available for selecting items for testing are:

- ✚ Selecting all items (100% examination);
 - The auditor may decide that it will be **most appropriate to examine the entire population of items**.
 - 100% examination is **unlikely in the case of tests of controls**; however, it is **more common for tests of details**.

For example:

- The population **constitutes a small number of large value items**;
- There is a **significant risk** and other means **do not provide sufficient appropriate audit evidence**; or
- The **repetitive nature of a calculation** or other process performed automatically by an information system makes a

100% examination cost effective.

Selecting specific items; and

The judgmental selection of specific items is subject to non-sampling risk. Specific items selected may include:

- **High value or key items.**

The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic.

- **All items over a certain amount.**

The auditor may decide **to examine items whose recorded values exceed a certain amount** so as to verify a large proportion of the total amount of a class of transactions or account balance.

- **Items to obtain information.**

The auditor may examine items to obtain information about matters **such as the nature of the entity or the nature of transactions.**

Audit sampling.

Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

Note: The **application of any one or combination** of these means may be appropriate **depending on the auditors' judgement** to obtain audit evidence.

Inconsistency in or Doubts over Reliability of Audit Evidence - If:

- + audit evidence obtained from one source is inconsistent with that obtained from another; or
- + the auditor has doubts over the reliability of information to be used as audit evidence,

the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspect of audit

Note: SA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.

BASIC LEVEL

✓ Case Study: Photocopy of Lease Agreement

You are auditing **Zodiac Interiors Pvt. Ltd.**, which has recently moved to a new office space.

The company has shown **"Prepaid Rent" of ₹5 lakhs** in its balance sheet. On inquiry, management states that this amount relates to a **2-year lease agreement** with the landlord. However, when you request supporting documentation, the accountant provides only a **photocopy of the lease agreement**, unsigned and undated. No rent receipts or bank payments for the

advance are available at the time.

Required:

As per **SA 500 – Audit Evidence**, what should be your course of action in evaluating the evidence provided? Comment on the reliability of the evidence in this case.

Suggested Answer :

According to **SA 500**, audit evidence should be:

- **Sufficient and appropriate**, where appropriateness relates to **relevance and reliability**.
- **External and original documents** are generally more reliable than **internal or photocopied documents**.

In this case:

- A **photocopy**, especially one **unsigned and undated**, is **less reliable**.
- The absence of payment proof or receipts **reduces the sufficiency** of the evidence.
- Auditor should:
 - Request the **original, signed lease agreement**.
 - Obtain **bank statements or rent receipts** to support the advance.
 - Consider sending a **direct confirmation to the landlord**.

Unless **adequate and reliable evidence** is obtained, the auditor may need to **report a limitation on scope** or consider the **appropriateness of management's assertion**.

INTERMEDIATE LEVEL

✓ Case Study: Reliance on Verbal Confirmation for a Major Receivable

You are auditing the financial statements of **Globe Trade Impex Ltd.**, an export trading company. The company has reported a **trade receivable of ₹1.8 crores** from a foreign customer – **Pacific Traders LLC** – outstanding for over 8 months. When you request supporting documents, the accountant provides:

- Copies of sales invoices and shipping documents.
- An internal email trail with the customer requesting payment reminders.
- A **verbal confirmation** from the sales head stating that the customer is "in regular contact and has promised to clear dues soon."

However, your **external confirmation request** to the customer **has not been responded to**, and the company insists no further follow-up is needed, citing a "good relationship."

Required:

As per **SA 500**, what should be your approach in evaluating the audit evidence for the outstanding receivable? What additional steps, if any, are necessary?

Suggested Answer:

Under **SA 500**, audit evidence must be:

- **Sufficient and appropriate**: This includes evidence that is **reliable** and **relevant** to support the financial statement assertions.
- **External confirmations** are more reliable than internal or verbal representations.

In this case:

1. **Evidence is insufficient and lacks reliability:**

- Internal documents and verbal assurance are not adequate for a material, long-outstanding receivable.
- Non-response to external confirmation is a **red flag**.

2. Auditor's responsibility:

- Perform **alternative procedures**, such as checking subsequent payments after year-end, bank statements, or follow-up correspondence.
- If no reliable evidence is obtained, assess the need for a **provision for doubtful debt**.
- Discuss with **management and TCWG** the risk of misstatement.

3. If management refuses to allow further audit procedures or fails to justify recoverability:

- Consider **modification in audit opinion** (qualified or adverse), depending on **materiality** and **pervasiveness**.

EXAM LEVEL

✓ Case Study: Doubtful Investment – Contradictory Audit Evidence

You are auditing the financial statements of **Vertex Infra Ltd.**, which has shown an **unquoted investment of ₹12 crores** in the balance sheet under **non-current investments**. Management explains that the amount was invested in **Starline Agro Pvt. Ltd.**, a start-up in the organic farming sector, and has classified it at **cost** due to lack of market data.

To verify the investment, you perform the following procedures:

- **Review of share certificates:** You find the certificates are in Vertex's name, but the issue date is over 2 years ago.
- **Board resolution** of Starline confirms allotment.
- **Bank statement** of Vertex shows the payment made.
- However, when you check the **ROC filings of Starline**, the paid-up capital reported is only ₹3 crores, and Vertex's name is **not listed among shareholders**.
- Management insists that Starline is yet to update its filings and that "things are in process."
- Your attempts to contact Starline's management have **gone unanswered** for over 3 weeks.

Required:

As per **SA 500**, how should you evaluate the reliability of audit evidence in this case? What steps should you take, and what would be the possible impact on your audit opinion?

Suggested Answer:

As per **SA 500**, audit evidence must be:

- **Sufficient and appropriate**, which means:
 - **Relevant** to the assertion being tested.
 - **Reliable**, depending on source, nature, and circumstances.

Analysis of Evidence:

- Documents provided (share certificates, board resolution, bank payment) support the **existence** of the transaction.
- However, **ROC records contradict management's claim**, and lack of confirmation from investee company raises concern.
- Contradictory evidence requires the auditor to:
 - **Exercise heightened professional skepticism.**
 - **Investigate further** using external sources (e.g., MCA portal, legal opinion).
 - Reconsider whether management's explanation is **reasonable or an attempt to misstate.**

Auditor's Course of Action:

1. Request updated ROC filings or proof of shareholder status.
2. Seek **written representation** from management (as per SA 580).
3. If still unresolved, treat it as a **limitation on audit evidence** or **possible material misstatement**.

Impact on Audit Opinion:

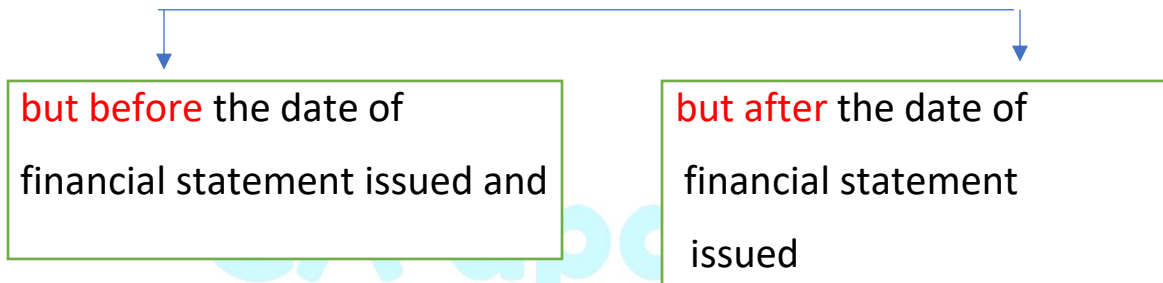
- If evidence remains inconsistent or insufficient, and the amount is **material**:
 - Issue a **qualified opinion** due to inability to obtain sufficient appropriate evidence.
- If amount is **material and pervasive**, and management's explanation lacks integrity:
 - Consider an **adverse opinion** or **disclaimer**, depending on judgment.

COMPLETION & REVIEW

SA 560 – Subsequent events

Meaning

- ✚ Events occurring **between** the date of the financial statements and the date of the auditor's report and
- ✚ Facts that become **known to** the auditor **after** the date of the **auditor's report**



Financial statements **may be affected** by certain events that occur **after the date of the financial statements**. Such ordinarily identify two types of events: -

- ✚ Those that **provide evidence of conditions** that **existed at the date** of the financial statements and
- ✚ Those that provide **evidence of conditions that arose after the date** of the financial statements.

Objectives

- ✚ Obtain **sufficient appropriate audit evidence** about whether events **occurring between** the date of the

financial statements and the date of the auditor's report **require adjustment of, or disclosure in**, the financial statements **are appropriately amended** in those financial statements **and**

- ✚ **Respond appropriately to facts** that become **known** to the auditor **after the date of the auditor's report**, suppose If such fact had been known to the auditor at the date of audit report, may have caused the auditor to amend the auditor's report.

Audit procedures relating

Events occurring **between the date of the financial statements and the date of the auditor's report**

- ♦ The auditor **needs to perform additional audit procedure** only on an event which **occurred between the date of F\S and audit report**.
- ♦ The auditor is **not expected to perform** additional audit procedures on matters to which previously applied audit procedures have **provided satisfactory conclusions**.

Audit procedures are-

- ✚ **Obtaining an understanding** of any **procedures** that management undertaken to ensure that subsequent events are identified.
- ✚ **Inquiring of management** or TCWG as to **whether** any

subsequent events have occurred which might **affect the financial statements**.

- ✚ **Reading minutes of the meetings** of the entity's owners, management and those charged with governance, that have been **held after the date of the financial statements** and **If minutes are not yet available, inquiring about matters discussed** at any such meetings.
- ✚ Reading the entity's latest subsequent interim financial statements, if any.
- ✚ Such information may also be obtained by auditor from accounting records pertaining to period after date of financial statements, reading entity's latest available budgets etc.

When, as a **result of the procedures performed**, the auditor identifies events **that require adjustment of, or disclosure in**, the financial statements, the **auditor shall determine** whether each such event is **appropriately amended** in those financial statements.

Moreover, the **auditor shall request management** and, where appropriate, TCWG, to **provide a written representation** in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the

applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Facts that become *known to the auditor after the date of the auditor's report but before the date of financial statement are issued*

- ✚ Discuss the matter with management and, where appropriate, TCWG.
- ✚ Determine whether the financial statements need amendment and, if so,
- ✚ Inquire how management intends to address the matter in the financial statements.

If management **amends** the financial statements, the auditor shall:

- ✚ Carry out the audit procedures necessary in the circumstances on the amendment.
- ✚ Extend the audit procedures, in addition to the already performed procedures, to the date of the new auditor's report and **issue new audit report on the amended financial statements**.

Note: The new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In some entities, management may not be required by the applicable law or the financial reporting framework to issue amended financial statements and accordingly, the

auditor **need not provide** an amended or **new auditor's report**.

However, when management **does not amend** the financial statements in above circumstances **where the auditor believes they need to be amended**, then: -

- ✚ If the auditor's **report has not yet been provided** to the entity, the auditor **shall modify** the opinion as required by SA 705 and **then provide** the auditor's report or
- ✚ If the auditor's **report has already been provided** to the entity, the auditor shall **notify management not to issue** the financial statements to third parties **before the necessary amendments have been made**.

In case, If the financial statements **subsequently issued without the necessary amendments**, the auditor **shall take appropriate action**, to seek to prevent reliance on the auditor's report.

Facts which become **known to the auditor after the financial statement have been issued**

- ✚ **Discuss the matter** with management and, where appropriate, TCWG.
- ✚ Determine whether the financial statements **need amendment** and, if so,
- ✚ **Inquire how management intends to address** the matter in the financial statements.

If management **amends** the financial statements, the auditor shall:

- ✚ Carry out the audit procedures necessary in the circumstances on the amendment.
- ✚ Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements along with the auditor's report thereon is informed of the situation.
- ✚ Extend the audit procedures, in addition to the already performed procedures, to the date of the new auditor's report and issue new audit report on the amended financial statements.

If management **does not take the necessary steps** to rely on the financial statements along with the auditor's report and **does not amend** the financial statements in circumstances where the auditor believes they need to be amended, the auditor **shall notify management**.

Despite of such notification, management or TCWG **do not take these necessary steps**, the auditor **shall take appropriate action** to seek to prevent reliance on the auditor's report.

BASIC LEVEL

Case Study: ABC & Co. – Subsequent Fire Incident

ABC & Co., a manufacturing firm, closes its books on **31st March 2024**. The audit work was completed on **20th May 2024**, but the audit report was scheduled to be signed on **30th May 2024**.

On **25th May 2024**, a major fire broke out at one of the company's warehouses due to an electrical short circuit. Inventory worth ₹15 lakhs was destroyed. The loss was not covered by insurance.

Issue: Should the auditor of ABC & Co. consider this event in the financial statements as per **SA 560**?

Questions for Analysis:

1. Is the fire incident an **adjusting** or **non-adjusting** event?
2. What should the auditor do as per SA 560?
3. Should this event be **disclosed** in the financial statements?

Suggested Answer:

1. The fire occurred **after the reporting date** (31st March 2024) and does **not relate to conditions that existed as at the balance sheet date**. Hence, it is a **non-adjusting event**.

2. As per SA 560, the auditor should:

- Discuss the matter with management.
- Ensure that the event is appropriately disclosed in the notes to accounts.
- Consider whether the disclosure is adequate to inform users of its financial impact.

3. Since the event is material and affects users' understanding of the entity's financial position, **disclosure is necessary** in the financial statements, even though no adjustment is required.

INTERMEDIATE LEVEL

Case Study: XYZ Ltd. – Legal Case Settlement

XYZ Ltd. is a pharmaceutical company whose financial year ended on **31st March 2024**. The audit fieldwork was completed on **15th May 2024**, and the audit report was scheduled to be signed on **25th May 2024**.

XYZ Ltd. was involved in a legal case regarding the patent of one of its best-selling drugs. The case was ongoing as on 31st March 2024, and based on legal advice, the company had disclosed it as a contingent liability in the financial statements without making any provision.

On **20th May 2024**, the court ruled against XYZ Ltd., ordering it to pay damages of ₹5 crores. This was prior to the date of signing the audit report.

Questions for Analysis:

1. How should the auditor treat this court verdict under SA 560? and Is this an adjusting or non-adjusting event?
2. What actions should the auditor take before signing the audit report?
3. What are the implications if the company refuses to adjust the financial statements?

Suggested Answer:

1. The court's verdict relates to a condition that **existed at the balance sheet date** (i.e., the pending legal dispute). Therefore, this is an **adjusting event** under SA 560.
2. The auditor should:
 - Request management to make necessary **adjustments** in the financial statements by creating a **provision of ₹5 crores**.
 - Ensure proper **disclosure** of the event in notes to accounts.
 - Obtain a written representation confirming management's responsibility for the adjustments.
3. If management **refuses to adjust**, the auditor should:
 - Consider the effect of the unadjusted event on

the financial statements.

- Determine whether a **qualified or adverse opinion** is necessary, depending on the materiality and pervasiveness.
- Document the communication with management and those charged with governance.

EXAM LEVEL

Case Study: PQR Ltd. – Going Concern Doubt Arising After Balance Sheet Date

PQR Ltd. is engaged in the hospitality sector and had been impacted due to declining tourism in FY 2023–24. The financial statements for the year ended **31st March 2024** were prepared on a going concern basis. The audit work was completed on **20th May 2024**, and the audit report was to be signed on **27th May 2024**.

On **22nd May 2024**, PQR Ltd. received a notice from its main lender stating that the company's **loan facility of ₹50 crores has been revoked** due to continuous defaults. The lender also initiated **recovery proceedings under the Insolvency and Bankruptcy Code (IBC)**.

Management did not revise the financial statements and insisted that the going concern assumption was still appropriate.

Questions:

1. What type of event is this under SA 560 — adjusting or non-adjusting?
2. How should the auditor evaluate the impact of this event on the financial statements and audit report?
3. If management refuses to revise the financial statements, what is the auditor's responsibility?
4. Can the financial statements still be prepared on a going concern basis? Justify with reasoning.

Suggested Answer:

1. **The event is an adjusting event** under SA 560, as it provides additional evidence about conditions (financial weakness, loan defaults) that existed at the reporting date.
2. The auditor should:
 - Evaluate whether the **going concern assumption** is still valid in light of the post-balance sheet event.
 - Discuss with management and those charged with governance about the implications of loan revocation and legal proceedings.
 - If the event indicates that going concern is no longer appropriate, the **basis of preparation** must be changed from going concern to

liquidation basis or similar.

3. If management **refuses to revise** the financial statements:

- The auditor must assess whether the misstatement is **material and pervasive**.
- In such a case, the auditor should **issue an adverse opinion**, as the financial statements are not prepared on an appropriate basis.

4. Based on the revocation of loan and IBC proceedings, there is a significant doubt about the company's ability to continue as a going concern. Unless there is convincing evidence (e.g., fresh funding, restructuring plan), **the going concern basis is no longer appropriate**.

SA 570 – Going Concern (GC)

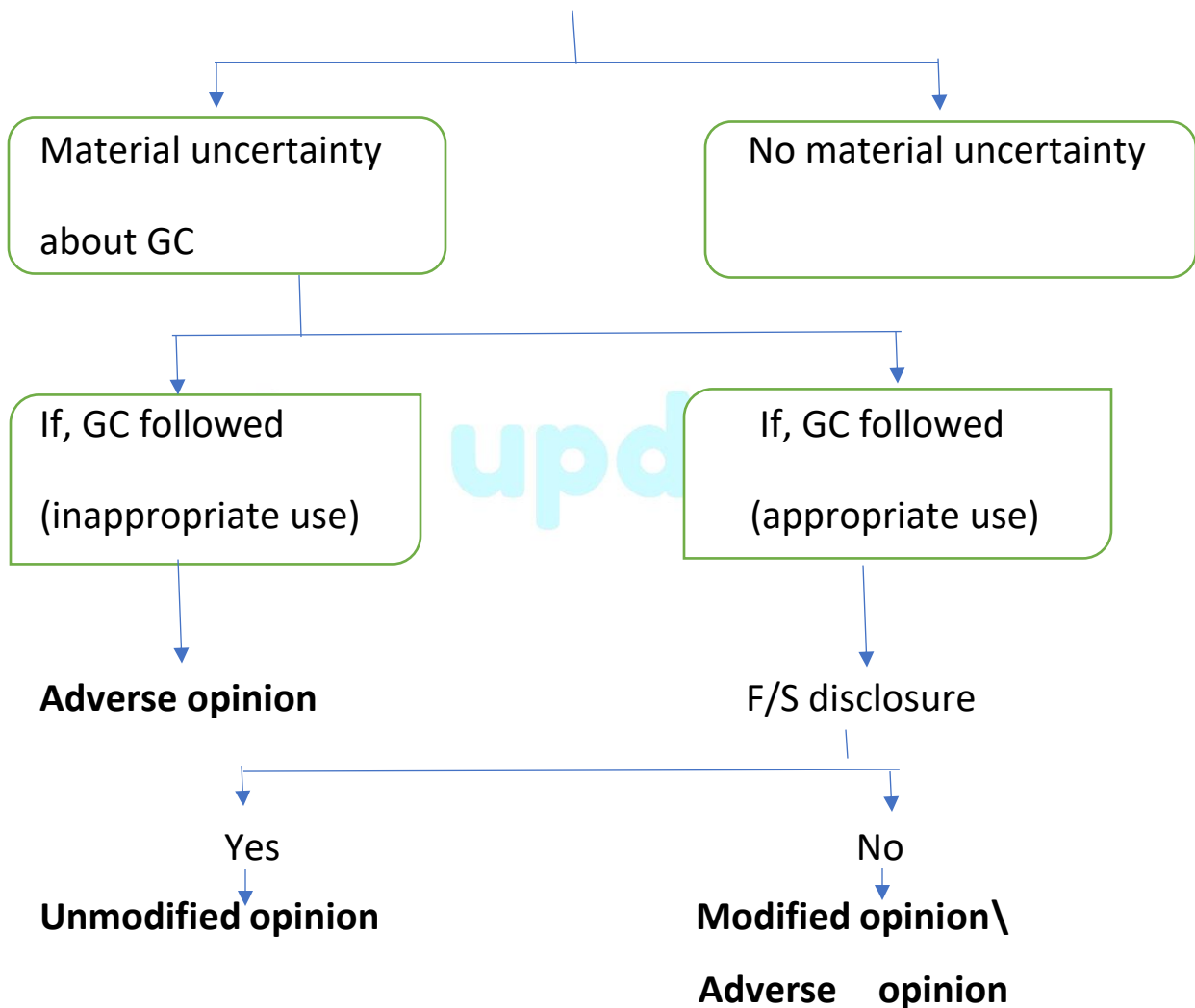
Preliminary Assessment of Management

(Events/ Conditions) – Symptoms of GC

Operating

Financing

Others



(Include the EMOP – Emphasis of Matters paragraph in audit report)

Note: In the Audit report shall include that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Objectives

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

Additional audit procedures when events or conditions are identified (Many times asked)

- ✚ Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

Note:

- In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework.
- If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements, the auditor shall request management to extend its assessment period to at least twelve months from that date.
- ✚ Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- ✚ Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:

- ♦ Evaluating the reliability of the underlying data generated to prepare the forecast; and
- ♦ Determining whether there is adequate support for the assumptions underlying the forecast.
- + Considering whether any additional facts or information have become available since the date on which management made its assessment.
- + Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

Auditor's Opinion

- + Management unwilling to make or extend its assessment - ***qualified opinion***.
- + If requested written representations from management regarding their plans for future actions and the feasibility of these plans is not reliable - ***disclaimer of opinion***.

BASIC LEVEL

Case Study: LMN Traders – Loss of Major Customer

LMN Traders is a wholesaler dealing in FMCG products. The financial year ended on **31st March 2024**. Around **40% of its sales** were to a single large customer, BigMart Ltd.

On **1st April 2024**, LMN received a written communication from BigMart stating that they will **discontinue business** with LMN from April 2024 due to internal restructuring.

Management believes this will not significantly impact operations, as they plan to find new customers. The auditor is in the process of conducting the audit and evaluating the impact of this development.

Questions for Discussion:

1. What does SA 570 require the auditor to assess in this case?
2. What steps should the auditor take to evaluate the **going concern** assumption?
3. Should this event impact the financial statements as on 31st March 2024?

Suggested Answer:

1. As per **SA 570**, the auditor is required to **assess the appropriateness of the going concern assumption** used in the preparation of financial statements.
2. The auditor should:
 - Obtain a written explanation from management regarding the impact of the loss of the major customer.
 - Review future cash flow projections, budgets, and management's plans for obtaining new customers.
 - Consider whether sufficient evidence exists to support management's conclusion that the entity will continue as a going concern.
3. Since the event occurred **after the balance sheet date**, but has a direct impact on the entity's future operations, it does **not require adjustment** but may require **disclosure** if it casts significant doubt on going concern. If the risk is high, the auditor should consider the need for an **Emphasis of Matter** or a **modified opinion**, depending on the adequacy of disclosures.

INTERMEDIATE LEVEL

Case Study: Delta Textiles Pvt. Ltd. – Bank Loan Renewal Pending

Delta Textiles Pvt. Ltd. is a garment manufacturing company. Its financial year ended on **31st March 2024**. The company has an outstanding working capital loan of **₹10 crores**, due for renewal on **15th April 2024**. As of the balance sheet date, the renewal was pending approval.

The management has prepared the financial statements on a **going concern basis**, assuming the loan will be renewed as usual. However, during the audit, the auditor noted that the company had been **irregular in interest payments** and the bank had **not yet communicated any decision** regarding the renewal, even by **20th May 2024**.

The management asserts that alternative financing is being explored and expects resolution soon.

Questions for Analysis:

1. What are the indicators of going concern risk in this case?
2. What audit procedures should be performed by the auditor as per SA 570?

3. What should the auditor do if management is unable to provide sufficient evidence of loan renewal or alternate funding?
4. How should the auditor report if management refuses to make adequate disclosure in the financial statements?

Suggested Answer:

1. Indicators of going concern risk:

- Major loan facility due for renewal with no confirmation from the bank.
- Past irregularity in interest payments.
- Uncertainty in securing alternate funding.

2. Audit procedures as per SA 570:

- Evaluate management's assessment of going concern, including assumptions and forecasts.
- Seek written confirmation or correspondence with the bank regarding renewal.
- Inquire about alternate funding arrangements and obtain supporting documents.

- Analyze cash flow forecasts and assess their reasonableness.

3. If sufficient evidence is not available:

- The auditor should conclude that a **material uncertainty exists** related to going concern.
- Ensure this uncertainty is adequately disclosed in the financial statements.
- If disclosed properly, include an **Emphasis of Matter** or **Material Uncertainty Related to Going Concern** paragraph.

4. If management refuses to disclose:

- The auditor should consider this a **material misstatement** due to inadequate disclosure.
- If the issue is material and pervasive, the auditor may issue a **qualified or adverse opinion**, as appropriate.

EXAM LEVEL

Case Study: Sunrise Hospitals Ltd. – Operating Losses and Negative Net Worth

Sunrise Hospitals Ltd. is a private healthcare provider. For the financial year ended **31st March 2024**, the company

incurred a **net loss of ₹18 crores**, and its **net worth turned negative**. The financial statements were still prepared on a **going concern basis**, with management citing the following mitigating factors:

- A proposal submitted to the State Government for a COVID-relief package, including subsidies and working capital assistance.
- Negotiations underway with private equity investors for a potential ₹25 crore infusion.
- Plans to reduce operating costs and close two unprofitable units.

As the auditor, you are reviewing these statements in **May 2024**. No firm agreements or sanction letters had been received for the funding or relief package as of the date of your audit report.

Required:

1. Identify the **red flags or indicators** that suggest a going concern risk.
2. What **specific audit procedures** would you perform under SA 570?
3. If management cannot provide sufficient appropriate audit evidence to support the going concern

assumption, how should the auditor modify the report?

4. What should the auditor do if the financial statements are appropriately prepared on going concern basis but disclose the material uncertainty adequately?

Suggested Answer:

1. Indicators of Going Concern Risk:

- Significant net losses and **negative net worth**.
- Reliance on **uncertain future funding** (relief package/investor infusion).
- No confirmed arrangements for support as of audit report date.
- Plans for cost reduction are **uncertain and not implemented**.

2. Audit Procedures as per SA 570:

- Evaluate **management's assessment** of going concern, including the assumptions used and forecast period (at least 12 months from balance sheet date).

- Verify correspondence and documentation related to **funding proposals**.
- Review the terms and likelihood of the relief package or private equity deal.
- Analyze **cash flow projections** and compare to historical performance.
- Discuss with management and those charged with governance the basis for preparing on a going concern basis.

3. **If sufficient audit evidence is not available to support going concern:**

- The auditor may issue a **qualified opinion** or **disclaimer of opinion**, depending on the significance of the uncertainty and the lack of evidence.

4. **If material uncertainty exists but is properly disclosed:**

- The auditor shall include a separate section titled **“Material Uncertainty Related to Going Concern”** in the audit report.

- No modification to the opinion is required in this case.

SA 580 – Written representation (WR)

Meaning - Written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.

Objective

- ✚ The Auditor requested the management or TCWG to provide confirmation regarding the fulfilment of Management responsibility to prepare & present F\S and provide information to the Auditor;
- ✚ Required by Auditor or other SA's, to support other audit evidence already obtained;
- ✚ To respond appropriately, if management provide requested written representation or if management did not provide requested written representation.

Written representation is –

- ✚ Corroborative (supportive) in nature.
- ✚ It is not a sufficient & appropriate audit evidence.
- ✚ Not a substitute for audit procedure performing.
- ✚ Management reconfirms its acknowledgement &

understanding of those responsibilities in audit engagement.

Who is responsible to provide requested written representation?

Those who are responsible for the preparation & presentation of F\S and who is knowledgeable of the matter requested by the Auditor.

Note: (Many times asked) In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

Written representation is specifically required when –

- ✚ Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- ✚ The terms of the audit engagement were prepared in a previous year;
- ✚ There is any indication that management misunderstands those responsibilities; or

- ✚ Changes in circumstances make it appropriate to do so.

Date & Period of WR - Requested WR shall be provide for the periods covered in the Audit report.

Form of WR (many times asked)

- ✚ Representation letter
- ✚ If company have regulatory obligation to make written public statement, the matters covered by such statement need not to be included in WR.

Disclaimer of Opinion

- ✚ Doubt on reliability of WR –
 - In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity and ethical values, shall determine the whether effect the reliability of representations and audit evidence in general.
 - If the auditor concludes that the written representations are not reliable the auditor shall take appropriate actions having regard to the requirement of disclaimer of opinion.

✚ **WR not provided** by management as requested by Auditor.

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

- **Discuss the matter** with management;
- **Re-evaluate the integrity** of management and evaluate the effect on the reliability of representations and audit evidence in general; and
- **Take appropriate actions.**

BASIC LEVEL

Case Study: RST Pvt. Ltd. – Obsolete Inventory

RST Pvt. Ltd. is a company engaged in the manufacturing of electronic gadgets. During the audit for the year ended **31st March 2024**, the auditor noticed that a portion of the inventory, valued at ₹4 lakhs, consisted of old models that might not be saleable due to technological obsolescence.

When the auditor inquired, the **management stated orally** that the inventory is **usable and saleable** at full value and that no write-down is necessary. However, they were **reluctant to give this confirmation in writing.**

Questions for Discussion:

1. What does SA 580 require in such a situation?

2. What should the auditor do if management refuses to provide written representation?
3. Can the auditor rely solely on oral explanations?

Suggested Answer:

1. As per **SA 580**, the auditor is required to obtain **written representations** from management on matters where other sufficient appropriate audit evidence cannot be reasonably expected, including judgments like inventory valuation.
2. If **management refuses** to provide a written representation:
 - The auditor should consider this a **limitation on the scope of the audit**.
 - This may lead the auditor to issue a **qualified opinion or disclaimer**, depending on the materiality.
3. Oral explanations alone **do not constitute sufficient audit evidence**. The auditor must obtain **written representation** to support management's assertion, especially when audit evidence from other sources is limited.

INTERMEDIATE LEVEL

Case Study: JKL Ltd. – Pending Litigation and Written Representations

JKL Ltd. is a construction company being audited for the year ended **31st March 2024**. The company is involved in a **legal dispute** with a subcontractor, where the subcontractor is claiming damages of ₹3 crores.

Management has disclosed the matter as a **contingent liability** in the notes to accounts, based on legal advice that the case is unlikely to result in a significant loss. The auditor asks for written representation confirming:

- Management's view on the outcome of the litigation.
- That all legal cases and contingent liabilities have been fully disclosed.

However, management **provides legal opinions but delays the written representation**, saying it's unnecessary since legal documents have been shared.

Questions:

1. Is the auditor justified in insisting on written representations even when legal documents are available?

2. What is the objective of obtaining written representations under SA 580 in this scenario?
3. What should the auditor do if management ultimately refuses to provide written representation?

Suggested Answer:

1. **Yes**, the auditor is justified. As per **SA 580**, written representations are necessary to **confirm management's responsibilities** and assertions, especially when matters involve **significant judgment**—like legal disputes.
2. The objective of obtaining written representation is to:
 - Confirm management's assertion that all known liabilities and contingencies have been disclosed.
 - Support audit evidence with a formal acknowledgement of management's **responsibility and judgment**.
 - Serve as audit evidence, particularly when there is **limited objective evidence** (like in legal matters).

3. If management **refuses** to provide written representation:

- It constitutes a **limitation on the scope** of the audit.
- The auditor should consider issuing a **qualified opinion or disclaimer of opinion**, depending on the **materiality and pervasiveness** of the matter.

EXAM LEVEL

Case Study: Nova Tech Solutions Ltd. – Capitalization of Development Costs

Nova Tech Solutions Ltd., an IT company, develops custom software for clients. For the year ended **31st March 2024**, the company has capitalized **₹12 crores** as **internally generated software development costs** under intangible assets.

As part of the audit, you reviewed the documentation supporting these costs, including time logs, project reports, and accounting policies. However, the **appropriateness of capitalization depends heavily on management's judgment** about technical feasibility, intention to complete, and future economic benefits — factors that are difficult to independently verify.

You requested a **written representation** from **management** asserting that:

- The capitalization of development costs is appropriate.
- The criteria for recognition under AS 26 / Ind AS 38 have been met.
- All estimates and assumptions used are reasonable and based on the best information available.

Management is hesitant, stating that the documents provided during the audit should be sufficient.

Required:

1. Why is a written representation **necessary** in this case despite the availability of documentation?
2. What does **SA 580** require the auditor to do when management is reluctant to provide written representations?
3. If management refuses to provide the written representation, how should the auditor **respond in the audit report**?

Suggested Answer:

1. A **written representation is necessary** because:

- The capitalization involves **significant management judgment**.
- The auditor cannot obtain sufficient appropriate audit evidence from other sources regarding management's intent and assumptions.
- Written representation formalizes management's **assertion and accountability**, especially in judgment-sensitive areas like internally generated assets.

2. As per **SA 580**, when management is reluctant:

- The auditor should **explain the purpose and importance** of written representations.
- Emphasize that it is part of the standard audit process and not an indication of mistrust.
- If still not provided, the auditor must consider this a **scope limitation**.

3. If management **refuses** to provide the representation:

- It constitutes a **limitation on scope**.

- The auditor must assess whether this limitation is **material and pervasive**.
- Likely, the auditor will need to issue a **qualified opinion** or a **disclaimer of opinion**, depending on the extent of reliance on the representation.

SA 260 – Communicating with TCWG

Objective –

- ✚ To **communicate clearly** with those charged with governance the **responsibilities of the auditor** in relation to the financial statement audit, and an **overview of the planned scope and timing of the audit**;
- ✚ To **obtain** from those charged with governance **information relevant to the audit**;
- ✚ To **provide** those charged with governance with **timely observations** arising from the audit **that are significant** and relevant to their responsibility **to oversee the financial reporting process and**
- ✚ To **promote effective two-way communication** between the auditor and those charged with governance.

Matters to be communicated by Auditor - Certain issues must communicate with TCWG by Auditor:

- ✚ Auditor's responsibilities (Audit of F/S & express opinion thereon).
- ✚ Planned scope and timing of audit.
- ✚ Significant findings -
 - Significant difficulties
 - Significant matters
 - Written representation
 - Situation affect form & content of Audit report
 - Required by Auditor

Communication regarding Auditor's Independence in case of Listed entities

- ✚ Provide **statement** that denote the **compliance of Ethical requirement** during audit.
- ✚ Communicate **details of other relationship** between entity & Auditors or audit firm.
- ✚ Related **safeguards undertaken** to protect independence.

Note: The auditor shall communicate on **timely basis** in the form of **written communication**.

Documentation

- ✚ Where matters required by SA 260 to be communicated are **communicated orally**, the auditor shall **include them in the audit documentation**, and **when and to whom** they were communicated.
- ✚ Where matters have been **communicated in writing**, the auditor **shall retain a copy of the communication** as part of the audit documentation.

Who are “Those charged with governance”?

(Many times, asked)

The person(s) or organization(s) with **responsibility** for overseeing the strategic direction of the entity and obligations related to the **accountability of the entity**. This includes **overseeing the financial reporting process**.

In some cases, **the appropriate persons with whom to communicate** may not be clearly identifiable.

In such cases, the auditor **may need to discuss and agree with the engaging party the relevant persons with whom to communicate**. The appropriate persons with whom to communicate may **vary depending on the matter to be communicated**.

BASIC LEVEL

Case Study: ZYX Pvt. Ltd. – Change in Accounting Policy

During the audit of **ZYX Pvt. Ltd.** for the year ended **31st March 2024**, the auditor noted that the company had changed its accounting policy for valuing inventory — from **FIFO to Weighted Average Method**. The change was disclosed in the notes to accounts, and the management informed the auditor that the change was made to better reflect the cost flow.

The audit team concluded that the change is in accordance with the applicable accounting standards and results in a material impact on the financial statements.

Questions for Discussion:

1. What does **SA 260** require the auditor to do in this case?
2. Who are considered “**those charged with governance**”?
3. Why is communication important in such situations?

Suggested Answer:

1. As per **SA 260**, the auditor is required to

communicate significant qualitative aspects of the entity's accounting practices to those charged with governance.

In this case, the **change in accounting policy** is a significant matter that must be formally communicated, even if it is in accordance with accounting standards.

2. **“Those charged with governance”** typically refers to:

- The **Board of Directors** (in a private limited company), or
- The **Audit Committee**, if one exists.

3. Communication is important because:

- It ensures transparency regarding matters that affect the financial reporting.
- It helps those charged with governance understand the implications of management's decisions.
- It supports the auditor's responsibility to maintain an open and constructive dialogue during the audit.

INTERMEDIATE LEVEL

Case Study: ABC Ltd. – Internal Control Deficiencies

ABC Ltd. is a manufacturing company that has been facing challenges in its internal controls over inventory management. During the audit for the year ended **31st March 2024**, the auditor discovered significant deficiencies in internal controls, particularly in the **inventory count process**. The following were observed:

- No regular reconciliation between the physical stock and the system records.
- Inconsistent approval process for write-offs and stock adjustments.
- Lack of segregation of duties between the staff involved in recording and verifying stock.

While the deficiencies are not material enough to affect the financial statements directly, they may result in a **risk of material misstatement** in the future.

The auditor has discussed these issues with management, and the management has indicated that they will address these issues by the end of the year.

Questions for Analysis:

1. **What should the auditor communicate to those charged with governance** about these internal control deficiencies under SA 260?
2. Who are considered **“those charged with governance”** in this scenario, and how should they be informed?
3. **What further steps should the auditor take** if management is unable to correct the deficiencies before the report date?

Suggested Answer:

1. **Communication with Those Charged with Governance:**

- Under **SA 260**, the auditor is required to **communicate deficiencies** in internal controls that could **potentially result in material misstatements**, even if they are not immediately affecting the current financial statements.
- The auditor should specifically inform those charged with governance about the **nature and**

extent of the deficiencies, the potential risk of material misstatement, and recommend any necessary improvements.

2. Who are Those Charged with Governance:

- In a company like ABC Ltd., those charged with governance are typically the **Board of Directors** or, if applicable, the **Audit Committee**.
- The communication should be formal and addressed to the **Board of Directors** or the **Audit Committee**, depending on the structure of governance at ABC Ltd.

3. Further Steps if Deficiencies Are Not Corrected:

- If management is unable to correct the deficiencies before the report date, the auditor may need to assess the **potential impact** on the financial statements and decide whether additional disclosures are needed.
- The auditor should also evaluate whether these deficiencies could **affect the risk of material misstatement** in future periods and might need to **modify their opinion** if the deficiencies are severe and pervasive enough to warrant it.

EXAM LEVEL

Case Study: Global Foods Pvt. Ltd. – Financial Reporting and Governance Issues

Global Foods Pvt. Ltd., a food manufacturing company, has experienced rapid growth in the past year, expanding its operations into new regions. During the audit for the year ended **31st March 2024**, the auditor identified the following issues:

1. **Inconsistent Revenue Recognition:** The company recognized revenue from sales when orders were shipped, rather than when payments were received, leading to potential overstatement of revenue. This practice was not aligned with the accounting policy disclosed in the financial statements.
2. **Inadequate Accounting for Inventory:** The company does not have a proper policy for valuing inventory at the lower of cost or market value, which raises concerns over the accuracy of inventory valuation, particularly with perishable goods.
3. **Significant Related Party Transactions:** The company had **undisclosed transactions** with a related party, a company owned by the managing director's family.

These transactions were not properly disclosed in the financial statements, even though they were material.

The auditor discussed these issues with the **management** during the audit process. Management has provided a **verbal assurance** that these issues will be rectified in the next financial year. However, the auditor has **not received written confirmation** from management regarding the future actions on these matters.

Required:

1. What is the key communication pointing the auditor must address with **those charged with governance** under SA 260 regarding these issues?
2. Who are considered **those charged with governance** in this scenario, and how should they be informed?
3. What is the auditor's responsibility if the issues are not resolved before the audit report date?
4. How should the auditor report if management refuses to make appropriate disclosures regarding the related party transactions?

Suggested Answer:

1. Key Communication Points to Those Charged with Governance:

- **Revenue Recognition Practice:** The auditor must inform those charged with governance of the **inconsistency in revenue recognition** and how this might lead to a **material misstatement** in the financial statements.
- **Inventory Valuation Issue:** The auditor should communicate the lack of a **proper inventory valuation policy**, highlighting the risks of incorrect asset valuation and potential financial misstatements.
- **Related Party Transactions:** The auditor must stress the **undisclosed related party transactions**, which could constitute a **material breach of accounting standards** (AS 18/Ind AS 24) and result in a **misleading presentation of financial statements**.
- The auditor should also provide **recommendations** for improvement and stress the **importance of timely resolution** of these

issues to ensure the integrity of the financial statements.

2. Who are those charged with governance and how should they be informed:

- In this case, those charged with governance are likely the **Board of Directors**, including any **Audit Committee** if applicable.
- The auditor should communicate directly with **those charged with governance** through a formal letter or report, addressing the **audit findings** and any concerns that could affect the financial statements. This should be done in a **written form**, emphasizing the importance of addressing these matters.

3. Auditor's Responsibility if Issues Are Not Resolved:

- If these issues are not resolved before the audit report date:
 - The auditor must evaluate whether the issues represent a **material misstatement** that could affect the **true and fair view** of the financial statements.

- The auditor should assess whether these issues affect the **financial statements as a whole**, and whether they require **modifications** to the audit opinion.
- If management fails to correct the issues and there is a **material misstatement**, the auditor may need to issue a **qualified opinion** or, in the most severe cases, an **adverse opinion**, depending on the nature and pervasiveness of the issues.

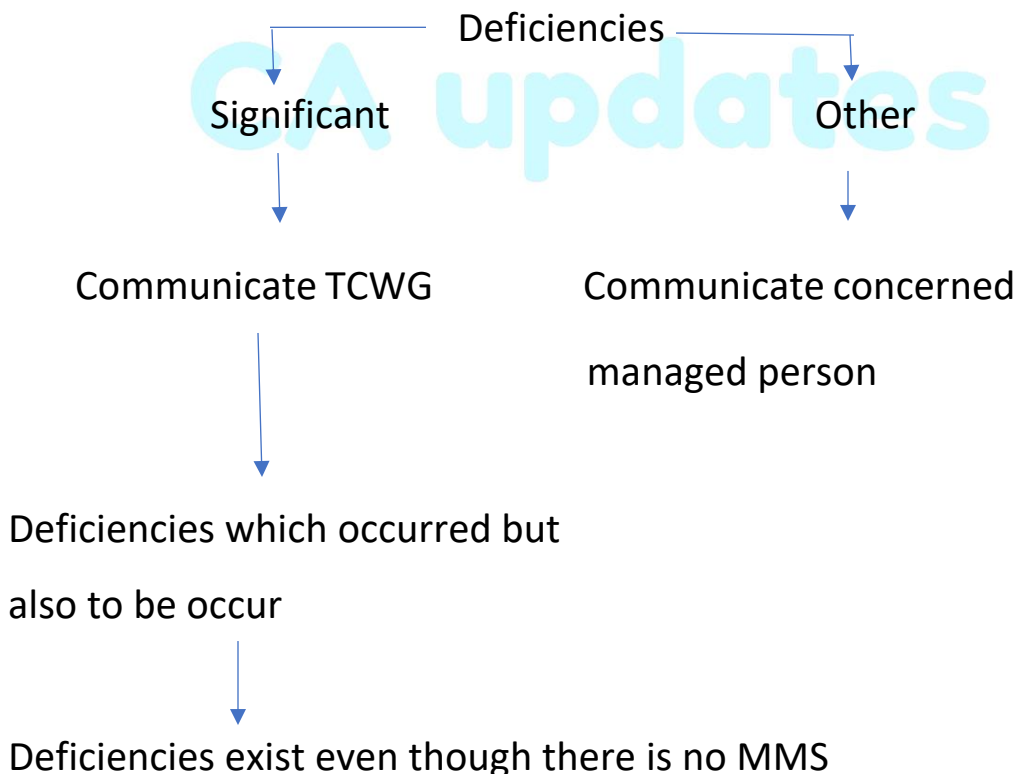
4. Auditor's Response if Management Refuses to Make Disclosures:

- If management refuses to **disclose related party transactions**, the auditor has an obligation to:
 - Consider this a **limitation on the scope** of the audit if the transactions are material and not disclosed.
 - The auditor must then consider whether this issue results in a **misstatement of the financial statements**. If so, the auditor should issue a **qualified opinion** or

disclaimer of opinion, depending on the pervasiveness of the issue.

- The refusal to disclose such material transactions is a **serious matter** and should be reported to those charged with governance, along with the potential consequences for the audit opinion.

SA 265 – Communicating Deficiencies in the internal control to TCWG & management



BASIC LEVEL

Case Study: PQR Electronics Pvt. Ltd. – Deficiencies in Payment Authorization Process

PQR Electronics Pvt. Ltd. is an electronics wholesaler. During the audit for the year ended **31st March 2024**, the auditor discovered a deficiency in the company's internal control system concerning the **payment authorization process**. Specifically:

- Payments to suppliers were being processed by the accounting team without proper **approval from the senior management**.
- The company has no formal policy for **segregation of duties** between the staff responsible for processing payments and those responsible for verifying invoices.

The auditor discussed these findings with the management, and management confirmed that these issues had been overlooked due to staff shortages. Management assured the auditor that corrective actions would be taken in the coming months.

Questions for Discussion:

1. What deficiencies in internal control were identified in this case?
2. As per **SA 265**, what is the auditor's responsibility regarding these deficiencies?

3. How should the auditor communicate these deficiencies to **those charged with governance**?
4. What actions should the auditor take if management does not take corrective actions in a reasonable time?

Suggested Answer:

1. Deficiencies Identified in Internal Control:

- **Lack of authorization:** Payments to suppliers were being processed without proper management approval, which could lead to unauthorized or fraudulent payments.
- **Lack of segregation of duties:** The same staff responsible for processing payments also verified invoices, creating a risk of errors or fraud due to insufficient checks and balances.

2. Auditor's Responsibility under SA 265:

- The auditor must **evaluate and report deficiencies** in internal controls that could affect the financial statements. These deficiencies may increase the risk of material misstatements.

- If the deficiencies are significant, the auditor must **communicate them** to both management and those charged with governance.

3. Communication to Those Charged with Governance:

- Under **SA 265**, the auditor must communicate **significant deficiencies** in internal controls to those charged with governance in writing.
- This communication should include:
 - The **nature of the deficiency**.
 - **Potential effects** on the financial statements.
 - **Recommendations for corrective actions**.
- In this case, the **Audit Committee** or **Board of Directors** should be informed about the deficiencies in the payment authorization process and the lack of segregation of duties.

4. Actions if Management Does Not Correct Deficiencies:

- If management does not take corrective actions in a reasonable time, the auditor should **consider the impact** of these deficiencies on the audit opinion.

- If the deficiencies are significant and pervasive, the auditor may need to **modify the audit opinion** and consider issuing a **qualified or adverse opinion** depending on the severity of the issue.
- The auditor should **follow up** with management and governance to ensure the matter is addressed appropriately.

INTERMEDIATE LEVEL

Case Study: PQR Electronics Pvt. Ltd. – Payment Authorization Deficiency

- PQR Electronics Pvt. Ltd. has deficiencies in its internal control over the **payment authorization process**.
- **Payments were processed without proper approval**, and there was no **segregation of duties** between those responsible for processing payments and verifying invoices.

Questions:

1. What deficiencies in internal control were identified?
2. What is the auditor's responsibility under SA 265?
3. How should the auditor communicate these deficiencies?

4. What actions should the auditor take if management does not take corrective actions?

Suggested Answer:

1. Identified deficiencies in internal control

- **Lack of authorization:** Payments were made without senior management's approval.
- **Inadequate segregation of duties:** The same employees handled both processing and verification of payments, increasing the risk of errors or fraud.

2. Auditor's responsibility

- The auditor is required to **evaluate and communicate deficiencies in internal controls** that may lead to material misstatements in the financial statements.
- These deficiencies must be communicated to **management and those charged with governance**.

3. Auditor should communicate

- The auditor should **document and communicate** the deficiencies in writing to **those charged with governance** (e.g., the Board of Directors or Audit Committee).

- The communication should include:
 - **Nature of the deficiency.**
 - **Potential impact** on the financial statements.
 - **Recommendations for corrective actions.**

4. Auditor's action, if management does not take corrective actions

- If management fails to correct the deficiencies, the auditor should evaluate their **impact on the financial statements**.
- If the deficiencies are significant and affect the financial statements, the auditor should consider issuing a **qualified opinion** or **adverse opinion**.
- The auditor should also follow up with **management and governance** to ensure that corrective actions are implemented.

EXAM LEVEL

Case Study: PQR Electronics Pvt. Ltd. – Deficiency in Payment Authorization Process

During the audit for the year ended **31st March 2024**, the auditor identified significant deficiencies in PQR Electronics Pvt. Ltd.'s internal

control, particularly in the **payment authorization process**. Specifically, the deficiencies included:

- Payments to suppliers were processed by the accounting team **without proper approval from senior management**.
- There was a **lack of segregation of duties**, with the same employees responsible for both processing payments and verifying invoices.

Management acknowledged these issues and indicated that they would rectify them in the upcoming financial year. However, the auditor must determine the appropriate course of action under **SA 265**.

Questions:

CA updates

1. What deficiencies in internal control were identified?
2. What is the auditor's responsibility under SA 265 regarding these deficiencies?
3. How should the auditor communicate these deficiencies to those charged with governance?
4. What should the auditor do if management does not take corrective actions in a reasonable time?

Suggested Answers:

1. Identified deficiencies in internal control

- **Lack of authorization:** Payments were being processed without proper senior management approval, creating a risk of unauthorized payments or fraud.
- **Lack of segregation of duties:** The same individuals were responsible for both verifying invoices and processing payments, which increases the risk of errors or fraudulent activities going undetected.

2. Auditor's responsibility

- Under **SA 265**, the auditor is required to **identify and communicate deficiencies in internal control** that could lead to material misstatements in the financial statements.
- The deficiencies must be communicated to **those charged with governance** (e.g., Board of Directors or Audit Committee) if they are significant. The communication should highlight the **nature and potential impact** of these deficiencies on the financial statements and recommend corrective actions.

- Even if the deficiencies do not directly impact the current financial statements, their **potential effect on future periods** and **control risks** must be communicated.

3. Auditor should communicate

- The auditor must **formalize the communication in writing**, outlining:
 - The **nature and specific details** of the deficiencies, including their **potential impact** on the financial statements.
 - **Management's response** to the deficiencies (including any planned corrective actions).
 - **Recommendations** for improvements in internal control and mitigating risks.
- The communication should be made to **those charged with governance** (such as the **Audit Committee** or **Board of Directors**), who are responsible for overseeing management's corrective actions.

4. Auditor's action, if management does not take corrective actions

- If management does not take timely corrective actions, the auditor must assess whether these deficiencies represent a **material weakness** or

control deficiency that could lead to a **material misstatement** in the financial statements.

- If the deficiencies are not corrected, the auditor may need to **modify the audit opinion** based on the pervasiveness of the deficiencies. This could lead to:
 - **A qualified opinion** if the deficiencies are material but not pervasive.
 - **An adverse opinion** if the deficiencies are both material and pervasive.
- The auditor should also consider whether the failure to correct deficiencies affects the **audit scope** and whether further **follow-up** is required with management and governance.

Conclusion:

In this scenario, the auditor is required to communicate internal control deficiencies, particularly concerning the **authorization of payments** and **segregation of duties**, which are fundamental to preventing errors or fraud. If not addressed, these deficiencies could lead to a modified audit opinion due to their impact on the financial statements. The auditor must ensure clear, documented communication with those charged with governance and follow up on corrective actions.

AUDIT REPORT

SA 700 (Revised)- Forming an Opinion and Reporting on Financial Statements

Objective

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

To Form Opinion - The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Evaluations by the Auditor – This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.

Specific Evaluations

- ✚ Selected and applied significant accounting policies are adequately disclosed.
- ✚ Accounting policies are consistent with applicable financial reporting framework.

- ✚ Accounting estimates by management are reasonable.
- ✚ Information in financial statement is relevant, reliable, comparable and understandable.
- ✚ Disclosures in financial statements are adequate to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.
- ✚ Terminology used in financial statements is appropriate

Fair presentation framework (Asked many times)

Evaluation in case of Fair presentation framework -

Further, when the financial statements are prepared in accordance with a fair presentation framework, shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation which shall include consideration of:

- ✚ The overall presentation, structure and content of the financial statements; and
- ✚ Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

Auditor's Opinion



Unmodified Opinion

Modified Opinion (SA 705)

Unmodified Opinion: The auditor shall express an **unmodified opinion** when the auditor **concludes** that the **financial statements are prepared**, in all material respects, in accordance with the applicable financial reporting framework.

Modified Opinion: If the auditor-

- ✚ The auditor **concludes** that, based on the audit evidence obtained, the financial statements **as a whole are not free from material misstatement**; **or**
- ✚ The auditor is **unable to obtain** sufficient appropriate **audit evidence** to conclude that the financial statements as a whole are free from material misstatement.

The auditor shall **modify the opinion** in the auditor's report in accordance with SA 705.

Types of Auditor's Opinion

There are **three types** of modified opinions, namely-

1. A qualified opinion –
2. An adverse opinion
3. A disclaimer of opinion

A qualified opinion - The auditor shall express a qualified opinion when:

- ✚ The auditor, having **obtained** sufficient appropriate audit **evidence**, **concludes** that **misstatements**, individually or in the aggregate, **are material**, **but not pervasive**, to the financial statements; **or**
- ✚ The auditor is **unable to obtain** sufficient appropriate **audit evidence** on which to base the opinion, **but the auditor concludes** that the possible effects on the financial statements of **undetected misstatements**, if any, **could be material** **but not pervasive**.

An adverse opinion - The auditor shall express an adverse opinion when the auditor, having **obtained** sufficient appropriate audit **evidence**, **concludes that misstatements**, individually or in the aggregate, **are both material** **and pervasive** to the financial statements.

A disclaimer of opinion - The auditor shall disclaim an opinion when the auditor is **unable** to obtain sufficient appropriate audit **evidence**.

NOTE: The auditor shall disclaim an opinion **when, in extremely rare circumstances** involving **multiple uncertainties**, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, **it is not possible to form an opinion on the financial statements** due to the **potential interaction of the uncertainties and their possible cumulative effect** on the financial statements.

In crisp,

Types of Opinion	Evidence	Material Misstatement (MMS)	Pervasive
Qualified opinion	Yes	Yes	No
	No	Yes	No
Adverse opinion	Yes	Yes	Yes
Disclaimer of opinion	No	Yes	Yes

NOTE: Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

When the auditor (decides) expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

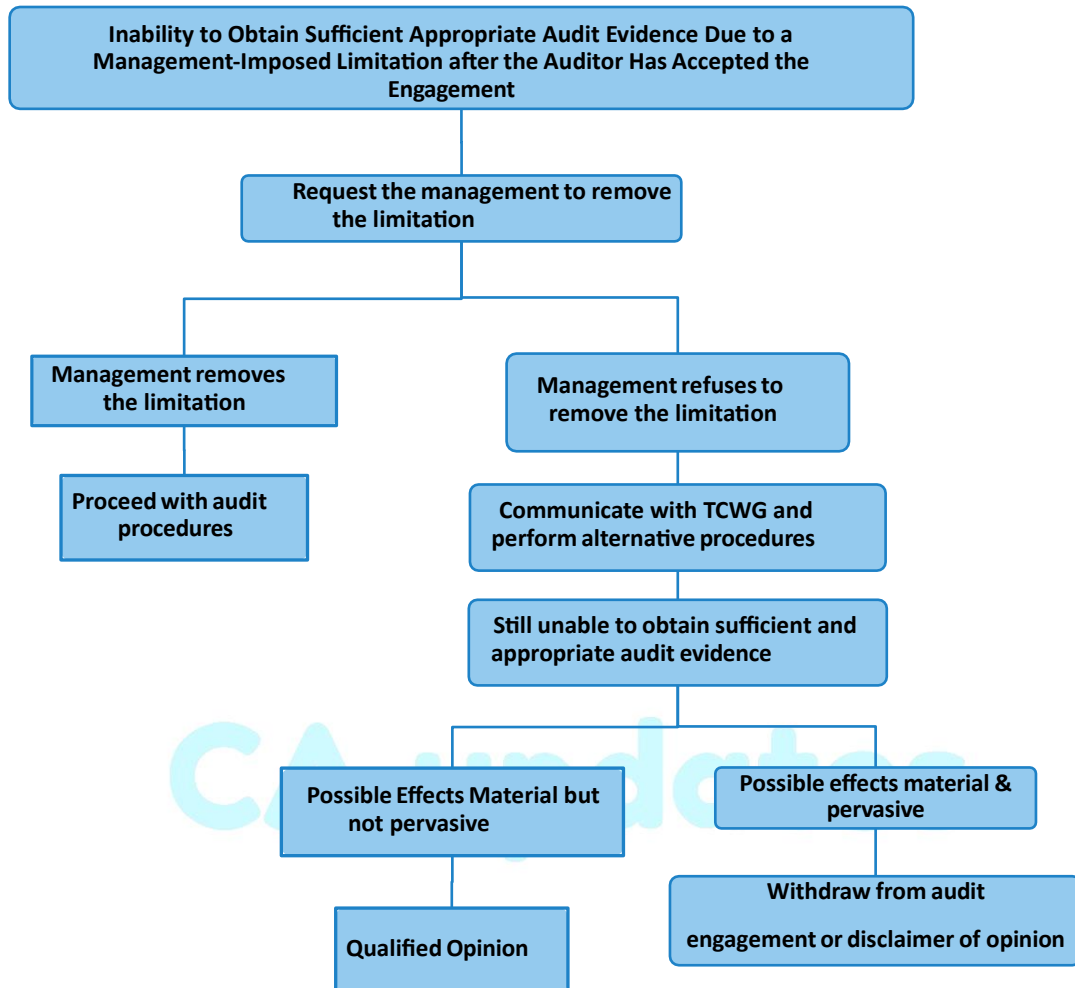
Which type of opinion is appropriate? - It depends upon:

- ✚ The nature of the matter giving rise to the modification; and
- ✚ The auditor's judgement about the pervasiveness

Definition of Pervasive – A term used, in the context of misstatements, to describe the effects or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Pervasive effects on the financial statements are those that, in the auditor's judgement: **(Many times asked)**

- (i) Are confined to many elements, accounts or items of the financial statements;
- (ii) If so confined, represent a substantial proportion of single item of the financial statements; or
- (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.



Elements AUDITOR'S REPORT - The auditor's report shall be in writing, include the following elements -

- + Title
- + Addressee
- + Auditor's Opinion
- + Basis for opinion
- + Going concern (SA 570)

- ✚ Key Audit Matters (SA 701)
- ✚ Other Information – Emphasis of matters (SA 706) & Other matters (SA 706)
- ✚ Responsibilities for the F\S (Management's responsibility)
- ✚ Auditor's Responsibilities
- ✚ Location of the description of the auditor's responsibilities
- ✚ Other Reporting Requirements (CARO)
- ✚ Signature of the Auditor
- ✚ Place of signature
- ✚ Date of the Auditor's Report

Title: The auditor's report shall have a title that clearly indicates that it is the **report of an independent auditor**.

For example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

Addressee: The auditor's report is normally **addressed to** those for **whom the report is prepared**, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

Auditor's Opinion:

The introductory language in this section of the auditor's report shall state that -

- ✚ Identify the entity whose financial statements have been

audited;

- + State that the financial statements have been audited;
- + Identify the title of each statement comprising the financial statements;
- + Refer to the notes, including the summary of significant accounting policies; and
- + Specify the date of, or period covered by, each financial statement comprising the financial statements.

The following points will be continued to the above-mentioned points as appropriate to the types of opinions. **(Asked many times)**

Unmodified Opinion:

When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, **use one of the following phrases**, which are regarded as being equivalent:

- (a) In our opinion, the accompanying financial statements **present fairly, in all material respects**, [...] in accordance with [the applicable financial reporting framework]; or
- (b) In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].

The phrases **“present fairly, in all material respects,”** and **“give a true and fair view”** are regarded as being equivalent.

Qualified Opinion:

- ✚ When the auditor expresses a qualified opinion **due to a material misstatement** in the financial statements, the auditor shall state that, in the auditor's opinion, **except for the effects of the matter(s) described in the Basis for Qualified Opinion section.**
- ✚ When the modification arises from an **inability to obtain sufficient appropriate audit evidence**, the auditor shall use the corresponding phrase **“except for the possible effects of the matter(s) ...**

Adverse Opinion:

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, **because of the significance of the matter(s) described in the Basis for Adverse Opinion section.**

Disclaimer of Opinion:

When the auditor disclaims an opinion due to an **inability to obtain sufficient appropriate audit evidence**, the auditor shall:

- ✚ State that the **auditor does not express an opinion** on the accompanying financial statements;
- ✚ State that, **because of the significance of the matter(s) described in the Basis for Disclaimer of**

Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

- ✚ Amend the statement required by SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- ✚ States that the audit was conducted in accordance with Standards on Auditing;
- ✚ Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- ✚ Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- ✚ States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

In case of Modified Opinion - Amend the heading “Basis for Opinion” required by SA 700 (Revised) to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate; and within this section, include a description of the matter giving rise to the modification.

NOTE: Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

Going Concern (SA 570) – refer Chap 7

Key Audit Matters - KAM (SA 701)

- ✚ Key Audit Matters are those matters that, in the auditor’s professional judgement were of most significance in the audit of the financial statements of the current period.
- ✚ Key audit matters are selected from matters communicated with those charged with governance.

Purpose of Communicating Key Audit Matters

To enhance the communicative value of the auditor’s report by providing greater transparency about the audit that was performed.

Determining Key Audit Matters - Those matters that required significant auditor's attention in the process of performing audit procedures.

Factors which determine to include those matters in KAM –

- ✚ Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- ✚ Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
- ✚ The effect on the audit of significant events or transactions that occurred during the period.

How to Communicate Key Audit Matters in Audit report?

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". The introductory language in this section of the auditor's report shall state that:

- ✚ Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements [of the current period]; and

- ✚ These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

Communicating Key Audit Matters is not a substitute for –

- ✚ Disclosures in the financial statements that the applicable financial reporting framework **requires management to make**, or that are otherwise necessary to achieve fair presentation;
- ✚ Auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- ✚ Reporting in accordance with SA 570 (Going concern) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- ✚ A separate opinion on individual matters.

Communication with Those Charged with Governance - The auditor shall communicate with those charged with governance:

- ✚ Those matters the auditor has determined to be the key audit matters; or

- ✚ If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report.

Other Information – Emphasis of matters (SA 706) & Other matters (SA 706)

Emphasis of matters (SA 706)

- ✚ Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
- ✚ The auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:
 - The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
 - When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Separate section for Emphasis of Matter paragraph– Read examples in page No. 8.49.

An Emphasis of Matter paragraph is not a substitute for

- ✚ Disclosures in the financial statements that the applicable financial reporting framework requires management to make;

- ✚ Auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised); or
- ✚ Reporting in accordance with SA 570 (Going concern) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Other matters (SA 706)

- ✚ Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to user's understanding of the audit, the auditor's responsibilities or the auditor's report.
- ✚ The auditor shall include an Other Matter paragraph in the auditor's report, provided:
 - This is not prohibited by law or regulation; and
 - When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Separate section for Other Matter paragraph in Audit report required, When the auditor includes an Other Matter paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading.

Communication with Those Charged with Governance

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.

Responsibilities for the F\S (Management's responsibility)

- ✚ Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
- ✚ Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.

Auditor's Responsibilities

Auditor's responsibility section to state -

- Objectives of the auditor
- That reasonable level of assurance is high level of assurance and not guarantee
- That misstatements can arise from fraud and error

Auditor's responsibility section to further –

- ✚ State that auditor exercises professional judgement and maintains professional skepticism.
- ✚ Describe an audit by stating that auditors' responsibilities are:
 - To identify and assess the risks of material misstatement
 - To obtain an understanding of the internal control system
 - To evaluate the appropriateness of accounting policies
 - To conclude the appropriateness of management's use of going concern
 - To evaluate the overall presentation, structure and content of financial statements
- ✚ Describe auditor's responsibility in group audit.

When the auditor **disclaims an opinion**, the auditor **shall amend the description of the auditor's responsibilities** required by SA 700 –

- ✚ A **statement** that the auditor's responsibility **is to conduct an audit** of the entity's financial statements in accordance with Standards on Auditing **and to issue an auditor's report**;
- ✚ A **statement** that **because of the matter(s) described in the Basis for Disclaimer of Opinion section**, the auditor **was not able to obtain** sufficient appropriate **audit evidence** to provide a basis for an audit opinion on the financial statements; and
- ✚ The **statement about auditor independence** and other ethical responsibilities required by SA 700 (Revised).

Location of the description of the auditor's responsibilities

- ✚ Within the body of the auditor's report
- ✚ Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or
- ✚ By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

Other Reporting Requirements

- ✚ Reporting requirements under the companies act, 2013 (refer page no. 8.68) – Read line by line because all points are important.
- ✚ Reporting under companies auditor's report order, 2020 (CARO,2020)- (refer page no. 8.73) - Read line by line because all points are important.

Signature of the Auditor

- ✚ The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where, the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.
- ✚ The partner/proprietor signing the audit report also needs to mention the membership number assigned by the ICAI. They also include the registration

number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

NOTE: Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them.

Accordingly, an auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report.

Place of Signature: The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

Date of the Auditor's Report: The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560.

SA – 705 Modifications to the opinion in the independent auditor's report

Audit Report are of 2 types –

Unmodified report – It issued when Auditor concluded unmodified opinion and decides not to include Emphasis of matter or other matter paragraph in the Audit report.

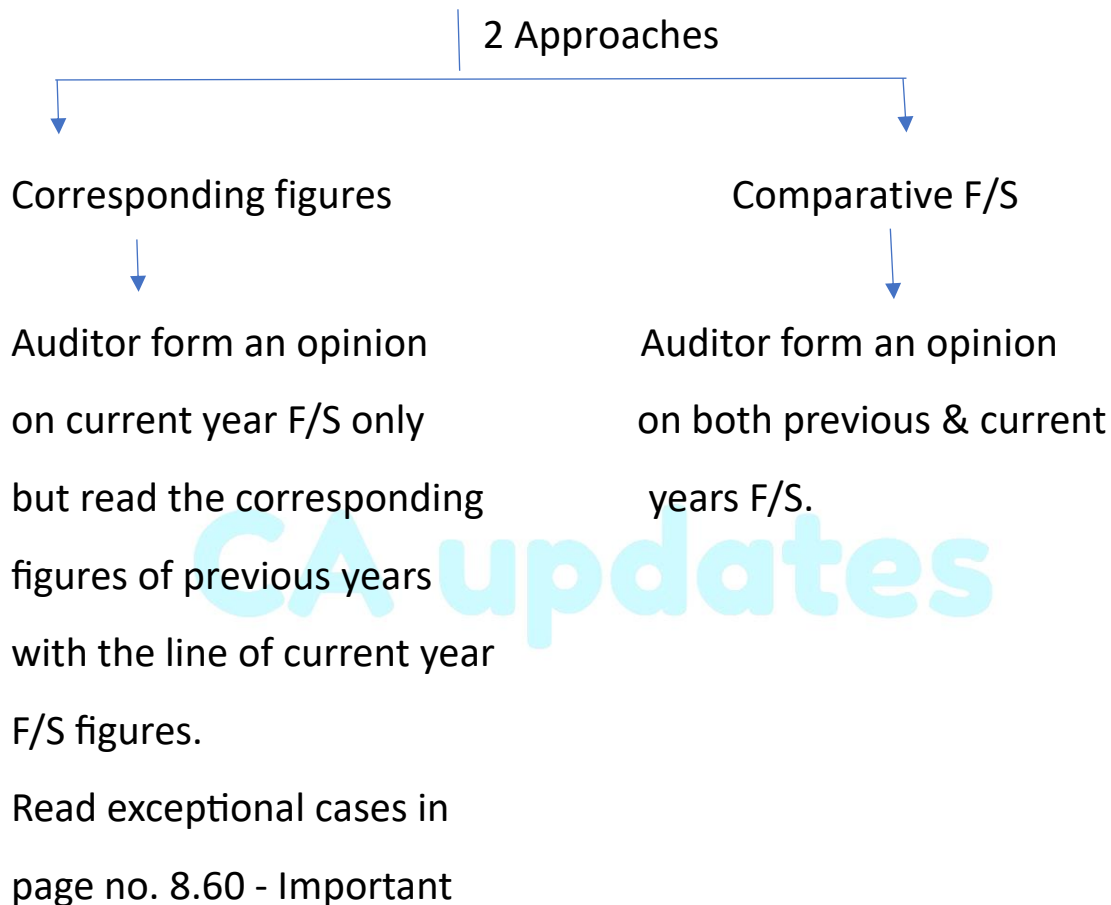
Modified report – It issued when Auditor concluded **modified opinion** such as qualified opinion or adverse opinion or disclaimer of opinion or decides **to include** Emphasis of matter or other matter paragraph in the Audit report.

To be noted, Auditor can issue modified audit report with unmodified opinion as he only includes the Emphasis of matter or other matter paragraph in the Audit report not modify the opinion.

Communication with TCWG

When the auditor **expects to modify the opinion** in the auditor's report, the **auditor shall communicate** with those charged with governance the circumstances that led to the **expected modification and the wording of the modification**.

SA 710 COMPARATIVE INFORMATION- CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS



Globally, General purpose F/S do not follow the comparative F/S approach. Only they do follow corresponding figures approach.

Comparative F/S approach is probably arisen when specific purpose F/S exist.

In short, General-purpose F/S means the financial statement (F/S) which is prepared & presented for the use of large public like shareholders in case of companies.

On the other hand, Specific purpose F/S means the financial statement (F/S) which is prepared & presented for the particular user.

SA 600 Using the Work of another Auditor

- There is great necessity for a **proper rapport** between the principal auditor & Other auditors for the purpose of an **effective audit**.
- It makes clear that in certain situations, the statute governing the **entity** may confer a **right on the principal auditor to visit a component** (Division, branch, Subsidiary, joint venture, associate or others) and **examine the books of account** and other records of the said component, **if he thinks it necessary to do so**.
- Where **another auditor has been appointed for the component**, the **principal auditor** would normally be entitled to **rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component** and/or to examine the books of account and other records of the said component.
- Further, it requires that the **principal auditor should perform** procedures to obtain sufficient appropriate audit evidence, that the **work of the other auditor is adequate for the principal auditor's purposes**, in the context of the specific assignment.

When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- ✚ advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and
- ✚ advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

Important: The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor **may also wish to visit** the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This

knowledge may have been enhanced from the review of the previous audit work of the other auditor.

SA 299 Joint Audit (Many times asked)

Read any 5 advantages & disadvantages in page no. 8.65 & 8.66

Special consideration in case of joint audit –

- + the engagement partner and other key members of the engagement team from each of the joint auditors should be **involved in planning the audit**.
- + the joint auditors should jointly establish an overall audit strategy which sets the scope, timing and direction of the audit, and **also guides the development of the audit plan**.
- + **before the commencement** of the audit, the joint auditors should **discuss and develop a joint audit plan**. In developing the joint audit plan, the joint auditors should:
 - identify **division of audit areas** and **common audit areas**;
 - ascertain **the reporting objectives** of the engagement;
 - **consider and communicate** among all joint auditors the **factors** that are **significant** in directing the engagement team's efforts;
 - consider the **results of preliminary engagement** activities, or similar engagements performed earlier.

- ascertain the **nature, timing and extent of resources** necessary to accomplish the engagement.
- **each of the joint auditors** should consider and **assess the risks** of material misstatement and **communicate** to other joint auditors.
- the joint auditors should **obtain common engagement letter** and **common management representation letter**.
- the **work allocation document** should **be signed by all the joint auditors** and communicated to those charged with governance.

On the other hand, all the joint auditors shall be **jointly and severally responsible** for:

- the audit work which **is not divided** among the joint auditors **and is carried out by all** joint auditors;
- decisions taken by all the joint auditors under **audit planning in respect of common audit areas**;
- matters which are **brought to the notice of the joint auditors by any one of them** and there is an **agreement among the joint auditors on such matters**;
- examining that the financial statements of the entity **comply with the requirements of the relevant statutes**;
- **presentation and disclosure** of the financial

statements as required by the applicable financial reporting framework.

In case a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

It may be noted that the joint auditors are required to issue common audit report. However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

SA 700 ("Forming an Opinion and Reporting on Financial Statements")

BASIC LEVEL

Case Study: XYZ & Co., Chartered Accountants were appointed as the statutory auditors of GreenEarth Pvt Ltd for the financial year 2024-25. After completing the audit, the auditors concluded that:

- The financial statements give a true and fair view.
- There are no material misstatements.
- The financial reporting framework used (Ind AS) is appropriate.

However, during the audit, they also noted that the company had voluntarily disclosed certain environmental risks in the Notes to Accounts, even though such disclosure was not mandated by the law or accounting standards.

The management requested the auditor to comment specifically on these voluntary disclosures in the main audit opinion.

Question:

As per SA 700, how should the auditor deal with the management's request? Should the auditor modify the opinion to specifically comment on voluntary disclosures?

Suggested Answer:

- As per SA 700, the auditor forms an opinion only on whether the financial statements as a whole are free from material misstatement and prepared according to the applicable financial reporting framework.
- If voluntary disclosures are included, the auditor is not required to express a separate opinion on them unless they are misleading or impact the overall true and fair view.
- Since the voluntary disclosures are not misleading and are simply additional information, no modification in the auditor's opinion is necessary.
- The auditor should not separately comment in the opinion paragraph about these disclosures.
- If the auditor considers it important to draw attention to these disclosures (without modifying the opinion), they may use an Emphasis of Matter paragraph as per SA 706, but this is optional.

INTERMEDIATE LEVEL

Case Study: MNR & Associates, Chartered Accountants, were appointed as the statutory auditors of **BlueSky Limited**, a company listed on a small stock exchange. During their audit of the financial year 2024-25, they noted the following:

- The company has properly applied Ind AS and prepared financial statements that give a **true and fair view**.
- There were no material misstatements found during the audit.
- The company has disclosed a **material lawsuit** pending against it, with proper estimation of liability in the notes to accounts.
- The management has appropriately disclosed the basis of accounting and significant accounting policies.
- However, the audit firm faced significant delays in receiving some audit evidence from the management, although ultimately all evidence was provided before finalization.

The audit team is now drafting the audit report.

Questions:

1. As per **SA 700**, what should be the **type of opinion** issued by the auditors?
2. Should the delays in obtaining audit evidence be mentioned in the audit report?
3. What key components must the auditor ensure are present in the audit report as per SA 700 requirements?
4. If the auditor wants to highlight the lawsuit disclosure for users' attention (without modifying the opinion), which paragraph should be used?

Suggested Answer:

1. Type of Opinion:

- Since the financial statements present a true and fair view and there are no material misstatements, the auditor should issue an **Unmodified (Clean) Opinion**.

2. Mentioning Delays:

- Since the delays **did not affect** the auditor's ability to obtain sufficient and appropriate audit evidence and **no limitation** arose finally, it is **not necessary to mention** the delays in the audit report.
- However, internally, the auditor should document the delays as part of audit documentation.

3. Key Components in Audit Report (as per SA 700):

- Title ("Independent Auditor's Report")
- Addressee (shareholders/members)
- Opinion paragraph
- Basis for Opinion paragraph (mandatory even for unmodified opinion)
- Key Audit Matters (if applicable, though for smaller listed companies, it may or may not be mandatory depending on regulations)
- Responsibilities of Management
- Auditor's Responsibilities
- Other Legal and Regulatory Requirements (as per Companies Act, 2013)

- Signature, Auditor's Name, Firm's Registration Number, Membership Number
- Place of Signature
- Date of the Audit Report

4. Highlighting the Lawsuit Disclosure:

- If the auditor wants to bring attention to the lawsuit disclosure without modifying the opinion, they should include an **Emphasis of Matter Paragraph** as per **SA 706**, not SA 700.
- The paragraph must clearly state that the auditor's opinion is not modified in respect of this matter.

EXAM LEVEL

Case Study: ABC & Co., Chartered Accountants were appointed as auditors of Sunlite Industries Ltd. for the year ending 31st March 2025.

While conducting the audit, the following facts were observed:

- The company has prepared the financial statements in accordance with the applicable financial reporting framework (Ind AS) and the Companies Act, 2013.
- All necessary audit evidence was obtained.
- The company has properly disclosed significant accounting policies.
- There were no material misstatements found; the financial statements give a true and fair view.

- During the year, the company revalued its land and building assets upwards, based on a valuation by an independent valuer.
- The revaluation surplus was properly recorded under Other Comprehensive Income and disclosed as per Ind AS 16.
- Management included a significant note explaining the basis of the asset revaluation, its impact on reserves, and potential effects on future depreciation.

The audit team has completed all procedures and is ready to issue the audit report.

Questions:

- As per SA 700, what type of audit opinion should the auditor issue?
- Is a Basis for Opinion paragraph mandatory even though the opinion is unmodified?
- Should the auditor make any special mention regarding the revaluation of assets in the main opinion?
- What are the essential elements the auditor must include in the Audit Report as per SA 700?
- If the auditor believes the revaluation is significant to users' understanding but does not affect the opinion, how should it be presented in the audit report?

Suggested Answer:

(a) Type of Opinion:

- Since the financial statements give a true and fair view and no material misstatements exist, the auditor should issue an Unmodified (Clean) Opinion.

(b) Basis for Opinion Paragraph:

- Yes, under SA 700, the Basis for Opinion paragraph is mandatory even for an unmodified opinion.
- It explains that the audit was conducted in accordance with Standards on Auditing and provides the basis for expressing the opinion.

(c) Special Mention Regarding Revaluation:

- In the main opinion paragraph, the auditor does not separately mention each accounting event like revaluation unless it leads to a modification of the opinion.
- Since the revaluation is properly accounted and disclosed, no change in the opinion paragraph is required.

(d) Essential Elements of Audit Report (SA 700 requirements):

- Title: "Independent Auditor's Report"
- Addressee: (e.g., Members of Sunlite Industries Ltd.)
- Opinion Paragraph

- Basis for Opinion Paragraph
- Key Audit Matters (if applicable — for listed companies)
- Responsibilities of Management and Those Charged with Governance
- Auditor's Responsibilities
- Other Legal and Regulatory Requirements (Companies Act, 2013)
- Signature of Auditor
- Date of Audit Report
- Place of Signature
- Name of Audit Firm, Membership No., FRN No.

(e) Presentation if Revaluation is Significant (but No Modification):

- If the auditor considers the asset revaluation note important for users' understanding, they should include an Emphasis of Matter Paragraph as per SA 706 (not modify the opinion).
- This paragraph should:
 - Refer to the Note in financial statements describing the revaluation.
 - Clearly state that the auditor's opinion is not modified in respect of this matter.

Quick Tip for Exams:

In exam answers, **clearly mention** if the auditor is *modifying* the opinion (qualified, adverse, disclaimer) or simply *drawing attention* (emphasis of matter). In **SA 700**, if no misstatement is found → opinion remains **unmodified**.

SA 701 ("Communicating Key Audit Matters in the Independent Auditor's Report")

BASIC LEVEL

Case Study: RKJ & Co., Chartered Accountants were appointed as auditors of Springfield Textiles Ltd., a listed company, for the financial year 2024–25.

During the audit, the auditors identified two important areas:

- The company had a significant amount of inventory that was subject to valuation uncertainty due to fluctuating market prices.
- The company had obtained a large bank loan during the year and there were complex debt covenant clauses.

The auditors obtained sufficient appropriate audit evidence and concluded that the financial statements give a true and fair view.

Now, while drafting the audit report, the auditor has to decide how to communicate these matters.

Questions:

- (a) As per SA 701, what is a Key Audit Matter (KAM)?
- (b) Should the auditor communicate these two matters as KAMs in the audit report?
- (c) What should the auditor mention while describing a KAM?

Suggested Answer:

(a) What is a Key Audit Matter (KAM)?

- As per SA 701, Key Audit Matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements for the current period.
- These matters are selected from matters communicated with those charged with governance.

(b) Should the auditor communicate these matters as KAMs?

- Yes, both matters (inventory valuation uncertainty and complex debt covenants) are significant and involved auditor's attention and judgment.
- Therefore, they should be communicated as Key Audit Matters in the auditor's report.

(c) What should the auditor mention while describing a KAM?

- A brief description of why the matter was considered significant.
- How the matter was addressed in the audit (e.g., procedures performed, findings).

- A reference to the related disclosure in the financial statements, if any.

Key Point:

- KAMs are not modifications of the opinion.
- Even if KAMs exist, the audit opinion can still be unmodified (clean).

INTERMEDIATE LEVEL

Case Study: KLM & Co., Chartered Accountants were appointed as auditors of **FutureTech Solutions Ltd.**, a listed company engaged in developing software products. During the audit for the year ending 31st March 2025, they identified the following:

- The company's **revenue recognition** involved **multiple-element contracts** (sale of software licenses + maintenance services), requiring significant judgment in allocating revenue between elements.
- The company had **capitalized significant development costs** relating to a new product, and the **recoverability** of these capitalized costs depended on the product's future success.

The audit was completed, and the auditors concluded that the financial statements give a **true and fair view**. The auditors now have to decide how to communicate these important matters in the audit report.

Questions:

(a) How should the auditor determine which matters are Key Audit Matters (KAMs) as per SA 701?

(b) Are the two matters identified (revenue recognition and capitalization of development costs) to be reported as KAMs? Why?

(c) How should the auditor describe these KAMs in the audit report?

(d) Does the communication of KAMs affect the audit opinion?

Suggested Answer:

(a) Determining Key Audit Matters:

As per **SA 701**, the auditor should identify KAMs from matters:

- Communicated with those charged with governance.
- That required significant auditor attention during the audit.
- Involving areas of higher assessed risk of material misstatement, significant auditor judgments, or significant events/transactions.

(b) Are the two matters KAMs?

- **Yes**, both should be reported as KAMs because:
 - **Revenue recognition** under multiple-element contracts involves **complex judgments**, which is an area of significant risk.

- **Capitalization and recoverability of development costs** involve **management assumptions and estimation uncertainty**, needing special audit attention.

(c) How to describe KAMs in the report:

- **Name the Matter** (e.g., Revenue Recognition under Multiple-Element Arrangements).
- **Explain why it was considered significant** (e.g., significant judgment in revenue allocation).
- **Describe how the matter was addressed in the audit** (e.g., testing management's allocation methods, reviewing supporting contracts).
- **Refer to related disclosures** in the financial statements (e.g., Note 15 — Revenue Recognition Policy).

(d) Impact on Audit Opinion:

- **No**, communication of KAMs does **not** modify the opinion.
- Even with KAMs, the auditor can still issue an **unmodified (clean)** opinion if financial statements are materially correct.

Important Tip for Exam Writing:

- Always remember: **KAMs ≠ Qualification**.
- KAMs simply highlight areas of most auditor effort and judgment — **without implying error or criticism**.

EXAM LEVEL

Case Study: SRK & Associates, Chartered Accountants, were appointed as statutory auditors of Prime Infrastructure Ltd., a company listed on a stock exchange, for the financial year ended 31st March 2025.

During the course of audit, the following matters were noted:

- The company has undertaken a major construction project involving long-term contracts. Revenue is recognized based on the percentage of completion method, which involves significant judgment regarding estimation of project costs and stage of completion.
- The company is facing a tax litigation relating to disallowance of certain expenses by the tax authorities. Adequate disclosure has been made in the Notes to Accounts under "Contingent Liabilities."

The auditors concluded:

- Financial statements are prepared as per Ind AS and Companies Act, 2013.
- Sufficient and appropriate audit evidence was obtained.
- Financial statements give a true and fair view.
- The audit report needs to be drafted accordingly, keeping in mind SA 701 requirements.

Questions:

- (a) What are the objectives of the auditor under SA 701?
- (b) Identify the matters that should be reported as Key Audit Matters (KAMs) in this case.
- (c) How should each KAM be described in the auditor's report?
- (d) Can the auditor communicate matters as KAMs if they lead to a modified opinion?

Suggested Answer:

(a) Objectives of the Auditor under SA 701:

- To determine, from matters communicated with those charged with governance, those matters that required significant auditor attention.
- To select those matters that are of most significance in the audit of the financial statements.
- To communicate those matters as Key Audit Matters (KAMs) in the auditor's report.
- To enhance the communicative value of the audit report by providing greater transparency.

(b) Matters to be Reported as KAMs:

- Revenue Recognition based on Percentage of Completion:
 - Involves significant judgment and estimation uncertainty regarding costs and project stage — hence, a KAM.

- Tax Litigation Disclosure:
 - Involves significant management judgment regarding the outcome of pending cases — also a KAM.

(c) How to Describe Each KAM

1. Revenue Recognition: Describe the judgment involved in estimating project costs and stage of completion, and the audit procedures performed to assess these estimates.
2. Tax Litigation: Describe the contingent liability disclosed in the Notes to Accounts and the audit procedures to assess the disclosure and potential outcomes.

(d) KAMs with Modified Opinion

Yes, the auditor can report KAMs even with a modified opinion. However, the modification must also be clearly communicated in the report.

SA 705 ("Modifications to the Opinion in the Independent Auditor's Report")

BASIC LEVEL

Case Study: PKR & Co., Chartered Accountants were appointed as statutory auditors of Zenith Enterprises Pvt. Ltd. for the financial year 2024–25.

During the audit, they observed the following:

- The company did **not provide depreciation** on its fixed assets during the year, which is **required** as per the Companies Act, 2013 and Ind AS.
- Management refused to correct the error despite repeated discussions.
- The auditors believe that **not charging depreciation** has caused the fixed assets and profit to be **overstated** significantly.

All other aspects of the financial statements were found to be correct, and sufficient audit evidence was obtained.

Questions:

- (a) As per SA 705, what type of modification should the auditor make in this case?
- (b) What are the three types of modified opinions under SA 705?
- (c) What is the basic structure of the audit report when a modified opinion is issued?

Suggested Answer:

(a) Type of Modification:

- Since the financial statements are **materially misstated** (due to non-provision of depreciation) but **not pervasive** (the misstatement is limited to a specific area),
- The auditor should issue a **Qualified Opinion** ("except for" the effects of the matter).

(b) Three Types of Modified Opinions (as per SA 705):

1. **Qualified Opinion** – Material but not pervasive misstatement or limitation.
2. **Adverse Opinion** – Material and pervasive misstatement.
3. **Disclaimer of Opinion** – When auditor **cannot obtain sufficient appropriate audit evidence** and the possible effects are material and pervasive.

(c) Basic Structure of Audit Report with Modified Opinion:

- Title ("Independent Auditor's Report")
- Addressee
- **Basis for Qualified Opinion** paragraph (describing the issue clearly)
- **Qualified Opinion** paragraph
- Other standard parts like: Management's Responsibility, Auditor's Responsibility, Other Legal and Regulatory Requirements, Signature, Place, and Date.

Key Tip:

- **Qualified** = *"Except for..."*
- **Adverse** = *"Do not give a true and fair view."*
- **Disclaimer** = *"We do not express an opinion."*

INTERMEDIATE LEVEL

Case Study: DNR & Co., Chartered Accountants were appointed as the statutory auditors of **Global Retailers Ltd.**, a private limited company, for the financial year 2024–25.

During the audit, the following situations arose:

- The company had **inventories located at multiple warehouses**.
- The auditor was **unable to attend the year-end physical inventory count** at a few warehouses due to travel restrictions.
- The company did not maintain proper **inventory records** for those locations, and **alternative audit procedures could not be performed** to verify the quantities and conditions of inventory at those locations.
- Inventories represent a **material** portion of the company's assets.

Otherwise, all other parts of the financial statements were properly audited, and no further misstatements were found.

Questions:

- (a) What type of opinion should the auditor issue as per SA 705 in this situation?
- (b) Differentiate between a Qualified Opinion and a Disclaimer of Opinion.
- (c) What key points must be included when reporting a Disclaimer of Opinion?

Suggested Answer:

(a) Type of Opinion:

- Since the auditor was **unable to obtain sufficient appropriate audit evidence** about the inventory (which is material),
- And inventory is **important** to the financial statements,
- The auditor should issue a **Disclaimer of Opinion** if the possible effects of the undetected misstatement could be **both material and pervasive**.

(b) Difference Between Qualified Opinion and Disclaimer of Opinion:

Point	Qualified Opinion	Disclaimer of Opinion
Reason	Material misstatement or limitation, but not pervasive	Inability to obtain sufficient audit evidence and possibly pervasive
Opinion	"Except for" the described issue, financials are okay	Auditor does not express an opinion at all
Wording	Positive assurance for remaining items	No assurance on financials

(c) Key Points to Include for a Disclaimer of Opinion:

- **Basis for Disclaimer of Opinion** paragraph:
 - Describe the limitation of scope (in this case, inability to verify inventories).
- **Disclaimer of Opinion** paragraph:
 - Clearly state that the auditor was unable to obtain sufficient appropriate audit evidence and **does not express an opinion** on the financial statements.
- Mention management's responsibility and auditor's responsibility properly.

Important Tip:

When there is a **scope limitation** and the issue is **material and pervasive**, the auditor must **disclaim** the opinion, not qualify it.

EXAM LEVEL

Case Study: RPS & Associates, Chartered Accountants, were appointed as statutory auditors of **Silverline Technologies Ltd.**, a listed company, for the financial year ended 31st March 2025.

During the course of audit, the following issues were identified:

- The company **did not consolidate** the financial statements of its wholly owned subsidiary, **Silverline**

Innovations Pvt. Ltd., even though it was **required** under Ind AS 110 "Consolidated Financial Statements".

- Management claimed that consolidation was **not done** because the subsidiary was undergoing operational restructuring and its accounts were not ready on time.
- However, the auditor determined that **non-consolidation was not in accordance with Ind AS**, and this **materially misstated** the group financial statements.
- The misstatement was assessed as **both material and pervasive** to the financial statements.

Apart from this, no other misstatements were observed, and sufficient appropriate audit evidence was obtained.

Questions:

- (a) What type of opinion should the auditor express as per SA 705?
- (b) Differentiate between Qualified Opinion and Adverse Opinion based on SA 705.
- (c) Draft a sample "Basis for Opinion" paragraph and "Opinion" paragraph based on the above case study.

Suggested Answer:

(a) Type of Opinion:

- Since **non-consolidation** is a **material** and **pervasive** misstatement (because the entire financial position of the group is impacted),

- The auditor should issue an **Adverse Opinion**.

(b) Difference Between Qualified Opinion and Adverse Opinion:

Point	Qualified Opinion	Adverse Opinion
Situation	Misstatement is material but not pervasive	Misstatement is material and pervasive
Language	"Except for the effects..."	"Do not present a true and fair view"
Assurance	Positive assurance given except for one issue	No assurance given for financial statements as a whole

(c) Draft — Sample "Basis for Adverse Opinion" and "Adverse Opinion" Paragraphs:

Basis for Adverse Opinion

We were appointed to audit the standalone financial statements of Silverline Technologies Ltd. for the year ended 31st March 2025.

The company has not consolidated the financial statements of its wholly owned subsidiary, Silverline Innovations Pvt. Ltd., as required by Ind AS 110 "Consolidated Financial Statements."

Had the subsidiary been consolidated, many elements of the financial statements would have been materially affected.

Accordingly, in our opinion, the standalone financial statements do not present a true and fair view in accordance with the applicable financial reporting framework.

Adverse

Opinion

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion section above, the financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of the financial position of Silverline Technologies Ltd. as at 31st March 2025, and of its financial performance and cash flows for the year then ended.

Key Learning:

- **Material + Pervasive Misstatement = Adverse Opinion** (e.g., non-consolidation).
- **Scope Limitation + Material + Pervasive = Disclaimer of Opinion.**

SA 706 ("Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report")

BASIC LEVEL - MNK & Co., Chartered Accountants were appointed as auditors of Sunshine Hospitals Pvt. Ltd. for the year ending 31st March 2025.

During the audit, the auditors noted:

- There was a major lawsuit filed against the company by a former employee, and the case was pending in court.

- The company's management has properly disclosed the lawsuit as a contingent liability in the Notes to Accounts.
- Based on legal advice, management believes that the outcome of the case will not materially affect the financial position of the company.

The auditor concluded that the disclosure is adequate and there is no material misstatement.

Questions:

- (a) Should the auditor modify the audit opinion?
- (b) Should the auditor include an Emphasis of Matter (EOM) paragraph? Why?
- (c) What is an Emphasis of Matter paragraph according to SA 706?

Suggested Answer:

(a) Should the auditor modify the opinion?

- **No**, the auditor should not modify the opinion because there is no material misstatement in the financial statements. The disclosure of the lawsuit as a **contingent liability** is appropriate, and the financial statements are in accordance with the applicable accounting framework.
- The auditor will issue an **unmodified opinion** (clean opinion).

(b) Should the auditor include an Emphasis of Matter (EOM) paragraph? Why?

- **Yes**, the auditor should include an **Emphasis of Matter (EOM)** paragraph.
- Even though the lawsuit does not result in a misstatement, the matter is **important** and **may affect the understanding of the financial statements** by users. The lawsuit is a significant **event** (pending court case) that is disclosed in the financial statements, and its **outcome** could have future financial implications for the company.
- The **EOM paragraph** will **highlight** this contingent liability, which the users should pay attention to while reading the financial statements.

(c) What is an Emphasis of Matter paragraph according to SA 706?

- An **Emphasis of Matter paragraph** is used to **highlight** a matter that is **important** for the users' understanding of the financial statements, but **does not affect the auditor's opinion**.
- This paragraph is typically used when there is a **material uncertainty** (e.g., pending litigation, going concern issues) that is disclosed in the financial statements, and the auditor believes it is important for users to pay attention to it.

- It must be placed **after the opinion paragraph** and be appropriately referenced.

Key Point:

- **EOM Paragraph:** Important to draw attention to matters that are significant for understanding but do not change the opinion.
- **No Impact on Opinion:** If the issue doesn't cause a misstatement in the financials, it doesn't affect the audit opinion, but can be highlighted with an EOM.

INTERMEDIATE LEVEL

Case Study:

KLM & Co., Chartered Accountants, were appointed as statutory auditors of Galaxy Electronics Ltd., a listed company, for the financial year ending 31st March 2025.

During the audit, the following facts were noted:

- The company has entered into a long-term contract with a foreign government for the supply of electronics. The contract will span 10 years and the company has recognized revenue over time based on the percentage of completion method.
- The company changed its accounting policy during the year related to the method of revenue recognition for these long-term contracts. The company has adequately disclosed this change in its financial statements under Note 15.

- The change in accounting policy is in accordance with the relevant accounting standards and does not result in any material misstatement. The auditors are satisfied with the disclosure made in the financial statements.

The auditors also noted the following:

- Pending litigation regarding an environmental fine from a regulatory body, which could result in a substantial penalty. The company has disclosed this as a contingent liability under Note 18 of the financial statements. However, the outcome of the litigation is uncertain.
- The company's management believes that the likelihood of losing the case is low, and no provision has been made. The auditors reviewed management's assessment and found the disclosure to be reasonable.

The auditors concluded that the financial statements are presented fairly, except for the matters described above.

Questions:

- (a) Should the auditor issue a modified opinion or an unmodified opinion on the financial statements?
- (b) Should the auditor include an Emphasis of Matter (EOM) paragraph related to the change in accounting policy?
- (c) Should the auditor include an Emphasis of Matter (EOM) paragraph related to the pending litigation?
- (d) How should the Emphasis of Matter (EOM) paragraphs be worded in the audit report?

Suggested Answer:

(a) Modified Opinion or Unmodified Opinion:

- Unmodified Opinion should be issued.
- Both the change in accounting policy and pending litigation are disclosed appropriately in the financial statements and do not result in any material misstatement.
- There is no need for a modification to the opinion, as the auditors are satisfied with the disclosures and explanations provided.

(b) Should the auditor include an Emphasis of Matter (EOM) paragraph for the change in accounting policy?

- Yes, the auditor should include an Emphasis of Matter paragraph for the change in accounting policy.
- Even though the change is in accordance with accounting standards and there is no misstatement, the change in revenue recognition is significant and affects the understanding of the financial statements. Therefore, it should be highlighted to the users for clarity.

(c) Should the auditor include an Emphasis of Matter (EOM) paragraph for the pending litigation?

- Yes, the auditor should include an Emphasis of Matter paragraph for the pending litigation.

- The litigation is a contingent liability, and while management believes that the likelihood of loss is low, it is a material uncertainty that could affect the company's financial position. Therefore, the auditor should emphasize this matter to make users aware of the potential risk.

(d) How should the Emphasis of Matter (EOM) paragraphs be worded?

Example 1: EOM Paragraph for Change in Accounting Policy
Emphasis of Matter

We draw attention to Note 15 in the financial statements, which describes a change in the company's accounting policy for revenue recognition related to long-term contracts. The company has adopted a new method for recognizing revenue over time based on the percentage of completion, in accordance with the relevant accounting standards. Our opinion is not modified in respect of this matter.

Example 2: EOM Paragraph for Pending Litigation
Emphasis of Matter

We draw attention to Note 18 in the financial statements, which describes a contingent liability arising from a pending litigation with a regulatory body concerning an environmental fine. The outcome of this litigation is uncertain, and while management believes the likelihood of an adverse outcome is low, the potential impact on the company's financial position could be significant. Our opinion is not modified in respect of this matter.

Key Points:

- EOM Paragraph is used to draw attention to important matters, such as changes in accounting policy or significant uncertainties (like contingent liabilities), that are adequately disclosed in the financial statements.
- EOM does not affect the opinion but serves to highlight certain matters to the users of the financial statements.
- Materiality and relevance are key in determining whether an EOM paragraph is necessary.

EXAM LEVEL - **ABC & Co., Chartered Accountants**, were appointed as the statutory auditors of **NextGen Solutions Ltd.**, a publicly listed company, for the financial year ending 31st March 2025.

During the audit, the following facts were noted:

1. Change in Accounting Estimate:

The company has revised its accounting estimate for **provision for doubtful debts** based on new internal data, which includes an increase in the percentage of provision due to a worsening credit environment. The provision has increased significantly compared to the previous year.

- The company has disclosed this change under **Note 10** of the financial statements, explaining the reason for the change and the impact on the financial statements.

- The auditors have reviewed the basis of the revised estimate and found it to be reasonable.

2. Pending

Litigation:

The company is involved in a **pending litigation** related to an environmental violation, where a regulatory body has imposed a penalty of ₹25 crore.

- The company has disclosed the pending litigation as a **contingent liability** in **Note 12** of the financial statements.
- The company's management believes that the likelihood of the penalty being imposed is low, but it is possible. Management has not made any provision in the financial statements.
- The auditors have reviewed the disclosure and management's assessment and found that the disclosure complies with the applicable accounting standards.

3. Going

Concern

Uncertainty:

The company has been facing financial difficulties due to a decline in market share and increasing competition. The company has disclosed in **Note 15** that it has undertaken restructuring measures, including cost-cutting and exploring new markets.

- Despite these efforts, the auditors believe there is **material uncertainty** related to the company's

ability to continue as a going concern due to ongoing financial challenges.

- However, the auditors are satisfied with the adequacy of the going concern disclosure provided by the company.

Questions:

- (a) Should the auditor issue a modified opinion or an unmodified opinion?
- (b) Should the auditor include an **Emphasis of Matter** (EOM) paragraph regarding the **change in accounting estimate**?
- (c) Should the auditor include an **Emphasis of Matter** (EOM) paragraph regarding the **pending litigation**?
- (d) Should the auditor include an **Emphasis of Matter** (EOM) paragraph regarding the **going concern uncertainty**?
- (e) How should the **Emphasis of Matter** paragraphs be worded for the above matters?

Suggested Answer:

(a) Modified Opinion or Unmodified Opinion?

- The auditor should issue an **unmodified opinion**.
- **Reasoning:**
 - The **change in accounting estimate** and **pending litigation** are adequately disclosed in the financial statements and do not result in a misstatement.

- The **going concern uncertainty** is appropriately disclosed, and while it is a significant matter, it does not affect the auditor's ability to issue an unmodified opinion.
- There are no material misstatements, and all disclosures are in compliance with the relevant accounting standards.

(b) Should the auditor include an Emphasis of Matter (EOM) paragraph regarding the change in accounting estimate?

- **Yes**, the auditor should include an **Emphasis of Matter (EOM)** paragraph for the **change in accounting estimate**.

- **Reasoning:**

- The increase in the provision for doubtful debts is significant and important for the users to understand, even though it is a change in an accounting estimate rather than an error.
- The change could impact users' decisions, so it is appropriate to highlight this in an EOM paragraph.

(c) Should the auditor include an Emphasis of Matter (EOM) paragraph regarding the pending litigation?

- **Yes**, the auditor should include an **Emphasis of Matter (EOM)** paragraph regarding the **pending litigation**.

- **Reasoning:**

- The pending litigation is significant and could affect the company's financial position.
- Even though the company believes the likelihood of an adverse outcome is low, it remains an **important matter** for the users to consider when assessing the financial statements.

(d) Should the auditor include an Emphasis of Matter (EOM) paragraph regarding the going concern uncertainty?

- **Yes**, the auditor should include an **Emphasis of Matter (EOM)** paragraph regarding the **going concern uncertainty**.
 - **Reasoning:**
 - The **going concern uncertainty** is material and requires the users' attention.
 - The auditors are satisfied with the adequacy of the disclosure, but it is a significant matter that could affect users' understanding of the company's financial position.

(e) How should the Emphasis of Matter paragraphs be worded?

1. Emphasis of Matter for Change in Accounting Estimate

Emphasis *of* *Matter*

We draw attention to Note 10 in the financial statements,

which describes the company's change in accounting estimate regarding the provision for doubtful debts. The provision has been increased based on new internal data due to the worsening credit environment. Our opinion is not modified in respect of this matter.

2. Emphasis of Matter for Pending Litigation

Emphasis of Matter

We draw attention to Note 12 in the financial statements, which describes a contingent liability arising from pending litigation related to an environmental violation. While management believes the likelihood of an adverse outcome is low, the outcome is uncertain, and the potential penalty could be material. Our opinion is not modified in respect of this matter.

3. Emphasis of Matter for Going Concern Uncertainty

Emphasis of Matter

We draw attention to Note 15 in the financial statements, which describes the company's financial difficulties and the uncertainty about its ability to continue as a going concern. While the company has undertaken restructuring measures, the future outcome remains uncertain. Our opinion is not modified in respect of this matter.

Key Points:

- **EOM Paragraphs** are used to **highlight significant matters** that don't affect the auditor's opinion but are crucial for the users to understand.

- **Material uncertainties**, like going concern issues or pending litigation, must be disclosed and emphasized in the report.
- **Changes in estimates** (such as provisions for doubtful debts) can also be significant enough to warrant an EOM paragraph if they impact users' understanding.

SA 710 (Comparative Information)

BASIC LEVEL

Case Study: First Year Financial Statements of XYZ Ltd.

Background: XYZ Ltd. is a new company that started its operations on 1st April 2024. It is preparing its first financial statements for the year ending 31st March 2025. Since it's the first year of operations, there are no comparative figures from the previous year.

Question: How should XYZ Ltd. present its financial statements in accordance with SA 710 for the first year of operations?

Suggested Answer:

Since XYZ Ltd. is preparing financial statements for the first time, SA 710 does not require comparative figures. The company should:

1. Present Financial Statements without any comparative information.
2. Disclose in the notes that it is the first year of operations, and therefore no comparative information is available.

In subsequent years, XYZ Ltd. will be required to present comparative figures for the previous year.

EXAM LEVEL

Case Study: First-Time Financial Statements of ABC Pvt. Ltd.

Background: ABC Pvt. Ltd. is a newly incorporated company that commenced its operations on 1st April 2024. The company is preparing its first set of financial statements for the year ending 31st March 2025. As it is the first year of operations, ABC Pvt. Ltd. does not have any prior year financial information for comparison.

Issue: The company needs to understand how to apply SA 710 (Comparative Information) in its first financial statements, considering there are no comparative figures available.

Question: How should ABC Pvt. Ltd. present the comparative information in its financial statements for the year ending 31st March 2025 in compliance with SA 710?

Suggested Answer:

1. **Comparative Information Not Required:** Since it is the first year of operations, **SA 710** allows for the **non-presentation** of comparative figures in the financial statements. There is no need to provide prior year's figures as comparative information.
2. **Disclosure Requirement:** ABC Pvt. Ltd. should disclose in the financial statements that it is the first year of operations, and as such, no comparative information is

available. This disclosure should be made in the **notes to the financial statements**.

3. **Subsequent Years:** In future years, the company will need to present the previous year's figures for comparison, as required by SA 710.

SA 299 (Responsibility of Joint Auditors)

EXAM LEVEL

Case Study: Audit Assignment of XYZ Ltd.

Background: XYZ Ltd. is a listed manufacturing company with operations in multiple states. Due to the size and complexity of its operations, XYZ Ltd. has appointed **two joint auditors**, Auditor A and Auditor B, to conduct the audit for the year ending 31st March 2025. Both auditors are responsible for different geographical locations and segments of the company.

During the audit, Auditor A is primarily responsible for the North and West divisions of the company, while Auditor B is responsible for the South and East divisions. However, both auditors have agreed to share the overall responsibility for the audit opinion, and they will issue a joint report.

Issue: There has been some confusion regarding the responsibilities of both joint auditors, especially when it comes to communicating findings and ensuring overall compliance with auditing standards. Auditor A has questioned whether they are jointly responsible for the audit

opinion, or if the responsibility is only confined to the sections they audited.

Question: What is the responsibility of the joint auditors, and how should they ensure compliance with **SA 299** (Responsibility of Joint Auditors) in issuing the audit opinion for XYZ Ltd.?

Suggested Answer:

1. **Joint Responsibility:** According to **SA 299**, both joint auditors share **joint responsibility for the audit opinion**. This means that both auditors are equally responsible for the audit opinion, regardless of the segments or geographical regions they have audited. The audit opinion should reflect the results of the work performed by both auditors.
2. **Audit Planning and Coordination:** The joint auditors must **plan and coordinate** their audit approach to ensure that the overall audit is thorough and that each auditor is fully aware of the work conducted by the other. Proper communication and sharing of audit findings are essential to forming a joint opinion.
3. **Key Areas of Responsibility:**
 - Each auditor should ensure that the work performed on their assigned areas is in accordance with applicable auditing standards and that the necessary procedures have been conducted.

- Both auditors must review the overall financial statements to ensure that they are consistent and free from material misstatement.
 - **Mutual Agreement:** It is essential that both auditors mutually agree on the audit procedures, findings, and the final audit report.
4. **Audit Report:** In the final audit report, both auditors should sign the report, and the opinion will reflect the combined findings of both auditors. If any issues or disagreements arise, these should be resolved between the joint auditors before issuing the opinion.

SA 600 (Using the Work of Another Auditor)

EXAM LEVEL

Case Study: Group Audit of ABC Group

Background: ABC Group is a large multinational conglomerate with subsidiaries in multiple countries. For the year ending 31st March 2025, ABC Ltd. (the parent company) has appointed Auditor A to perform the group audit. Auditor A is responsible for the audit of the parent company's consolidated financial statements.

ABC Ltd. has a subsidiary in Country X, where Auditor B is responsible for the audit of the subsidiary's financial statements. Auditor B has issued an unmodified opinion on the subsidiary's financial statements for the year ended 31st March 2025.

The group financial statements of ABC Ltd. are prepared in accordance with Indian Accounting Standards (Ind AS). Auditor A plans to use the work of Auditor B for the subsidiary's financial statements.

Issue: Auditor A needs to determine how to use the work of Auditor B, the auditor of the subsidiary, and ensure that the group audit is in compliance with SA 600.

Question: How should Auditor A use the work of Auditor B in the group audit of ABC Ltd. for the year ending 31st March 2025, in compliance with SA 600 (Using the Work of Another Auditor)?

Suggested Answer:

1. Assessing the Work of Auditor B: Auditor A, as the group auditor, must assess the adequacy of the work performed by Auditor B (the component auditor). According to SA 600, Auditor A needs to evaluate the professional competence, independence, and objectivity of Auditor B to ensure the work can be relied upon.
2. Communication with Auditor B:
 - Auditor A should communicate with Auditor B to understand the scope of the audit, the audit procedures performed, and the findings. This helps ensure that the work is consistent with the group audit requirements.

- Auditor A should also obtain access to the working papers of Auditor B for review, especially for significant areas that might affect the group's financial statements.

3. Determining the Impact of the Component's Financial Statements:

- Auditor A should assess whether the financial statements of the subsidiary (audited by Auditor B) materially affect the consolidated financial statements of the group.
- If the subsidiary is material to the group, Auditor A must ensure that sufficient audit procedures are performed to support the opinion on the group's consolidated financial statements.

4. Consideration of the Type of Opinion:

- If Auditor B has issued an unmodified opinion on the subsidiary's financial statements, Auditor A should consider whether any modifications are needed to the group audit opinion.
- If there are issues with the subsidiary's financial statements that could affect the group's financial position or performance, Auditor A should address these issues through further audit procedures or seek additional information.

5. Forming the Group Opinion:

- If the work of Auditor B is found to be adequate and the subsidiary's financial statements do not require modification, Auditor A can use the work of Auditor B in forming the group audit opinion.
- The group audit opinion should reflect the results of the work of both Auditor A and Auditor B, ensuring that the audit is comprehensive and covers all material components.

6. Documentation: Auditor A should document the steps taken to assess and rely on the work of Auditor B. This includes the review of Auditor B's work, communications with them, and any additional procedures performed.

CA updates

NOTES

CA updates

CA updates

CA updates

CA updates