1. FUNDAMENTALS, NATURE, OBJECTIVE & SCOPE OF AUDIT - SA 200

KEEP THESE POINTS IN MIND

DEAR STUDENTS,

1) THIS IS A VERY IMPORTANT SUBJECT FOR YOUR EXAMS & CAREER. FOCUS WELL.
2) YOU CAN'T QUALIFY THIS SUBJECT JUST BY MUGGING UP. IN THE EXAM THE QUESTIONS ARE GENERALLY TRICKY AND WILL MAKE THE STUDENT GET CONFUSED ABOUT WHICH ANSWER TO BE WRITTEN. THE ONLY OPTION IS TO LISTEN TO THE CLASSES WITH UTMOST ATTENTION AND TRY TO REVISE THE SUBJECT AS MUCH AS POSSIBLE.
3) WE DON'T HAVE A LUXURIOUS TIME, SO THAT FACULTY CAN DICTATE THE RUNNING NOTES. YOU NEED TO MAINTAIN THE SAME ON YOUR OWN.
4) TRUE OR FALSE STATEMENTS AND MCQs WILL BE PROVIDED IN A SEPARATE MATERIAL. AFTER COMPLETION OF EACH CHAPTER, STUDENTS SHALL PREPARE THEM ON THEIR OWN.
5) WE HAVE CLASSIFIED THE CONCEPT QUESTIONS INTO 3 CATEGORIES & TYK QUESTIONS INTO 2 CATEGORIES:
   a) CONCEPT QUESTIONS (CRD) & TYK (CRD): STUDENTS NEED TO NOTE THE ANSWERS EXPLAINED BY THE FACULTY IN THE CLASSROOM. WE WILL NOT PROVIDE THESE SOLUTIONS FOR ANY REASON.
   b) CONCEPT QUESTIONS (SP) & TYK (SP): STUDENTS NEED TO SOLVE THEM ON THEIR OWN. WE WILL PROVIDE THESE SOLUTIONS IN WORKBOOK SOLUTIONS.
   c) ADVANCED CONCEPT QUESTIONS (CRD): STUDENTS NEED TO NOTE BOTH QUESTIONS AND ANSWERS EXPLAINED BY THE FACULTY IN THE CLASSROOM. WE WILL NOT PROVIDE THESE QUESTIONS AND ANSWERS FOR ANY REASON.
6) SELF-LEARNING IS MANDATORY TO CRACK THIS SUBJECT. AS AND WHEN YOUR FACULTY TEACHES A TOPIC, TRY TO ANSWER CORRESPONDING CONCEPT QUESTIONS FOR SP, PRACTICAL QUESTIONS FOR SELF-PRACTICE & TYK FOR SELF-PRACTICE ON YOUR OWN.
7) CONTENT GIVEN UNDER THE HEADING ADDITIONAL EXPLANATION:
   a) IF IT IS SUFFICIENT TO UNDERSTAND AND NOT REQUIRED TO REPRODUCE THE SAME IN THE EXAMS THEN IT IS GIVEN IN 'ITALICS'.
   b) IF IT IS REQUIRED FOR THE STUDENTS TO READ, UNDERSTAND AND REPRDOCUE THEN WE HAVE NOT USED ANY 'ITALICS'. IN INTERNAL AS WELL AS PUBLIC EXAMS YOU CAN EXPECT QUESTIONS ON THIS CONTENT.

LEARNING OBJECTIVES

AFTER STUDYING THIS CHAPTER, YOU WILL HAVE THE UNDERSTANDING AND THE KNOWLEDGE OF:

1) Definition of Audit, its scope, and principles.
2) Types of Audits, Advantages and Disadvantages of Audit.
3) Inherent limitations of Auditing, and other disciplines.
4) Understand the functional classification and qualities of an Auditor.
5) Quality control for an Audit of Financial Statements.
6) Agreeing on terms of Audit Engagement.
7) Distinguish between auditing and investigation.

CHAPTER OVERVIEW

DIVISION	TOPIC
1.	THEORY FOR CLASSROOM DISCUSSION (CRD)
2.	IDENTICAL QUESTIONS (SELF-STUDY)
3.	TEST YOUR KNOWLEDGE (CRD)
4.	TEST YOUR KNOWLEDGE (SELF-STUDY)
5.	IMPORTANT TECHNICAL TERMS (SELF-STUDY)
6.	CONCEPTS THAT ARE RESHUFFLED

DIVISION 1: THEORY FOR CLASSROOM DISCUSSION (CRD)

UNIT 1: FUNDAMENTALS OF AUDITING

Q.No.1. Define the term Audit. **(OLD SM-TYK) (L to L)**

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

   ADDITIONAL EXPLANATION (CRD): (**NON-ICAI SOURCES) (N)**

   a) ***"HISTORICAL FINANCIAL INFORMATION"*** *means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.*

   b) ***INDEPENDENCE:***

      i) *This implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.*

      ii) *The auditor should be independent of an entity whose financial statements are subject to audit so that he can form an opinion without being affected by any influence.*

      iii) *Independence increases the auditor's ability to act objectively without creeping into any biases.*

   c) ***RESPONSIBILITY OF MANAGEMENT:*** *Preparation and presentation of financial statements of an entity is the responsibility of the management of the entity.*

   d) ***OPINION:*** *The auditor expresses an opinion on financial statements by means of a written audit report.*

2) **MEANING OF LEGAL FORM:** There are several types of legal forms in which people ordinarily conduct businesses. This is similar to the "Person" Definition under Income Tax. The following are the various types of legal forms:

   a) Proprietorship firm
   b) Partnership firm
   c) Limited Liability Partnership
   d) Society and Company
   e) AOP or BOI
   f) Any other Artificial Judicial Person

CONCEPT QUESTIONS (SP):

1) **Does audit apply only to the Profit Oriented entities? Explain.** **(DRAFTED) (N)**
2) **Will Size of the Organization will be a deciding factor for Conducting Audit?** **(DRAFTED) (N)**

Q.No.2. Define the term Books of Accounts under Companies Act 2013 (L to L)

As per the Companies Act, 2013 "Books of Account" as defined in Section 2(13) includes records maintained in respect of:

1) All sums of money received and expended by a Company and matters in relation to which the receipts and expenditure take place.
2) All sales and purchases of Goods and Services by the Company.
3) The assets and liabilities of the Company; and
4) The items of cost as may be prescribed under section 148.

ADVANCED CONCEPT QUESTIONS: Faculty will discuss 1 CQ here **(N)**

Q.No.3. Define the term Financial Statements and List out their uses to various users of FS. (L to L)

1) **GENERAL MEANING:**
   a) A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework.
   b) The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.
   c) The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement.

2) **AS PER THE COMPANIES ACT:** Financial Statements include the following.
   a) Profit and Loss account or Income and Expenditure account
   b) Balance Sheet
   c) Cash flow Statement
   d) Statement of change in equity, if applicable
   e) Any explanatory notes annexed to or forming part of financial statements.

3) **USERS OF FINANCIAL STATEMENTS:** **(OLD SM)**

Users	Purpose
Management	For day-to-day decision-making and performance evaluation.
Proprietor/shareholders	To analyse performance, profitability, and financial position. **Note:** Prospective investors are interested in the track record of the company.
Lenders - banks & financial Institutions	To determine the financial position and strength of the Company, Debt Service Coverage, etc.
Suppliers	To determine the creditworthiness of the company.
Customers	To know the general business viability before entering into long-term contracts and arrangements.

Users	Purpose
Government	• To ensure prompt collection of Direct and Indirect Tax revenues. • To evaluate performance and contribution to social objectives.
Research Scholars	For the study, research, and analysis purpose.
Employees	Job security, Bonus.

ADVANCED CONCEPT QUESTIONS: Faculty will discuss 1 CQ here. **(N)**

Q.No.4. Explain Applicable Financial Reporting Framework and enumerate its types?

1) **APPLICABLE FINANCIAL REPORTING FRAMEWORK:** The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. **(L TO L)**

ADDITIONAL EXPLANATION (SP): **(NON-ICAI SOURCES) (N)**

Meaning of the word "Financial Reporting Framework":

a) *The "Financial Reporting Framework" refers to a set of rules, guidelines, and standards that dictate how financial information and data should be presented and communicated in an organization's financial statements and reports.*

b) *This framework provides a structured way for companies to prepare and present their financial information in a consistent and understandable manner, making it easier for stakeholders such as investors, creditors, and regulators to assess the financial health and performance of the organization.*

c) *The framework typically includes accounting principles, rules for disclosure, measurement guidelines, and formats for presenting financial data accurately and transparently.*

2) **TYPES OF FINANCIAL STATEMENTS (BASED ON PURPOSE)**

a) **General purpose financial statements (GPFS):**

i) If the F/S are prepared in accordance with General Purpose Framework (GPFW) then they are called GPFS.

ii) **General purpose framework:** A Financial reporting framework designed to meet the common financial information needs of a wide range of users. (Framework may be understood as Rules and Regulations).

iii) **Characteristics of GPFW:**

- Fundamental Accounting Assumptions are used in this type of Framework.
- Compliance with GAAP.
- Accounting standards as per AFRFW.
- Annual Preparation, periodically.

b) **Special purpose financial statements (SPFS):**

i) The Financial statements are prepared in accordance with a special purpose framework.

ii) In other words, if the financial statements are prepared as per the requirement of a specific user, then they are known as SPFS.

iii) E.g.: Income Tax FS

3) **TYPES OF FINANCIAL STATEMENTS (BASED ON LAW):** Further, this financial reporting framework may be a Compliance Framework (or) a Fair Presentation Framework.

a) **FAIR PRESENTATION FRAMEWORK:** **(L TO L)**

i) The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and

- Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

  E.g.: Most of the general-purpose financial statements are prepared as per a fair presentation framework.

b) **COMPLIANCE FRAMEWORK (CFW):**

i) The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements in (i) or (ii) above the definition of fair presentation framework.

E.g.: Most of the special purpose financial statements are prepared as per the compliance framework.

(FACULTY SHALL DISCUSS Q.NO.4 IN 'TYK FOR CRD' NOW)

CONCEPT QUESTIONS (CRD):

1) **"Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.** **(NEW SM-TYK)**

CONCEPT QUESTIONS (SP):

3) **Which type of Framework Allow management to go beyond to achieve fair presentation of the financial statements?** **(DRAFTED) (N)**

4) **List out any two examples of Fair Presentation framework?** **(DRAFTED) (N)**

ADVANCED CONCEPT QUESTIONS: Faculty will discuss 2 CQ here. **(N)**

Q.No.5. Define the term Misstatement and its types?

MISSTATEMENT:

1) **MEANING:** A difference between the Amount, Classification, Presentation, Or Disclosure of a reported financial statement item AND the Amount, Classification, Presentation, Or Disclosure that is required as per Applicable financial reporting framework.

2) **TYPES:** Misstatements can arise from error or fraud.

a) **Fraud:** An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

b) **Error:** The term "error" refers to unintentional mistakes in financial statements such as:

i) Clerical errors, like errors of omission, errors of commission, errors of duplication and compensating errors.

ii) Misapplication of accounting policies (errors of principle).

iii) From the point of view of Audit these errors are two types namely

- Self-revealing errors (Apparent on record and easily identifiable) and
- Non-self-revealing errors (Not apparent and require additional efforts to detect them).

(FACULTY SHALL DISCUSS Q.NO.1, 2, 5 IN 'TYK FOR CRD' NOW)

ADVANCED CONCEPT QUESTIONS: Faculty will discuss 3 CQ here. **(N)**

Q.No.6. Define the term Auditor and Engagement Team?

1) Auditor:

a) "Auditor" is used to refer to the person or persons conducting the Audit, usually the engagement partner or other members of the engagement team, or the firm.

b) When it comes to acceptance of Responsibility or being accountable to regulatory authorities then the engagement partner shall only be referred to as Auditor.

c) Practically the meaning of Auditor includes the following persons (mentioned in 2)

2) Engagement Team:

a) Engagement Partner

b) Audit Manager

c) Paid assistant

d) Senior article assistant

e) Junior article assistant

f) Any other designation

(FACULTY SHALL DISCUSS Q.NO.3 IN 'TYK FOR CRD' NOW)

CONCEPT QUESTIONS (CRD):

2) CA Jayaprakash and his team Mr. Karthik, Miss Anjali both are article assistants working together under CA Jayaprakash as a team to conduct Audit for ABC Ltd. The management of ABC Ltd wants Miss Anjali to sign the Audit report claiming that she is part of engagement team, and she is also treated as Auditor. Does the contention of Management is correct? (DRAFTED) (N)

Q.No.7. Define the term Management and those charged with Governance?

1) Management: The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

2) Those Charged with Governance (TCWG): The persons or organizations with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

UNIT 2: NATURE OBJECTIVE & SCOPE OF AUDITING

SA 200: OVERALL OBJECTIVES OF AN INDEPENDENT AUDITOR AND CONDUCT OF AN AUDIT IN ACCORDANCE WITH STANDARDS ON AUDITING

Q.No.8. Explain the purpose of Audit, objectives of an Auditor as per SA 200 and state the Implications of Auditor's opinion on Financial Statements?
(M19-RTP, M20-RTP, M21-RTP, N15-5M, M22-3M, M23-3M) (OLD SM-TYK) (L to L)

1) **PURPOSE OF AN AUDIT:** Audit enhances degree of confidence (assurance) of users of financial statements as they are verified for its validity and accuracy by an independent competent person.

2) **Overall Objective:**

   a) To obtain reasonable Assurance about whether the financial statements as a whole are free from material misstatements.

   Whether due to fraud or error and to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

   b) To report on the financial statements as per relevant SA's based on the Auditor's findings.

ADDITIONAL EXPLANATION (CRD): **(NON-ICAI SOURCES) (N)**

a) Reasonable assurance is to be distinguished from absolute assurance.

b) Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements.

However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance, but it is not complete assurance.

c) Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated.

On basis of that, conclusions are drawn, and opinion is formed. It leads to high level of assurance, which is called as reasonable assurance, but it is not absolute assurance.

d) The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing.

3) **IMPLICATIONS OF AUDIT OPINION:**

   a) The audit is just an opinion on historical financial information as to whether they are reliable or not.

   b) The Auditor's opinion does not guarantee regarding:

      i) Future viability of the entity

      ii) Efficiency and effectiveness of management.

CONCEPT QUESTIONS (CRD):

3) CA N is the Auditor of SR Ltd. The Auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements were free from material misstatements or not. In your opinion, whether CA N has complied with objectives of audit considering the applicability of relevant SA? (M22-3M)

4) A person who requests his brother, a Chartered Accountant, to audit accounts of his proprietary concern and issue a report. Can CA audit accounts of concern in which his brother is sole proprietor? (OLD SM -EX)

5) Take another case where a CA has invested in shares of a company. Can he audit accounts of such a company in which he holds shares? (OLD SM -EX)

CONCEPT QUESTIONS (SP):

5) For an auditor it is sufficient to have professional competence need not require any skills If not Explain? (DRAFTED) (N)

6) What are the possible ways for the misstatements that can be occurred in financial statements? (DRAFTED) (N)

7) Auditor of a company need not look over the effect of misstatement on the financial statement as a whole? Explain. (DRAFTED) (N)

ADVANCED CONCEPT QUESTION: **Faculty will Discuss 1 CQ here** **(N)**

Q.No.9. The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself about certain factors, Explain?
(OR) (M18 5M, M19-RTP, M20-RTP, N15)
When an Auditor can say that the FS are free from Material Misstatements
(OR)
Auditor has to report whether FS give a true & Fair View. Here, what constitutes True & Fair View?
(OR)
An audit is independent examination of financial information of any entity, whether profit oriented or not, & irrespective of its size or legal form when such an examination is conducted with a view to expressing an opinion thereon. What the auditor is supposed to do to satisfy himself that nothing contained in the statements will mislead anybody? (NON-ICAI SOURCES) (N)

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

1) The accounts have been drawn up with reference to entries in the books of account.

2) The journal entries in the books of accounts are supported by sufficient and appropriate (Proper) evidence.

3) Ensure none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements. (No omissions or duplications or fictitious entries)

4) The financial statement amounts are properly classified, described, and disclosed in conformity with accounting standards. (Clear and unambiguous i.e., without confusion).

5) The statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

6) The information conveyed by the statements is clear and unambiguous.

CONCEPT QUESTIONS (CRD):

6) Mr. John has been appointed as an Auditor of the company X Ltd. Mr. John is aware of that Audit is independent examination of financial information and ultimate objective of the Auditor is to express an opinion on the FS. Explain how a person conducting the audit should take care to ensure that financial statements would not mislead anybody. (M20-RTP)

CONCEPT QUESTIONS (SP):

8) An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form when such an examination is conducted with a view to expressing an opinion thereon. What the Auditor is supposed to do to satisfy himself that nothing contained in the statements will mislead anybody? (N19-MTP1)

9) While auditing the books of accounts of ABC Limited for the financial year 2020-21, the auditor observed that following transactions were not recorded in financial statements, even though they were recorded in books of accounts:

a) Equipment H amounting for ₹ 40,000.

b) Trade Receivable of ₹ 29,000 & Trade Payable of ₹ 22,000.

c) Repair & Maintenance Expenses of ₹ 56,000.

d) Other Incomes of ₹ 94,000.

Every amount mentioned above was of material in nature. Comment on the true & fair view as depicted by the financial statements of the above-mentioned company. (NON-ICAI SOURCE) (N)

Q.No.10. Discuss various types of Audits.
(OR)
"Audit is not legally obligatory for all types of business organizations or institutions" Discuss. (N)
(N11-5M, N13-5M, N14-RTP, M15-RTP)

Audit is not legally obligatory for all types of business organizations or institutions. On this basis audits may be of two broad categories i.e.,

1) STATUTORY AUDIT: (Audit Required Under Law)

a) The organization which requires compulsory audit under law is known as statutory audit.

E.g.: Company audit u/s 139 of companies act, 2013.Tax audit u/s 44AB of Income tax Act, 1961, Bank audit under Banking regulation act, 1949 etc.

b) The Auditor shall be independent in case of statutory audits. (In terms of Both Mind and Appearance)

c) The rights and duties of the Auditor are determined under the law and terms of engagement.

ADDITONAL EXPLANATION (CRD): *The scope of engagement shall be such a way to ensure that it shall covers all the minimum requirements of statues.*

2) NON - STATUTORY AUDIT / VOLUNTARY AUDIT:

a) The Appointment of Auditors even though, is not mandatory under the law is known as Non statutory audit. Also known as VOLUNTARY AUDIT.

E.g.: Audit of sole proprietary concern, audit of partnership firms.

b) Many of such enterprises as a matter of internal rules or on the directives of Government for various purposes like sanction of grants, loans, etc. get their accounts audited.

c) The Auditor needs to be independent of mind.

d) The rights and duties are determined as per the terms of engagement by the appointing authority.

e) Generally, entities go for audit for obtaining various benefits that accrues to them through audit.

(FACULTY SHALL DISCUSS Q.NO. 6 IN 'TYK FOR CRD' NOW)

CONCEPT QUESTIONS (CRD):

7) The scope and objectives of an Auditor can be reduced in case of statutory audit, by way of terms of engagement.

Q.No.11. What are the advantages of an independent audit?

(OR)

What is the importance of having the accounts audited by an independent auditor?

(OLD SM) (M19-RTP, M15-RTP, M11-RTP, N18-RTP, N16-RTP, N13-RTP)

1) **SAFEGUARD OF INTEREST OF STAKEHOLDERS:** In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their interest is safeguarded by an audit.

2) **MORAL CHECK ON EMPLOYEES:** It acts as a moral check on the employees from committing frauds or errors such as defalcations or embezzlement.

3) **TAXES AND LOANS**: Helpful in settling liability for taxes, negotiating loans for a business.

4) **PURCHASE CONSIDERATION:** For determining the purchase consideration for a business in case of amalgamations.

5) **REVIEW OF OPERATIONS & CONTROLS:**

a) For detection of weakness in internal controls those are leading to wastages and losses.

b) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially the wastage and loss that occur due to the absence or inadequacy of internal checks or internal control measures.

6) **SETTLEMENTS OF ACCOUNTS:** To help in the settlement of accounts at the time of admission or death of partner.

7) **OBTAINING LICENSES:** Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

8) **COMPLIANCE WITH LAW:** Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.

9) **SETTLEMENT OF INSURANCE CLAIMS:** Also helps to settle insurance claims in case of any catastrophe.

10) **SETTLEMENTOF DISPUTES:** Useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.

11) **RELIABLITY OF INTERNAL CONTROLS:** As an appraisal function, audit reviews the existence and operations of various controls in the organizations and reports weaknesses, inadequacies, etc., in them.

12) **RELIABILITY OF FINANCIAL STATEMENTS:** The chief utility of audit lies in reliable financial statements on the basis of which state of affairs may be easy to understand.

CONCEPT QUESTIONS (CRD):

8) The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organizations where audit is not compulsory. Explain. (M15-5M, M12-8M, M08-8M)

CONCEPT QUESTIONS (SP):

10) How can an audited financial statement help an Users of financial statements? (DRAFTED) (N)

Q.No.12. Write a short note on Inherent Limitations of Audit. (L to L)

(OR)

Distinguish between absolute Assurance and reasonable Assurance. Identify the type of Assurance that is expected in an audit of financial statements, clearly outlining the reasons to justify your point of view. (N)

(OR)

The process of auditing is such that it suffers from certain limitations which cannot be overcome irrespective of the nature and extent of audit procedures." Explain.
(N) (N20-3M, M18-RTP, M23-RTP, N22-RTP, M11-2M, N19-RTP)

1) **ABSOLUTE vs REASONABLE ASSURANCE:**

a) The Auditor is not expected to and cannot reduce audit risk to zero & cannot therefore obtain absolute Assurance.

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

c) Because of the limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned & performed in accordance with SA's. This risk can be called as "Audit Risk."

2) THE INHERENT LIMITATIONS OF AN AUDIT ARISE FROM:

a) NATURE OF FINANCIAL REPORTING:

i) The financial statements preparation involves many judgements and assumptions by management in applying the requirements of the entity's Applicable financial reporting framework.

ii) In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

iii) These assumptions or estimates may go wrong, which can make the Auditors opinion wrong.

E.g.: Accounting estimates such as life of assets, provision for doubtful debts, Net realisable value for inventory.

iv) One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls.

v) However, such controls may not have operated to produce reliable financial information due to their own limitations.

b) NATURE OF AUDIT PROCEDURES:

i) The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence.

ii) For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation.

iii) Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It creates a legal limitation.

iv) The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor.

v) It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, such documents could be fake or non-genuine. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents.

vi) It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

c) NOT IN NATURE OF INVESTIGATION:

i) Audit is not an official investigation. We must clearly understand that audit is distinct from investigation.

ii) **INVESTIGATION** is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

iii) **AUDIT**, on the other hand as we have already discussed, objective is to obtain reasonable Assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the Auditor to express an opinion.

iv) **CONCLUSION**, audit is never started with a pre-conceived notion about state of affairs; about wrongdoing; about some wrong having been committed.

d) TIME, COST-BENEFIT COMPARISON: (Timeliness of financial reporting and the balance between benefit and cost)

i) The matter of difficulty, time, or cost involved is not in itself a valid basis for the Auditor to omit an audit procedure for which there is no alternative.

ii) Appropriate planning assists in making sufficient time and resources available for the conduct of the audit.

iii) Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

e) FUTURE EVENTS:

i) Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business.

ii) The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

iii) Therefore, it is in view of above factors, that an auditor cannot provide a guarantee that financial statements are free from material misstatements due to frauds or errors.

CONCEPT QUESTIONS (CRD):

9) Management of a company has devised a control that all purchase bills should reflect stamp and signatures of an authorized person in "Goods Receiving Section" of the company stating the date and time of receiving goods in premises. (OLD SM-TYK)

10) An auditor who is conducting audit of a company since last two years. During these two years, he has sought detailed information from management of company regarding various matters. During his third-year stint, he chooses to rely upon some information obtained as part of audit procedures of second year. Explain? (OLD SM-TYK)

11) Audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the Auditor to believe that audit evidence is valid when it is not. Explain. (OLD SM-TYK)

CONCEPT QUESTIONS (SP):

11) A Partnership Firm of Chartered Accountants SW and Associates was appointed to audit the books of accounts of Efficient and Vibrant Limited for the financial year 2020-21. While auditing the books of accounts of the above-mentioned company, Mr. S one of the partners of SW and Associates observed that the management and other senior employees of the above-mentioned company were not cooperating in providing required information for the purpose of audit to him and his audit team members. Identify the type of limitation in the given case.

12) The audit is not an investigation into an alleged wrongdoing. Justify the given statement. (OLD SM-TYK)

13) An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (NEW SM-TYK) (N)

ADVANCED CONCEPT QUESTIONS: Faculty will discuss 2 CQ here. (N)

Q.No.13. Write about Independence of Auditor and measures to safeguard Independence? (L to L)

(OR)

Describe the guiding principles which the auditor should take into account which serves as the safeguards to eliminate the threats to independence.

(OR)

Independence of the Auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. Explain. (M23 RTP, N20-4M, N21-RTP, N19-RTP, OLD SM-TYK)

1) CONCEPT OF INDEPENDENCE:

a) Professional integrity and independence are considered as essential characteristics of all the professions but are more so in the case of the accountancy profession.

b) Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

c) It is not possible to define "independence" precisely.

d) Rules of professional conduct dealing with independence are framed primarily with a certain objective. But the rules themselves cannot create or ensure the existence of independence.

e) Independence is a condition of mind as well as personal character. It should not be confused with the superficial and visible standards of independence which are sometimes imposed by law.

f) There are two interlinked perspectives of independence of Auditors,

i) Independence of mind **ii)** Independence in appearance.

The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

i) **Independence of mind:** The state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

ii) **Independence in appearance:** The avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an Auditor's integrity, objectivity or professional skepticism had been compromised."

2) **SAFEGUARDS TO INDEPENDENCE:** The Chartered Accountant has a responsibility to remain independent and implement safeguards available to eliminate the threats.

THE FOLLOWING ARE THE GUIDING PRINCIPLES IN THIS REGARD:

a) For the public to have confidence in the quality of audit, it is essential that Auditors should always be and appears to be independent of the entities that they are auditing.

b) In the case of audit, the key fundamental principles are integrity, objectivity, and professional scepticism, which necessarily require the Auditor to be independent.

c) Before taking on any work, an Auditor must consider whether it involves threats to his independence.

d) If the Auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

e) When such threats exist, the Auditor should either withdraw from the task or take certain precautions to eliminate them.

CONCEPT QUESTIONS (CRD):

12) **Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of Assurance engagements may differ, and consequently different threats may exist requiring the application of different safeguards. Explain the common safeguards to be implemented by the Auditor.**

13) **CA Raman Gupta is offered appointment as auditor of a company. One of his distant uncles held some shares in the same company. Holding of such shares, by a distant relative, is not prohibited under provisions of law nor does it affect his independence. Before he could accept appointment, he received unfortunate news of death of his uncle who had died without any children. He came to know that he was nominee of these shares having substantial value. It landed him in a tricky situation. What should be the proper course of action for him? (OLD SM-TYK)**

Q.No.14. "The code of ethics for professional accountants prepared by the international federation. of accountants (IFAC) identifies five types of threats to independence" Explain?
(N18-MTP1-5M) (M22-RTP) (M23-RTP) (OLD SM-TYK)

1) INDEPENDENCE:

a) The term independence means that the judgment of Auditor should not be made subordinate to the wishes and directions of management or any other person.

b) The audit decisions should be taken without giving importance to personal wishes.

2) THREATS TO INDEPENDENCE: The International Federation of Accountants (IFAC) had identified five types of threats:

a) SELF-INTEREST THREATS: Occurs when an auditing firm or any partner benefiting from a financial interest in the audit client.

E.g.:

i) Shares in the company, loan or guarantee to or from the concerned client,

ii) Close business relationship with an audit client, Direct financial interest, or materially significant indirect financial interest in a client,

iii) Potential employment with the client, and

iv) Contingent fees for the audit engagement.

v) undue dependence on a client's fees and, hence, concerns about losing the engagement,

b) SELF-REVIEW THREATS: occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client.

E.g.:

i) When an Auditor having recently been a director or senior officer of the company, and

ii) When Auditors perform services that are themselves subject matters of audit like accounting services.

c) ADVOCACY THREATS: It occur when the Auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised. In such situations, Auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that Auditor is not acting and working objectively.

E.g.:

i) When an Auditor deals with shares or securities of the audited company or

ii) Auditor becomes the client's advocate in litigation and third-party disputes.

d) FAMILIARITY THREATS: These are self-evident and occur when Auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways.

SIMPLIFIED VERSION(SP): Occurs when Auditor has some association or relation with the clients either directly or indirectly.

E.g.:

i) Close relative of the Auditor working in a senior position in the client company,

ii) Long association between Auditors and client. (Creates Sympathy),

iii) Former partner of the audit firm being a director or senior employee of the client,

iv) Acceptance of significant gifts or hospitality from the client company, its directors or employees

ADDITIONAL EXPLANATION (SP): Provisions in Companies Act, 2013 regarding rotation of Auditors mainly address these very familiarity threats. Such provisions prescribe that Auditor is rotated after a certain number of years so that Auditors do not become too familiar with their clients.

e) INTIMIDATION THREATS: It occurs when Auditors are deterred from acting objectively with an adequate degree of professional skepticism.

Such threats attempt to intimidate Auditors to deter them from acting objectively (Blackmailing)

E.g.:

i) Threat of replacement or pressure to disproportionately reduce work in response to reduced audit fees.

ii) Being threatened with litigation

(FACULTY SHALL DISCUSS Q.NO. 9 IN 'TYK FOR CRD' NOW)

CONCEPT QUESTIONS (CRD):

14) Mr. S and Mr. W are partners in SW and Associates, a Partnership Firm of Chartered Accountants. During the financial year 2020-21, SW and Associates were appointed as Auditors of Capable and Composed Limited. The brother of Mr. W was involved in the management of Capable and Composed Limited. Mr. S being aware of the whole situation, on behalf of SW and Associates did not accept the appointment as Auditors of Capable and Composed Limited as it would act as a threat and affect independence of Auditors. Identify the threat in the given case.

15) Mr. Ravi, Auditor of Sun Ltd has accepted the hospitality offered by one of the directors of Sun Ltd. Identify the threat involved in the given case.

16) About 40% of his total audit fees come from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client. What are such types of threats referred to as? (OLD SM-TYK)

17) CA Murli Madhavan provides accounting and bookkeeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO. Identify and discuss what kind of threat to independence may be involved in accepting such an engagement. (NEW SM-TYK)

CONCEPT QUESTIONS (SP):

14) In case an audit firm unduly relies on fees from a client, it may result in threat to self-review. (DRAFTED) (N)

15) List out Some of the Examples of Non-audit services? (DRAFTED) (N)

16) When Audit Attracts Self review threat? (DRAFTED) (N)

Q.No.15. Write a short note on Professional Skepticism.
(L to L) (N22-RTP, M14-6M, OLD N-19-4M, M13-RTP, N20-RTP, N18-RTP)

MEANING: Professional skepticism refers to an attitude of questioning mind, being alert to unusual situations and a critical assessment of audit evidence.

1) BEING ALERT TO THE FOLLOWING SITUATIONS INCLUDE:

a) Conflicts between multiple audit evidence.

b) Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. (Doubts as to reliability of audit evidence)

c) Conditions that may indicate possible fraud.

d) Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

2) CRITICAL ASSESSMENT OF AUDIT EVIDENCE:

a) Is evidence obtained from reliable sources?

b) Is evidence obtained sufficient?

c) Is evidence obtained appropriate i.e., relevant?

d) Is there a requirement for an alternative or additional evidence.

3) **PROFESSIONAL SKEPTICISM IS NECESSARY TO REDUCE THE RISKS OF:**

   i) Overlooking unusual circumstances.

   ii) Over generalizing while taking decisions from audit observations.

   iii) Taking inappropriate decisions regarding nature, timing, and extent of the audit procedures.

4) The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary.

5) In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

6) The auditor cannot be expected to disregard past experience of the honesty and integrity of the management and those charged with governance.

7) Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

ADVANCED EXPLANATION (SP): **(NON-ICAI SOURCE) (N)**

1) **Following are the examples of the application of professional skepticism.**

   a) **Designing additional auditing procedures to obtain more reliable evidence in support of a particular financial statement assertion.**

   b) **Obtaining corroboration of management's explanations through consultation with a specialist.**

   c) **Using third-party confirmations to provide support for management's representations.**

CONCEPT QUESTIONS (CRD):

18) **A belief that management and those charged with governance are honest and have integrity relieves the Auditor of the need to maintain professional skepticism. Correct/ Incorrect.**

CONCEPT QUESTIONS (SP):

17) **Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. The Auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. Explain giving examples.** **(N19-4M, N20-RTP)**

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

(TYK FOR CRD Q.NO 6 SHALL BE DISCUSSED HERE)

Q.No.16. Write a short note on Professional Judgment as per SA 200.

(OR)

Professional judgment is essential to the proper conduct of an audit, Explain.
(L to L) (N15-RTP, N18-5M, N19-5M, M23-4M)

1) **MEANING:** It refers to taking informed decisions by the Auditor during the course of his audit that are appropriate in the circumstances by using his knowledge, training and experience. Judgment includes assumptions and estimations made by Auditor.

2) **USAGE:** Professional judgment is used throughout planning, performing and concluding the audit.

3) **EXAMPLES:** **Professional judgement is necessary in particular regarding decisions about:**
   - **a)** Materiality & audit risk.
   - **b)** The nature, timing, & extent of audit procedures used to meet the requirements of the SAs & gather audit evidence.
   - **c)** Evaluating whether SAAE has been obtained, & whether more needs to be done to achieve the objectives of the SAs & thereby, the overall objectives of the Auditor.
   - **d)** The evaluation of management's judgments in applying the entity's AFRF.
   - **e)** The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

4) **ESSENTIALITY:** Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements & the SAs & the informed decisions required throughout the audit cannot be made without the application of relevant knowledge & experience to the facts & circumstances.

5) **DOCUMENTATION:** Professional judgment needs to be exercised throughout the audit. And needs to be appropriately documented. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts & circumstances of the engagement or SAAE.

Q.No.17. Define Assurance Engagement and its essential elements and various types? (N)

ASSURANCE ENGAGEMENT: Engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

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

ESSENTIAL ELEMENTS:

1) **Three Party Relationship:**
   - **a)** **Practitioner** is a person who provides the assurance, which is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
   - **b)** **Responsible party** is the party responsible for preparation of subject matter.
   - **c)** **Intended users** are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

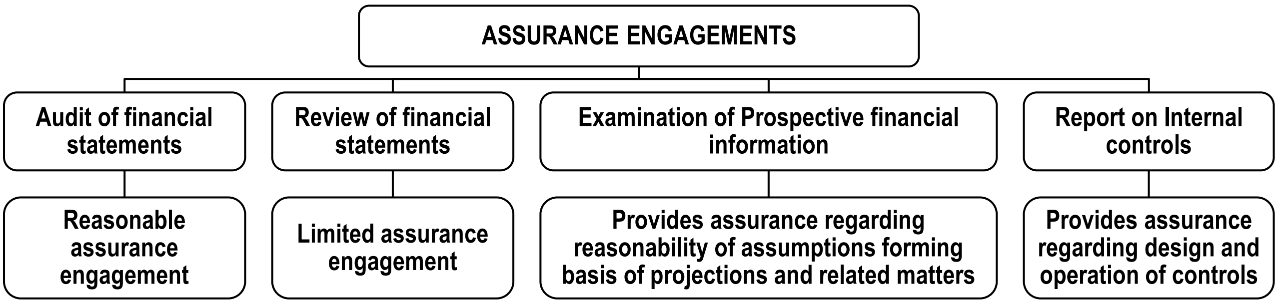
2) **Appropriate Subject Matter:** It refers to the information to be examined by the practitioner. For example, financial information contained in financial statements while conducting audit of financial statements.

3) **Suitable criteria:** These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules, and regulations.

4) **Sufficient appropriate evidence:**
   - **a)** The practitioner aims at obtaining sufficient appropriate evidence.
   - **b)** It is on the basis of evidence that conclusions are arrived, and an opinion is formed by auditor.
   - **c)** “Sufficient” relates to quantity of evidence obtained by auditor.
   - **d)** “Appropriate” relates to quality of evidence obtained by auditor.

5) **A written assurance report in appropriate form:** A written report is provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is the outcome of an assurance engagement.

TYPES OF ASSURANCE ENGAGEMENTS:



(FACULTY SHALL DISCUSS Q.NO. 8 IN 'TYK FOR CRD' NOW)

CONCEPT QUESTIONS (CRD):

19) Assurance engagements are not restricted to audit of financial statements alone. Discuss. (NEW SM-TYK) (N)

CONCEPT QUESTIONS (SP):

19) A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. (NEW SM-TYK) (N)

Q.No.18. Write about Audit and Review Engagement and enumerate the differences among them? (N)

AUDIT ENGAGEMENT:

1) Engagement means an arrangement to do something.

2) In auditing, a formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

3) The purpose of external audit engagements is to enhance the degree of confidence of intended users of financial statements.

4) Such engagements are also reasonable assurance engagements.

5) For example, in India, companies are required to get their annual accounts audited by an external auditor.

6) Even non-corporate entities may choose to have their accounts audited by an external auditor because of benefits of such an audit.

REVIEW ENGAGEMENT:

a) Audit is a reasonable assurance engagement. It provides reasonable assurance. However, review is a limited assurance engagement. It provides lower level of assurance than audit.

b) Further, review involves fewer procedures and gathers sufficient appropriate evidence based on which limited conclusions can be drawn up. However, both "audit" and "review" are related to financial statements prepared based on historical financial information.

REASONABLE ASSURANCE ENGAGEMENT VS. LIMITED ASSURANCE ENGAGEMENT

REASONABLE ASSURANCE ENGAGEMENT	LIMITED ASSURANCE ENGAGEMENT
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.

REASONABLE ASSURANCE ENGAGEMENT	LIMITED ASSURANCE ENGAGEMENT
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

ADDITIONAL EXPLANATION (SP): Other types of assurance engagement relate to providing assurance on internal controls in an entity or "Prospective financial information". **(N)**

Q.No.19. Write about examination of Prospective Financial Information? (N)

1) It is examination of financial information based on assumptions about events at may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.
2) Examination is not of historical financial information.
3) Historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.
4) The practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions, and it is properly presented and all material assumptions are adequately disclosed.
5) The auditor cannot express an opinion as to whether the results shown in the prospective financial information will be achieved.
6) Therefore, in such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.
7) Hence, such type of assurance engagement provides only a moderate level of assurance.

Q.No.20. Explain Engagement and quality control Standards? (N)

1) **NEED FOR STNADARDS:** Purpose of issue of these standards is to Establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services.
   a) Standards ensure carrying out of audit against established benchmarks at par with global practices.
   b) Standards improve quality of financial reporting thereby helping users to make diligent decisions.
   c) Standards promote uniformity as audit of financial statements is carried out following these Standards.
   d) Standards equip professional accountants with professional knowledge and skill.
   e) Standards ensure audit quality.

2) **Types of Engagement Standards:**
   a) Standards on auditing (SAs): Audit of historical financial information.
   b) Standards on review engagements (SREs): Review of historical financial information.
   c) Standards on Assurance engagements (SAEs): Assurance engagements other than audits and review of historical financial information.
   d) Standards on Related Services (SRSs): agreed upon procedures to information, compilation engagements and other related service engagements.
   e) Standards on Quality Control (SQC)

3) STANDARDS ON AUDITING:

- **a)** Standards on Auditing apply in the context of an audit of financial statements by an independent auditor.
- **b)** It is important to remember that Standards on Auditing apply in audit of historical information.
- **c)** These establish high quality benchmarks and are followed by auditors in conducting audit of financial statements.
- **d)** Standards on Auditing have been issued on wide spectrum of issues in the field of auditing ranging from –
  - **i)** Overall objectives of independent auditor,
  - **ii)** Audit documentation,
  - **iii)** Planning an audit of financial statements,
  - **iv)** Identifying, and assessing risk of material misstatement,
  - **v)** Audit sampling,
  - **vi)** Audit evidence
  - **vii)** Forming an opinion and
  - **viii)** Reporting on financial statements.
- **e)** These cover all significant aspects of audit of financial statements.

4) STANDARDS ON REVIEW ENGAGEMETS:

- **a)** Standards on review engagements apply in the context of review of financial statements.
- **b)** We have already understood that review is a limited assurance engagement, and it provides assurance which is lower than that provided by audit.
- **c)** It is due to the fact that review involves fewer procedures as compared to audit.
- **d)** Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence.
- **e)** For example, when an auditor performs review of interim financial information of an entity.

5) STANDARDS ON ASSURANCE ENGAGEMENTS:

- **a)** Deals with subject matters other than historical financial information.
- **b)** Such assurance engagements do not include "audit" or "review" of historical financial information.
- **c)** For example, an assurance engagement relating to examination of prospective financial information. It is to be noted that in such type of assurance engagements, examination is not of historical financial information or engagement may relate to providing assurance regarding non-financial matters like design and operation of internal control in an entity.

6) STANDARDS ON RELATED SERVICES:

- **a)** These standards apply in engagements to perform agreed-upon procedures regarding financial information.
- **b)** For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a financial statement, say, a balance sheet or even a complete set of financial statements.
- **c)** An engagement in which practitioner may be called upon to assist management with the preparation and presentation of historical financial information without obtaining assurance on that information.

Such type of compilation engagements fall in the category of related services and practitioner issues a report clearly stating that it is not an assurance engagement, and no opinion is being expressed.

d) These types of services are called related services and standards have been issued to deal with practitioner's responsibilities in this regard.

7) STANDARDS ON QUALITY CONTROL:

a) Standards on Quality Control (SQCs) have been issued to establish standards and provide guidance regarding a firm's responsibilities for its system of quality control for the conduct of audit and review of historical financial information and for other assurance and related service engagements.

b) It requires auditors/practitioners to establish system of quality control so that firm and its personnel comply with professional standards and regulatory & legal requirements and reports issued are appropriate.

c) Its basic objective is that while rendering services, to which engagement standards apply, there should be a system of quality control within firms to ensure complying with professional standards/legal requirements.

d) System of quality control ensures issuing of appropriate reports in the circumstances.

e) Further, it is also to be remembered that Standards on Quality Control (SQCs) are to be applied for all services covered by Engagement Standards.

Q.No.21. Explain need for standards and duties in relation to engagement and quality control standards? (N)

DUTIES IN REALTION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS:

a) It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants.

b) However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement.

c) In such a case, he is required to document how alternative procedures performed achieve the purpose of required procedure.

d) Also, reason for departure has also to be documented unless it is clear. Further, his report should draw attention to such departures.

e) It is also to be noted that a mere disclosure in the report does not absolve a professional accountant from complying with applicable Standards.

CONCEPT QUESTIONS (CRD):

20) CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing. Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing? (NON-ICAI SOURCES) (N)

Q.No.22. Write a short note on Scope of Audit? (L to L) (N19-4M, M20-RTP)

Scope refers to range or reach of something.

1) Purpose of an audit is to enhance the degree of confidence of intended users, which is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

2) The Following Points Are Included In Scope Of Audit Of Financial Statements:

a) **COVERAGE OF ALL ASPECTS OF ENTITY:** Audit of financial statements should be organized adequately to cover all aspects of the entity relevant to the financial statements being audited.

b) **RELIABILITY AND SUFFICIENCY OF FINANCIAL INFORMATION:**

i) The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data is reliable and sufficient basis for preparation of financial statements.

ii) The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries, and procedures.

c) **PROPER DISCLOSURE OF FINANCIAL INFORMATION:**

i) The auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

ii) It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

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

iv) The auditor evaluates selection and consistent application of accounting policies by management. Whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

v) Understand that financial statements of an entity are prepared on historical financial information basis.

d) **EXCLUSION FROM SCOPE OF AUDIT:**

i) Auditor is not expected to perform duties which fall outside domain of his competence. For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him.

ii) It is not expected from an auditor to determine suitability and life of civil structures like buildings. These require different skillsets which may be performed by qualified engineers in their respective fields.

iii) An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field. An audit is not an official investigation into alleged wrongdoing.

iv) He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation. Audit is distinct from investigation.

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

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

vii) The scope of audit is general and broad whereas scope of investigation is specific and narrow.

SIMPLIFIED VERSION:

OVERVIEW OF SCOPE OF AUDIT:

Check Box	Scope of audit of financial statements
✓	Coverage of all aspects of entity relevant to the financial statements being audited
✓	Reliability and Sufficiency of financial information
✓	Proper disclosure of financial information
✓	Expression of an opinion on financial statements
X	Responsibility of preparation and presentation of financial statements
X	Duties outside scope of competence of auditor
X	Expertise in authentication of documents
X	Investigation

CONCEPT QUESTIONS (CRD):

21) Management of the company X Ltd requested the Auditor of the company to determine the outcome of a pending litigation. Explain whether the Auditor is expected to perform the same.

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

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

CONCEPT QUESTIONS (SP):

20) Mr. Ram has been appointed as an Auditor of Raghu Ltd. Management of the company argues that audit is restricted to examination of financial statements and books of accounts alone. It has no control over other areas of the entity. Comment.

(COMPREHENSIVE)

21) Approaches an Internal Auditor about as to what would be covered in Audit. Advice regarding principal aspects (any four) to be covered in getting accounts audited. (M18-MTP1-5M, N18-MTP2-5M, M19-MTP1-4M)

22) State the principal aspects which the statutory auditor should look into before framing an opinion on finalization of audit of accounts. (DRAFTED) (N)

ADVANCED CONCEPT QUESTION: **Faculty will discuss 1 CQ here. (N)**

Q.No.23. What are the qualities of an ideal Auditor? (M19-RTP, 13-RTP, N15-RTP, N10-RTP)

1) TECHNICAL OR PRFOESSIONAL QUALITIES:

a) An auditor is concerned with the reporting on financial matters of business and other institutions.

b) Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent.

2) PERSONAL QUAITIES:

a) Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness, and reliability are some of qualities which an auditor should have.

b) Personal qualities that go to make a good businessman contribute to the making of a good auditor.

c) He must have the shine of culture for attaining a great height.

d) He must also have the highest degree of integrity backed by adequate independence.

ADDITIONAL EXPLANATION (SP): **(N)**

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

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

An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.

CONCEPT QUESTIONS (CRD):

24) Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an Auditor should be as regards the personal qualities. He said, "an Auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care." Explain also stating the qualities of Auditor. (M19-RTP, M21-MTP1-4M)

DIVISION 2: IDENTICAL QUESTIONS (SELF STUDY)

1) Inherent limitations of Audit Vs Inherent Limitations of Internal Controls

HINT: Inherent limitations shall mean limitations exist in audit whereas inherent limitations of Internal controls shall be discussed in the chapter "RISK ASSESSMENT AND INTERNAL CONTROL"

2) Reasonable Assurance vs Limited Assurance

HINT: Reasonable Assurance is high level of Assurance but not absolute Assurance i.e., Auditor opinion does not provide guarantee of 100%, and Audit was conducted in accordance with "Quality Control and Engagement standards" (SA's). Whereas Limited review shall mean review conducted in accordance with "Standards on Review Engagements" (SRE's) – shall be discussed in detailed in the chapter of "Standards on Auditing".

3) Different types of Engagements – SA, SAE SRE SQC SRS **(N)**

STANDARDS ON AUDITING(SA): The auditing standards issued by ICAI are known as the Standards on Auditing (SAs). The SAs issued by ICAI are based on the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). However, ICAI may make certain modifications or provide additional guidance to suit the Indian legal and regulatory environment.

STANDARDS ON ASSURANCE ENGAGEMENT(SAE): Standards on Assurance Engagements (SAEs) to provide guidance for performing various assurance engagements other than audits of historical financial information. These standards outline the requirements and procedures to be followed when conducting assurance engagements.

STANDARDS ON REVIEW ENGAGEMENT (SRE): Standards on Review Engagements (SREs) to provide guidance for conducting review engagements. Review engagements involve assessing the financial statements or other financial information of an entity with limited assurance.

STANDARDS ON QUALITY CONTROLS (SQC): These provide guidance on the quality control procedures for firms engaged in auditing and assurance services, including independence, ethical requirements, leadership responsibilities, engagement performance, and monitoring compliance with professional standards.

STANDARDS ON RELATED SERVICES (SRE): The purpose of this Standard on Related Services (SRS) is to establish standards and provide guidance on the auditor's professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken and, on the form and content of the report that the auditor issues in connection with such an engagement.

DIVISION 3: TEST YOUR KNOWLEDGE (CRD)

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

2) The management of Exotic Tours and Travels Limited requests its auditor Raja & Co.to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures. Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case? **(NEW SM-TYK) (N)**

3) After auditing the books of accounts of Talented and Efficient Limited for the financial year 2020-21, the Auditor of the above-mentioned company wants to express an opinion on the financial statements. He asks your advice regarding the implications of audit opinion.

4) In case of certain subject matters, limitations on the Auditor's ability to detect material misstatements are particularly significant. Explain what those are matters. **(OLD SM -TYK), (JUL 21-3M, N22-3M, M20-RTP)**

5) The Auditor is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques. Explain considering qualities of Auditor.

6) It is important both for Auditor and client that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work. Explain? **(M18-MTP2-5M)**

7) There are practical and legal limitations on the Auditor's ability to obtain audit evidence. Explain with examples. **(OLD SM-TYK), (N20-MTP1-3M, M20-RTP)**

8) An assurance engagement involves a three-party relationship. Discuss meaning of three parties in such an engagement. **(NEW SM-TYK) (N)**

9) The Auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude, and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of Assurance engagements may differ, and consequently different threats may exist requiring the application of different safeguards. **(OLD SM-EX)**

10) Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit? **(NEW SM-EX) (N)**

DIVISION 4: TEST YOUR KNOWLEDGE (SELF STUDY)

1) Gopi & Co, a firm has been appointed as an Auditor of the company. The firm was negligent while conducting the Audit. Subsequently it was found that the firm did not fulfil their responsibilities properly and regulatory authorities want to make the Auditor responsible for the same. Explain who will be specifically responsible in the given case. **(NON-ICAI SOURCES) (RELATED TO Q.NO.6) (N)**

2) **The basic objective of Audit does not change with reference to nature, size, or form of an entity. Correct/Incorrect. (RELATED TO Q.NO.8)**

3) **The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements". Explain the objectives of audit as per SA 200. (RELATED TO Q.NO.8)**

4) **GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects. (M18-RTP) (RELATED TO Q.NO.22)**

5) **The Auditor should get the scope of his duties and responsibilities defined by obtaining instructions in writing. Explain the types of audits on the basis of legal requirements. (NON-ICAI SOURCES) (N) (RELATED TO Q.NO.10)**

6) **MNO Ltd requested the Auditor CA P to provide for absolute Assurance in respect of its ten branches scattered in Delhi and confirm whether that the financial statements are free from material misstatement due to fraud or error. Advise. (N18-RTP) (RELATED TO Q.NO.23)**

7) **HAI & Co. Chartered Accountants successfully carried out the audit of Shree Garments for the F.Y. 2015-2016. After the completion of the audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the Auditor. Management alleges that it is failure on the part of Auditor. Comment. (N20-MTP1-4M) (RELATED TO Q.NO.25)**

8) **The matter of difficulty, time, or cost involved is not in itself a valid basis for the Auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain. (M18-RTP) (RELATED TO Q.NO.12)**

9) **Independence of Mind and Independence in appearance are interlinked perspectives of independence of Auditors. Explain. (M19-3M, N20-MTP1-4M) (RELATED TO Q.NO.12)**

10) **Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. Explain the guiding principles in this regard. (N20-4M, JUL 20-MTP1-4M, M21-MTP2-3M) (RELATED TO Q.NO.13)**

11) **The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards.**

    Explain stating clearly the five types of threats as contained in Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC)? (COMPREHENSIVE) (N18-MTP2-7M) (RELATED TO Q.NO.13)

12) **Familiarity threats are self-evident and occur when Auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain. (M19-MTP2-4M) (M22-MTP2-4M) (RELATED TO Q.NO.14)**

13) **SWM is proprietorship firm engaged in the manufacturing of different kind of yarns. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of K 30 crores. It has also availed cash credit limit of 3 crores from Dena Bank. In the year 2018-19. Proprietor of the firm is worried about the financial position of the company & is under the impression that since he is out of India, therefore firm might not run well. He approaches an Internal Auditor about as to what would be covered in Audit. Advice regarding principal aspects (any four) to be covered in getting accounts audited. (M19-3M, N15-4M, M18-3M) (RELATED TO Q.NO.14) (N)**

DIVISION 5: IMPORTANT TECHNICAL TERMS (SELF STUDY)

1) **CONCEPT OF TRUE AND FAIR VIEW:**

   a) The concept of **true** & **fair** is a fundamental concept in auditing.

   b) The phrase **"true & fair"** in the Auditor's report signifies that the Auditor is required to express his opinion as to whether the state of affairs & the results of the entity as ascertained by him in the course of his audit are truly & fairly represented in the accounts under audit.

c) What constitutes a **'true & fair' view** is a matter of an Auditor's judgment in the circumstances of a case. In more specific terms, to ensure **true & fair view,** an Auditor has to see.

Assets	**i)** That the assets are neither **undervalued nor overvalued,** according to the applicable accounting principles, **ii)** No material assets are **omitted.** **iii)** The **charge,** if any, on assets are disclosed;
Liabilities	**iv)** Material **liabilities** should not be **omitted**
Balance Sheet and Profit & Loss Account	**v)** The profit & loss account & balance sheet **discloses all the matters** required to be disclosed;
Accounting Policies	**vi)** Accounting policies have been followed **consistently**
Exceptional Items	**vii)** All unusual, exceptional, or non-recurring items have been **disclosed separately**.

2) **RISK ASSESSMENT:** Risk assessment is a systematic process that involves identifying, analysing, and evaluating potential risks associated with a particular activity, situation, or decision. It is commonly used in various fields, including business, finance, engineering, healthcare, and environmental management, to assess and manage potential hazards and uncertainties.

3) **INTIMIDATION:** Intimidation refers to the act of instilling fear, apprehension, or a sense of threat in someone else through various means, such as aggressive behaviour, threats, or coercion. It is a tactic used to manipulate, control, or dominate others by creating a climate of fear or unease.

4) **ELECTRONIC DATA PROCESSING (EDP) AUDIT:** also known as Information Systems Audit or IT Audit, is a systematic examination and evaluation of an organization's information technology systems, processes, and controls. It focuses on assessing the reliability, integrity, availability, and security of electronic data processing within an organization.

5) **PROFESSIONAL STANDARDS AS PER ICAI:**

a) Accounting Standards (AS) issued by the ICAI.

b) Auditing Standards (SA's) issued by the ICAI.

c) Code of Ethics issued by ICAI.

d) Standards on Quality Controls (SQC).

e) Guidance Notes issued by ICAI.

f) Standards on Internal Audit (SIA's) issued by ICAI.

g) Standards on Review Engagement (SRE's) issued by ICAI.

DIVISION 6: CONCEPTS THAT ARE RESHUFFLED

S.NO.	TOPIC / CONCEPT	COVERAGE IN ICAI STUDY MATERIAL	COVERAGE IN MASTERMINDS MATERIAL
1)	INDEPENDENCE OF AUDITOR AND MEASURES TO SAFEGUARD	ETHICS & TERMS OF AUDIT ENGAGEMENT – SQC 1, SA 210, SA 220	COVERED IN THIS CHAPTER

S.NO.	TOPIC / CONCEPT	COVERAGE IN ICAI STUDY MATERIAL	COVERAGE IN MASTERMINDS MATERIAL
2)	THREATS TO INDEPENDENCE	ETHICS & TERMS OF AUDIT ENGAGEMENT – SQC 1, SA 210, SA 220	COVERED IN THIS CHAPTER
3)	PROFESSIONAL SKEPTICISM	ETHICS & TERMS OF AUDIT ENGAGEMENT – SQC 1, SA 210, SA 220	COVERED IN THIS CHAPTER
4)	PROFESSIONAL JUDGMENT	ETHICS & TERMS OF AUDIT ENGAGEMENT – SQC 1, SA 210, SA 220	COVERED IN THIS CHAPTER
6)	INTERDISCIPLINARY NATURE OF AUDITING - RELATIONSHIP WITH DIVERSE SUBJECTS	NATURE, OBJECTIVE & SCOPE OF AUDIT	MISCELLENEUS CHAPTER
7)	APPOINTMENT OF AUDITOR OF COMPANY AND SUBMISSION OF AUDIT REPORT	NATURE, OBJECTIVE & SCOPE OF AUDIT	MISCELLENEUS CHAPTER
8)	IDEAL QUALITIES OF AN AUDITOR	NATURE, OBJECTIVE & SCOPE OF AUDIT	MISCELLENEUS CHAPTER
9)	ADDITIONAL EXPLANATION ON "NON-STATUTORY AUDIT"	NATURE, OBJECTIVE & SCOPE OF AUDIT	CONCEPTS BEYOND EXAM STANDARDS

THE END

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