

# Chapter 1 - Nature, Objective and Scope of Audit - Question Bank

## Part I : Descriptive Questions

### Meaning of Auditing

Q1.	<p>"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." Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. (MTP1, Nov 2019, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing. (RTP, May 2020, NA) (MTP1, Nov 2021, 4 marks)</p>
	<p>"An audit is <b>independent examination</b> of <b>financial information</b> of <b>any entity</b>, whether <b>profit oriented or not</b>, and irrespective of its <b>size or legal form</b>, when such an examination is conducted with a view to expressing an <b>opinion</b> thereon."</p> <p>Analysis of the definition:</p> <ul style="list-style-type: none"> <li>• Audit is an <b>independent</b> examination of financial information.</li> <li>• Audit applies to various entities, including non-profits (e.g., NGOs, trusts), regardless of size or legal form (e.g., sole proprietorships, partnerships, LLPs, private/public companies, societies, trusts).</li> <li>• The purpose of the audit is to express an <b>opinion</b> on the financial statements.</li> </ul> <p>The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:</p> <ol style="list-style-type: none"> <li>1. the accounts have been drawn up with <b>reference to entries</b> in the books of account;</li> <li>2. the entries in the books of account are adequately supported by <b>sufficient and appropriate evidence</b>;</li> <li>3. none of the entries in the books of account has been <b>omitted</b> in the <b>process of compilation</b> and nothing which is not in the books of account has found place in the statements;</li> <li>4. the information conveyed by the statements is <b>clear and unambiguous</b>;</li> <li>5. the financial statement amounts are <b>properly classified, described and disclosed in conformity with accounting standards</b>; and</li> <li>6. the statement of accounts presents a <b>true and fair picture</b> of the operational results and of the assets and liabilities.</li> </ol>

### Objectives of Audit

Q2.	<p>Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide a picture of healthy financial performance having robust turnover, low debt and good profits. On the 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? (ICAI Study Material- Test Your Understanding)</p> <ul style="list-style-type: none"> <li>• An audit does not provide assurance to investors in shares regarding safety of his money. Share prices of securities are affected by a range of factors.</li> <li>• An audit only provides <b>reasonable</b> assurance that financial statements are free from material misstatement whether due to fraud or error.</li> </ul> <p><b>Conclusion:</b> Lalji Bhai is <b>not correct</b>.</p>
Q3.	<p>CA N is the auditor of SR Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements or not. In your opinion, whether CA N has complied with objectives of audit considering the applicability of relevant SA? (SA, May 2022, 3 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>CA Jatin is the auditor of JP Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements. Explain w.r.t SA 200. (MTP2, May 2023, 3 marks)</p>

	<p style="text-align: center;"><b>OR</b></p> <p>Explain the overall objective of the auditor as contained in SA 200. (RTP, May 2019, NA) (RTP, May 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2023-24, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives (RTP, Nov 2023, NA)</p>
	<p><b>Overall Objectives of the Independent Auditor:</b></p> <p>As per <b>SA 200</b> "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <ul style="list-style-type: none"> <li>To obtain <b>reasonable assurance</b> about whether the financial statements as a whole are <b>free from material misstatement</b>, whether due to <b>fraud</b> or <b>error</b>, thereby enabling the auditor to <b>express</b> an <b>opinion</b> on whether the financial statements are <b>prepared</b>, in <b>all material respects</b>, in accordance with an <b>applicable financial reporting framework</b>; and</li> <li>To <b>report</b> on the financial statements, and <b>communicate</b> as required by the SAs, in accordance with the auditor's findings.</li> </ul> <p>In the given case, the auditor expressed his opinion on the financial statements of the company without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that the auditor did <b>not comply</b> with the objective of audit as stated in SA 200</p>
Q4.	<p>The auditor of PQR LTD. is unable to obtain sufficient appropriate audit evidence and also the auditor thinks that the possible effects of undetected misstatements on the financial statements would be both material and pervasive. The auditor perceives the situation involving multiple uncertainties there by the auditor concludes that 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. Advise and explain the type of opinion the auditor would issue in the given circumstances. You are also required to explain the meaning of pervasive in this regard. (MTP2, May 2018, 5 marks)</p> <p>The auditor shall <b>disclaim an opinion</b> when the auditor is <b>unable to obtain sufficient appropriate audit evidence</b> on which to base the opinion, and the auditor concludes that the <b>possible effects</b> on the financial statements of <b>undetected misstatements</b>, if any, could be <b>both material and pervasive</b>.</p> <p>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 <b>potential interaction of the uncertainties and their possible cumulative effect</b> on the financial statements.</p> <p><b>Meaning of Pervasive</b> – A term used, in the context of misstatements, to describe the <b>effects</b> on the financial statements of misstatements <b>or</b> the <b>possible effects</b> on the financial statements of <b>misstatements</b>, if <b>any</b>, that are <b>undetected</b> due to an inability to obtain sufficient appropriate audit evidence.</p> <p><b>Pervasive effects on the financial statements are those that, in the auditor's judgment:</b></p> <ol style="list-style-type: none"> <li>Are <b>not confined</b> to specific elements, accounts or items of the financial statements</li> <li><b>Even</b> if it is <b>confined</b> to a specific element the effect can be considered as pervasive if it represent a <b>substantial proportion</b> of financial statements</li> <li>In relation to <b>disclosures</b>, are <b>fundamental</b> to <b>users' understanding</b> of the financial statements.</li> </ol>

## Test Checking and Judgment

Q5.	<p>"Professional judgment is essential to the proper conduct of an audit." Discuss. (MTP1, Nov 2020, 3 Marks) (SA, Nov 2018, 5 Marks)</p> <p><b>Meaning of Professional Judgment :</b> The application of relevant <b>training, knowledge</b> and <b>experience</b>, within the context provided by auditing, accounting and ethical standards, in making <b>informed decisions</b> about the courses of action that are appropriate in the circumstances of the audit engagement.</p> <p><b>Relevant SA :</b> SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with</p>
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## Standards on Auditing”

The auditor shall exercise **professional judgment** in planning and performing an audit of financial statements.

Professional judgment is **essential** to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- **Materiality and audit risk.**
- The **nature, timing, and extent** of audit **procedures** used to meet the requirements of the SAs and gather audit evidence.
- Evaluating whether **sufficient appropriate audit evidence** has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- The evaluation of **management's judgments** in applying the entity's applicable financial reporting framework.
- 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.

## Assertions

Q6.

Name the assertions for the following audit procedures:

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

(SA, May 2018, 5 Marks) (MTP2, May 2021, 5 Marks) (RTP, Nov 2022, NA)

OR

Name the assertions for the following audit procedures:

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

(MTP2, Nov 2023, 4 marks)

- i) **Existence** Assertion i.e. Inventory recognized in the balance sheet actually existed as at the period end.
- ii) **Valuation** Assertion i.e. all the assets have been valued appropriately and as per generally accepted accounting policies and practices. This assertion checks whether the depreciation expense has been correctly calculated and allocated among the assets over their useful lives. It ensures that the assets are not over or under-valued in the financial statements as a result of incorrect depreciation charges.
- iii) **Rights & Obligations** Assertion i.e. the entity has valid legal ownership rights over the land claimed to be held by the entity and recorded in the financial statements
- iv) **Completeness** assertion i.e. all the liabilities that were supposed to be recorded have been recognized in the financial statements.
- v) **Presentation & Disclosure** i.e. whether related party transactions have been disclosed appropriately as per the requirements of AS 18 – Related Party Disclosures.

**NOTE:** In ICAI suggested answers, only the assertion name is mentioned. However, the assertion can be explained briefly.

Q7. State assertions that are implied in the extract of financial statement given below:

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

- Indicate assertions in respect of transactions and events for the period relating to PPE.
- State specific assertions relating to the above extract of financial statements.

(MTP2, May 2019, 6 Marks) (MTP1, May 2021, 6 Marks) (MTP1, Nov 2023, 6 Marks)

- Assertions about transactions and events for the period relating to fixed assets :**
  - Occurrence**—transactions and events relating to fixed assets have been **recorded**, have occurred and **pertain to the entity**.
  - Completeness**—all transactions and events relating to fixed assets that **should have been recorded have been recorded**.
  - Accuracy**—amounts and other data relating to recorded transactions and events have been recorded **appropriately**.
  - Cut-off**—transactions and events have been recorded in the **correct accounting period**.
  - Classification**—transactions and events have been recorded in the **proper accounts**.
- Specific assertions are as follows:**
  - Rights and Obligation assertion:**
    - the firm **owns** the plant and machinery;
    - the asset is being **utilised** in the **business** of the company productively;
  - Completeness** : the **historical cost** of plant and machinery is ₹ 4 lacs;
  - Valuation assertion:**
    - total charge of depreciation on this asset is ₹ 1,66,000 to date on which ₹ 26,000 relates to the year in respect of which the accounts are drawn up; and
    - the **amount** of depreciation has been calculated on recognised basis and the calculation is correct
  - Existence assertion:** the plant and machinery **physically exists**;

**NOTE:** ICAI has not mentioned the assertion names in the suggested answers of (ii) part

Q8. What are the obvious assertions in the following items appearing in the Financial Statements?

- Statement of Profit and Loss  
Travelling Expenditure ₹ 50,000
- Balance Sheet  
Trade receivable ₹ 2,00,000

(MTP1, Nov 2019, 3 Marks)

- Travelling Expenditure ₹ 50,000**
  - Occurrence:** Expenditure has been **actually incurred** for the purpose of travelling.
  - Completeness:** Total amount of expenditure incurred is ₹ 50,000 during the year.
  - Cut-off:** Travelling has been undertaken **during the year** under consideration.
  - Classification:** It has been treated as **revenue expenditure** and charged to Statement of Profit and Loss.

**NOTE :** ICAI has not written anything about Accuracy Assertion

- Trade receivable ₹ 2,00,000**
  - Completeness:**



	<ul style="list-style-type: none"> <li>○ These have been <b>recorded properly</b>, they <b>actually exist</b> and <b>occurred</b> during the year.</li> <li>○ These include <b>all sales transactions</b> that occurred during the year.</li> <li>● <b>Rights and Obligations</b> : These constitute <b>assets</b> of the entity.</li> <li>● <b>Valuation</b>: These have been shown at <b>proper value</b>, i.e. after showing the deduction on account of provision for bad and doubtful debts.</li> </ul>
Q9.	<p>Name the assertion that the auditor will check by performing the following audit procedures.</p> <ol style="list-style-type: none"> <li>a) Employees benefit expense in respect of all personnel have been fully accounted for.</li> <li>b) Discounts on sales has been properly adjusted/ accounted for.</li> <li>c) Employee benefit expense recorded during the period relates to the current accounting period only</li> </ol> <p><b>(MTP1, May 2023, 3 marks)</b></p> <ol style="list-style-type: none"> <li>a) <b>Completeness</b> - all transactions and events that should have been recorded have been recorded)</li> <li>b) <b>Measurement</b> - Transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been no errors while preparing documents or in posting transactions to ledger. The figures and explanations are not misstated</li> <li>c) <b>Cut Off</b> - transactions and events have been recorded in the correct accounting period)</li> </ol> <p><b>NOTE:</b> In ICAI suggested answers, only the assertion name is mentioned. However, the assertion can be explained briefly.</p>

## Scope of Audit

Q10.	<p>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 &amp; 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?</p> <p><b>(ICAI Study Material- Test Your Understanding)</b></p>
	<p><b>Scope of Audit</b></p> <p>The following points are included in scope of audit of financial statements: -</p> <ol style="list-style-type: none"> <li>1. <b>Coverage of all aspects of entity</b> : Audit of FSs should be organized adequately to cover <b>all</b> aspects of the entity relevant to the FSs being audited.</li> <li>2. <b>Reliability and sufficiency of financial information</b> : The auditor should be <b>reasonably</b> satisfied that information contained in underlying <b>accounting records</b> and <b>other</b> source data (like bills, vouchers, documents etc.) is reliable and provide <b>sufficient</b> basis for preparation of financial statements.</li> <li>3. <b>Proper disclosure of financial information</b>: The auditor must ensure FSs adequately <b>disclose relevant</b> information and <b>comply</b> with statutory <b>requirements</b>, verifying that they accurately summarize recorded transactions and considering management's judgments in their preparation.</li> </ol> <p><b>Conclusion:</b> Proper disclosure of financial information is well within scope of audit.</p>
Q11.	<p>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? <b>(ICAI Study Material- Test Your Understanding)</b></p>
	<ul style="list-style-type: none"> <li>● An audit is <b>independent examination of financial information of any entity</b>, whether <b>profit oriented or not</b>, and irrespective of its <b>size or legal form</b>, when such an examination is conducted with a view to expressing an <b>opinion</b> thereon</li> <li>● An audit is <b>not</b> an <b>official investigation</b> into alleged <b>wrongdoing</b>.</li> <li>● In the given case, appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company.</li> </ul> <p><b>Conclusion:</b> Services rendered by CA are in the <b>nature of investigation</b> and therefore his report will not be in the nature of</p>

	audit report.
Q12.	<p>"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. (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> <li>Choosing appropriate accounting policies is the <b>responsibility of management</b>. The role of auditor lies in evaluating selection and consistent application of accounting policies by management</li> <li>The auditor <b>evaluates management's judgments</b> in FS preparation, including the selection and consistent application of accounting policies, such as depreciation methods for fixed assets and inventory valuation, ensuring proper choice and period-to-period consistency.</li> </ul>
Q13.	<p>An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss. (RTP, May 2023, NA)</p> <ul style="list-style-type: none"> <li>Audit is distinct from investigation. <b>Investigation</b> is a <b>critical examination</b> of the accounts with a <b>special purpose</b>. 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.</li> <li>The objective of audit is to obtain <b>reasonable</b> assurance about whether the financial statements as a whole are <b>free</b> from <b>material misstatement</b>, whether due to <b>fraud</b> or <b>error</b>, thereby enabling the auditor to express an <b>opinion</b>.</li> <li>Therefore, <b>audit</b> is <b>never</b> started with a <b>preconceived notion</b> about state of affairs; about <b>wrong-doing</b>; about some wrong having been committed. The auditor seeks to report what he finds in the normal course of examination of accounts.</li> <li>However, it is quite possible that sometimes investigation results from the <b>prima facie findings</b> of the auditor. It may happen that the auditor has given some findings of serious concern. Such findings may prompt for calling an investigation</li> </ul>

## Benefits of Audit

Q14.	<p>RAG is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 5 crores from Canara Bank. In the year 2023-24, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited. (MTP1, May 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain. (RTP, Nov 2018, NA)</p> <p><b>Advantages of audit of Financial statements:</b></p> <ul style="list-style-type: none"> <li>Audited accounts provide <b>high quality information</b>. It gives <b>confidence</b> to <b>users</b> that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.</li> <li>In case of companies, shareholders may or may not be involved in daily affairs of the company. The FSs are prepared by management consisting of directors. As shareholders are owners of the company, they need an <b>independent mechanism</b> so that financial information is <b>qualitative</b> and <b>reliable</b>. Hence, their interest is <b>safeguarded</b> by an audit.</li> <li>An audit acts as a <b>moral check</b> on <b>employees</b> from committing frauds for the fear of being discovered by audit.</li> <li>Audited FSs are helpful to <b>government</b> authorities for determining tax liabilities.</li> <li>Audited FSs can be relied upon by <b>lenders</b>, bankers for making their credit decisions i.e. whether to lend or not to lend to a particular entity.</li> <li>An audit may also <b>detect fraud</b> or <b>error</b> or both.</li> <li>An audit <b>reviews</b> the <b>existence</b> and <b>operations</b> of various <b>controls</b> operating in any entity. Hence, it is useful at pointing out deficiencies.</li> </ul>
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## Inherent Limitations of Audit

Q15.	<p>Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ &amp; 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.</p> <p>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. (ICAI Study Material- Test Your Understanding)</p>
	<ul style="list-style-type: none"> <li>The auditor is <b>not expected</b> to, and <b>cannot, reduce audit risk to zero</b> and <b>cannot</b> therefore <b>obtain absolute assurance</b> that the financial statements are free from material misstatement due to fraud or error. This is because there are <b>inherent limitations</b> of an audit.</li> <li>Circumstances given in the question is an example of <b>failure of internal controls</b> of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls.</li> </ul> <p><b>Conclusion:</b> The view of the partners is <b>not correct</b>. This is an inherent limitation of audit.</p>
Q16.	<p>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. (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2023, 3 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples. (RTP, May 2020, NA) (MTP1, Nov 2020, 3 Marks) (RTP, Nov 2021, NA) (RTP, Nov 2023, NA)</p>
	<p><b>The Nature of Audit Procedures</b></p> <ul style="list-style-type: none"> <li>An auditor does <b>not test all transactions</b> and <b>balances</b>. He forms his opinion only by testing <b>samples</b>. It is an example of practical limitation on auditor's ability to obtain audit evidence.</li> <li>Management may <b>not provide complete information</b> as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.</li> <li>The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing <b>fraud</b> by designing <b>sophisticated</b> and carefully <b>organized schemes</b> which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.</li> <li>It is quite possible that the entity may have entered into some transactions with <b>related parties</b>. Such transactions may be only paper transactions and may not have actually occurred. The auditor may <b>not be aware</b> of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.</li> </ul>
Q17.	<p>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain. (RTP, Nov 2018, NA)</p>
	<p>The auditor is <b>not expected</b> to, and <b>cannot, reduce audit risk to zero</b> and <b>cannot</b> therefore <b>obtain absolute</b> assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from:</p> <ol style="list-style-type: none"> <li><b>The Nature of Financial Reporting:</b> Preparation of financial statements involves making many <b>judgments</b> by management. These judgments may involve <b>subjective</b> decisions or a degree of <b>uncertainty</b>. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors</li> <li><b>The Nature of Audit Procedures:</b> There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example,             <ul style="list-style-type: none"> <li>an auditor does <b>not test all transactions</b> and <b>balances</b>. He forms his opinion only by testing <b>samples</b>. It is an example of a practical limitation on an auditor's ability to obtain audit evidence.</li> </ul> </li> </ol>

	<ul style="list-style-type: none"> <li>Management may <b>not provide complete information</b> as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.</li> </ul> <p>3. <b>Not in nature of investigation:</b> An audit is <b>not</b> an <b>official investigation</b>. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors</p> <p>4. <b>Timeliness of Financial Reporting and the Balance between Benefit and Cost:</b> The relevance of information decreases over time and auditor <b>cannot</b> verify each and every matter. Therefore, a <b>balance</b> has to be struck between <b>reliability</b> of information and <b>cost</b> of obtaining it.</p> <p>5. <b>Future events:</b> Future events or conditions may affect an entity adversely. <b>Adverse events</b> may seriously affect an entity's ability to continue its business. The business may <b>cease to exist</b> in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.</p>
Q18.	<p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation. (RTP, Nov 2022, NA)</p> <p><b>The Nature of Audit Procedures:</b> There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example,</p> <ul style="list-style-type: none"> <li>An auditor does <b>not test all transactions and balances</b>. He forms his opinion only by testing <b>samples</b>. It is an example of practical limitation on auditor's ability to obtain audit evidence.</li> <li>Management may <b>not provide complete information</b> as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.</li> <li>The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing <b>fraud</b> by designing <b>sophisticated</b> and carefully <b>organized schemes</b> which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.</li> <li>It is quite possible that the entity may have entered into some transactions with <b>related parties</b>. Such transactions may be only paper transactions and may not have actually occurred. The auditor may <b>not be aware</b> of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.</li> </ul> <p><b>Difference between audit and investigation</b></p> <ul style="list-style-type: none"> <li>An audit is <b>not</b> an <b>official investigation</b> into alleged <b>wrongdoing</b>. He does <b>not</b> have any specific <b>legal powers</b> of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.</li> <li><b>Investigation</b> is a <b>critical examination</b> 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.</li> <li>The objective of audit is to obtain <b>reasonable</b> assurance about whether the financial statements as a whole are free from <b>material misstatement</b>, whether due to <b>fraud</b> or <b>error</b>, thereby enabling the auditor to express an opinion.</li> <li>The scope of audit is general and <b>broad</b> whereas scope of investigation is specific and <b>narrow</b></li> </ul>

### Interdisciplinary Nature of Auditing relationship with Diverse Subjects

Q19.	<p>Both accounting and auditing are closely related with each other. Explain (RTP, Nov 2020, NA)</p> <ul style="list-style-type: none"> <li>Both accounting and auditing are <b>closely related</b> with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process.</li> <li>Auditing <b>begins when accounting ends</b>.</li> <li>It requires that the auditor must have a <b>thorough</b> and sound <b>knowledge</b> of <b>generally accepted principles</b> of accounting before he can review the financial statements.</li> </ul>
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## Assurance Engagement

Q20.	<p>The management of Exotic Tours and Travels Limited requests its auditor Raja &amp; Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures. Can Raja &amp; 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? <b>(ICAI Study Material- Test Your Understanding)</b></p> <p>In the given case, Raja &amp; Co. can provide a <b>review report</b>. Review is a <b>limited</b> assurance engagement and it provides assurance which is lower than that provided by audit. It is due to the fact that review involves fewer procedures as compared to audit.</p> <p>Therefore, Raja &amp; Co can provide a report as requested by the management of the company. Such a report would be in the nature of <b>"review"</b>.</p> <p>Raja &amp; Co is required to obtain sufficient appropriate evidence based on limited procedures performed.</p>
Q21.	<p>Assurance engagements are not restricted to audit of financial statements alone. Discuss. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <ul style="list-style-type: none"> <li>• "Assurance engagement" means an engagement in which a practitioner expresses a <b>conclusion</b> designed to enhance the <b>degree of confidence</b> of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.</li> <li>• Scope of Assurance engagements is <b>not restricted to audit</b> of financial statements only, it also extends to examination of prospective financial information and examination of internal controls.</li> <li>• Example of assurance engagement             <ul style="list-style-type: none"> <li>◦ <b>Audit</b> of financial statements - <b>Reasonable</b> assurance engagement</li> <li>◦ <b>Review</b> of financial statements - <b>Limited</b> assurance engagement</li> <li>◦ <b>Examination of Prospective financial information</b> - Provides <b>assurance</b> regarding <b>reasonability</b> of assumptions forming basis of projections and related matters</li> <li>◦ <b>Report</b> on controls operating at an organization - Provides <b>assurance</b> regarding <b>design</b> and <b>operation</b> of controls</li> </ul> </li> </ul>
Q22.	<p>An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p>A three party relationship involving a practitioner, a responsible party, and intended users</p> <ul style="list-style-type: none"> <li>• <b>Practitioner:</b> A practitioner is a person who <b>provides assurance</b>. The term practitioner is broader than auditor. <b>Audit</b> is related to <b>historical</b> information whereas <b>practitioner</b> may provide assurance <b>not necessarily</b> related to <b>historical</b> financial information.</li> <li>• <b>Responsible party:</b> A responsible party is the party <b>responsible</b> for <b>preparation</b> of <b>subject matter</b>.</li> <li>• <b>Intended users:</b> Intended users are the persons for <b>whom</b> an assurance <b>report</b> is <b>prepared</b>. These persons may use the report in making <b>decisions</b>.</li> </ul>
Q23.	<p>A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <ul style="list-style-type: none"> <li>• "Assurance engagement" means an engagement in which a practitioner expresses a <b>conclusion</b> designed to <b>enhance</b> the <b>degree of confidence</b> of the intended <b>users</b> other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.</li> <li>• Reasonable assurance is a <b>high level</b> of assurance but it is <b>not absolute</b> assurance</li> <li>• In the given case, a Chartered Accountant is specifically asked to check accounts whether fraud exists.</li> <li>• It is not a reasonable assurance engagement. It is in the <b>nature of investigation</b>.</li> </ul>

## Qualities of Auditor

Q24.	Explain qualities of an Auditor. <b>(RTP, May 2019, NA) (MTP1, May 2021, 4 Marks) (MTP1, Nov 2021, 4 Marks)</b>
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**Qualities of an Auditor:**

- **Tact, caution**, firmness, good temper, integrity, discretion, industry, judgment, patience, clear headedness and reliability are some of qualities which an auditor should have. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor.
- He must have the highest degree of **integrity** backed by adequate independence.
- The auditor, who holds a position of **trust**, must have the basic human qualities apart from the technical requirement of professional training and education.
- **Knowledge of an expert**. He is called upon constantly to critically review FSs 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**.

**Quality Control and Engagement Standards**

Q25. CA. P Babu is conducting an 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? **(ICAI Study Material- Test Your Understanding)**

- 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.
- However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, professional accountant is required to
  - **Document** how alternative procedures performed achieve the purpose of the required procedure.
  - **Reason for departure** has to be documented
  - **Report** should draw attention to such departures

**Conclusion:** Hence, CA. P Babu is required to follow the above procedure.

Q26. Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples. **(RTP, May 2022, NA)**

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

"**Historical financial information**" 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.

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

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements. Some examples of Standards on Auditing are :

- **SA 200** Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- **SA 230** Audit Documentation
- **SA 315** Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- **SA 500** Audit Evidence

- **SA 700** Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

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

## Part II: Correct/Incorrect Questions

Q1.	<p>The basic objective of audit does not change with reference to nature, size or form of an entity. (ICAI Study Material- Test Your Knowledge)</p> <p><b>Correct.</b> An audit is <b>independent examination</b> of <b>financial information</b> of <b>any entity</b>, whether <b>profit oriented or not</b>, and irrespective of its <b>size or legal form</b>, when such an examination is conducted with a view to expressing an <b>opinion</b> thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does <b>not change</b> with reference to nature, size or form of an entity.</p>
Q2.	<p>The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. (ICAI Study Material- Test Your Knowledge) (MTP1, May 2023, 2 marks)</p> <p><b>Correct.</b> As per <b>SA 200</b> "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to <b>enhance the degree of confidence</b> of intended <b>users</b> in the financial statements. This is achieved by the expression of an <b>opinion</b> by the auditor on whether the <b>financial statements</b> are prepared, in <b>all material</b> respects, in accordance with an <b>applicable financial reporting framework</b>.</p>
Q3.	<p>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. (ICAI Study Material- Test Your Knowledge)</p> <p><b>Correct.</b> As per <b>SA 200</b> "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is <b>not expected</b> to, and <b>cannot, reduce audit risk to zero</b> and <b>cannot</b> therefore obtain <b>absolute</b> assurance that the <b>financial statements</b> are <b>free</b> from <b>material misstatement</b> due to fraud or error. This is because there are <b>inherent limitations</b> of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being <b>persuasive</b> rather than conclusive.</p>
Q4.	<p>Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. (ICAI Study Material- Test Your Knowledge) (MTP1, Nov 2020, 2 Marks) (SA, July 2021, 2 Marks) (RTP, May 2023, NA) (MTP1, May 2023, 2 marks)</p> <p><b>Incorrect.</b> Assertions refer to <b>representations</b> by <b>management</b> that are embodied in the financial statements as <b>used</b> by the <b>auditor</b> to consider the different types of the potential misstatements that may occur.</p>
Q5.	<p>Mr. S, one of the new team members of the auditor of Extremely Effective Limited was of the view that for the purpose of conducting an audit, only knowledge of direct tax is required whereas no knowledge of indirect tax is required. (Old ICAI Study Material)</p> <p><b>Incorrect.</b> The viewpoint of Mr. S is incorrect because for the purpose of conducting an audit, proper knowledge of <b>both</b> direct tax as well as indirect tax is required.</p>
Q6.	<p>According to Mr. H, one of the team members of the auditor of Very Essential Limited was of the view that no relation exists between accounting and auditing from the point of view of a company. (Old ICAI Study Material)</p> <p><b>Incorrect.</b> The viewpoint of Mr. H is incorrect because there exists a <b>proper relation</b> between accounting and auditing from the point of view of a company. Audit is conducted for financial statements of a company and those financial statements are prepared with the help of books of accounts of that company. In order to properly conduct an audit of a company, an auditor is required to be aware of accounting <b>principles</b> and accounting <b>policies</b> of that company.</p>
Q7.	<p>The term "Engagement Standards" refer to Standards on Auditing only. (Old ICAI Study Material)</p>

	<b>Incorrect.</b> Engagement Standards refer not only to Standards on auditing but also to <b>Standards on review engagements, Standards on assurance engagements</b> and <b>Standards on related services</b> .
Q8.	<p>The objective of audit is to obtain absolute assurance and to report on the financial statements. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>As per SA 200 "Overall Objectives of the Auditor", in conducting an audit of financial statements, the overall objectives of the auditor is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement due to fraud. (RTP, May 2023, NA)</p>
	<p><b>Incorrect.</b> As per <b>SA 200</b> "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <ul style="list-style-type: none"> <li>• To obtain <b>reasonable assurance</b> about whether the <b>financial statements</b> as a whole are <b>free</b> from <b>material misstatement</b>; whether due to fraud or error, thereby enabling the auditor to express an <b>opinion</b> on whether the financial statements are prepared, in all material respects, in accordance with an <b>applicable financial reporting framework</b>; and</li> <li>• To <b>report</b> on the financial statements, and <b>communicate</b> as required by the SAs, in accordance with the auditor's findings</li> </ul>
Q9.	<p>As explained in SA 200, absolute assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk. (MTP2, May 2018, 2 Marks)</p>
	<p><b>Incorrect.</b> As explained in <b>SA 200</b>, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", <b>reasonable assurance</b> is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated.</p>
Q10.	<p>Misstatements in the financial statements can arise from fraud only. (MTP1, May 2018, 2 Marks) (MTP1, Nov 2018, 2 Marks) (MTP2, Nov 2018, 2 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Misstatement in the financial statement is always because of fraud (SA, July 2021, 2 Marks)</p>
	<p><b>Incorrect.</b> Misstatements in the financial statements can arise from <b>either fraud or error</b>. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is <b>intentional or unintentional</b>. The '<b>fraud</b>' deals with <b>intentional</b> misrepresentation but, '<b>error</b>', on the other hand, refers to <b>unintentional</b> mistakes in financial information.</p>
Q11.	<p>The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. (RTP, Nov 2018, NA) (RTP, May 2019, NA)</p>
	<p><b>Incorrect.</b> The preparation of financial statements involves <b>judgment by management</b> in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve <b>subjective</b> decisions or assessments or a degree of <b>uncertainty</b>, and there may be a range of acceptable interpretations or judgments that may be made.</p>
Q12.	<p>An audit is an official investigation into alleged wrongdoing. (RTP, Nov 2018, NA) (RTP, May 2019, NA)</p>
	<p><b>Incorrect.</b> An audit is <b>not</b> an <b>official investigation</b> into alleged <b>wrongdoing</b>. Accordingly, the auditor is <b>not</b> given specific <b>legal powers</b>, such as the power of search, which may be necessary for such an investigation.</p>
Q13.	<p>Management of the organization is solely responsible for the compliance of auditing standards while preparing financial statements. (SA, Nov 2018, 2 Marks)</p>
	<p><b>Incorrect.</b> The management is responsible for the <b>preparation</b> of the <b>financial statements</b> in accordance with the applicable financial reporting framework. Management is responsible for the compliance of <b>accounting standards</b>. The <b>auditor</b> is responsible for the compliance of <b>standards on auditing</b> while auditing the financial statements of the entity.</p>



Q14.	<p>The objective of audit is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement. <b>(MTP2, May 2019, 2 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor is expected to and can reduce audit risk to zero. <b>(MTP1, May 2020, 2 Marks)</b></p>
	<p><b>Incorrect.</b> As per <b>SA 200</b> "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the objective of audit is to obtain <b>reasonable</b> assurance about whether the financial statements as a whole are free from material misstatement. In auditing, reasonable assurance can be given which is <b>high level</b> assurance but not absolute assurance. The auditor is <b>not expected</b> to, and <b>cannot, reduce</b> audit risk to <b>zero</b> and <b>cannot</b> therefore <b>obtain absolute</b> assurance that the <b>financial statements</b> are <b>free</b> from <b>material misstatement</b> due to fraud or error. This is because there are <b>inherent limitations</b> of an audit.</p>
Q15.	<p>The Auditor is expected to reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. <b>(SA, Jan 2021, 2 Marks) (MTP2, Nov 2022, 2 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor is expected to, and can, reduce audit risk to zero and can therefore obtain absolute assurance. <b>(MTP1, Nov 2021, 2 Marks)</b></p>
	<p><b>Incorrect.</b> As per <b>SA 200</b> "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", The auditor is <b>not expected</b> to, and <b>cannot, reduce</b> audit risk to <b>zero</b> and <b>cannot</b> therefore <b>obtain absolute</b> assurance that the <b>financial statements</b> are <b>free</b> from <b>material misstatement</b> due to fraud or error. This is because there are <b>inherent limitations</b> of an audit.</p>
Q16.	<p>There are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being conclusive rather than persuasive. <b>(MTP2, May 2021, 2 Marks)</b></p>
	<p><b>Incorrect.</b> As per <b>SA 200</b>, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is <b>not expected</b> to, and <b>cannot, reduce</b> audit risk to <b>zero</b> and <b>cannot</b> therefore obtain <b>absolute</b> assurance that the <b>financial statements</b> are <b>free</b> from <b>material misstatement</b> due to fraud or error. This is because there are <b>inherent limitations</b> of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being <b>persuasive</b> rather than conclusive.</p>
Q17.	<p>Audit procedures used to gather audit evidence may be effective for detecting an intentional misstatement. <b>(RTP, Nov 2018, NA) (RTP, May 2019, NA)</b></p>
	<p><b>Incorrect.</b> <b>Fraud</b> may involve <b>sophisticated</b> and carefully <b>organized</b> schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be <b>ineffective</b> for detecting an intentional misstatement. The auditor is <b>neither trained</b> as <b>nor</b> expected to be an <b>expert</b> in the <b>authentication</b> of documents.</p>
Q18.	<p>The preparation of financial statements involves judgment by management. <b>(MTP2, Nov 2021, 2 Marks) (MTP1, May 2022, 2 marks)</b></p>
	<p><b>Correct.</b> The preparation of financial statements involves <b>judgment</b> by <b>management</b> in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve <b>subjective</b> decisions or assessments or a degree of <b>uncertainty</b>, and there may be a range of acceptable interpretations or judgments that may be made.</p>
Q19.	<p>Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are detected by obtaining sufficient appropriate audit evidence. <b>(SA, May 2022, 2 Marks)</b></p>
	<p><b>Incorrect.</b> Pervasive is a term used, in the context of <b>misstatements</b>, to describe the effects on the financial statements of misstatements or the <b>possible effects</b> on the financial statements of misstatements, if any, that are <b>undetected</b> due to an inability to obtain sufficient appropriate audit evidence.</p>
Q20.	<p>There is no difference between "audit" and "review." <b>(RTP, Nov 2022, NA)</b></p>
	<p><b>Incorrect.</b> "Audit" and "Review" are two different terms. <b>Audit</b> is a <b>reasonable</b> assurance engagement, and its <b>objective</b> is</p>

	<b>reduction</b> in assurance engagement <b>risk</b> to an <b>acceptably low</b> level in the circumstances of the engagement. However, "review" is a <b>limited</b> assurance engagement, and its <b>objective</b> is a <b>reduction</b> in assurance engagement <b>risk</b> to a <b>level</b> that is <b>acceptable</b> in the <b>circumstances</b> of the engagement
Q21.	For auditor's opinion, reasonable assurance is an absolute level of assurance. (RTP, Nov 2022, NA) (RTP, Nov 2023, NA)  <b>Incorrect.</b> Reasonable assurance is a <b>high</b> level but <b>not</b> an <b>absolute</b> level of assurance, because there are <b>inherent limitations</b> of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being <b>persuasive</b> rather than conclusive.
Q22.	Negative assertions, encountered in the financial statements, may be expressed or implied. (RTP, Nov 2022, NA) (MTP2, Nov 2023, 2 marks)  <b>Correct.</b> Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is <b>no contingent liability</b> it would be an expressed <b>negative assertion</b> ; on the other hand, if in the balance sheet there is no item as "building", it would be an <b>implied negative assertion</b> that the entity did not own any building on the balance sheet date.
Q23.	Misstatements in the financial statements can arise from either fraud or error. (MTP1, Nov 2022, 2 Marks)  <b>Correct.</b> Misstatements in the financial statements can arise from <b>either fraud or error</b> . The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is <b>intentional</b> or <b>unintentional</b> . Hence misstatement can arise from error or fraud.
Q24.	Historical financial information relates to financial information based on assumptions about occurrence of future events and possible actions by an entity. (SA, Nov 2022, 2 marks) (MTP2, Nov 2023, 2 marks)  <b>Incorrect.</b> <b>Historical</b> financial information relates to information expressed in <b>financial</b> terms of an entity about <b>economic events</b> , conditions or circumstances occurring in <b>past</b> periods. Whereas <b>financial information</b> based on assumptions about occurrence of <b>future</b> events and possible actions by an entity relates to prospective financial information.

### Part III: Multiple Choice Questions

Q1.	Which of the following is not an advantage of audit? (a) It provides high quality financial information. (b) It acts as a moral check on employees. (c) It enhances risk of management bias. (d) It helps in safeguarding interests of shareholders. (ICAI Study Material - Test Your Knowledge)  <b>Correct answer:</b> (c) It enhances risk of management bias <b>Explanation:</b> Advantages of Audit are- provides high quality financial information, acts as a moral check on employees, helps in safeguarding interests of shareholders, helpful to government authorities, relied upon by lenders, detect fraud or error, and reviews existence and operations of various controls. "It enhances risk of management bias" is not an advantage of audit.
Q2.	Which of the following is NOT TRUE about an assurance engagement? (a) It relates to providing assurance about historical financial information only. (b) The practitioner obtains sufficient appropriate evidence. (c) There is some information to be examined by practitioner. (d) A written assurance report in appropriate form is issued by practitioner. (ICAI Study Material - Test Your Knowledge)  <b>Correct answer:</b> (a) It relates to providing assurance about historical financial information only. <b>Explanation:</b> Assurance can also be related to matters other than historical financial information. Such an assurance may relate to prospective financial information. It may relate to providing assurance on internal controls in an entity. Hence, statement 1 is incorrect.

Q3.	<p>Which of the following is TRUE about Engagement Standards?</p> <p>(a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.</p> <p>(b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.</p> <p>(c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.</p> <p>(d) Engagement standards ensure savings in resources of clients</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties</p> <p><b>Explanation:</b> Standards are needed for carrying out audits against established benchmarks, for improving quality of financial reporting, for promoting uniformity, for equipping professional accountants with professional knowledge &amp; skill and for ensuring audit quality.</p>
Q4.	<p>Consider following statements in relation to "Limited assurance engagement":-</p> <p>Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.</p> <p>Statement II - Review of interim financial information of a company is an example of limited assurance engagement.</p> <p>(a) Statement I is correct. Statement II is incorrect.</p> <p>(b) Both Statements I and II are correct.</p> <p>(c) Both Statements I and II are incorrect.</p> <p>(d) Statement I is incorrect. Statement II is correct.</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) Statement I is incorrect. Statement II is correct</p> <p><b>Explanation:</b> In reasonable assurance engagements, the practitioner obtains sufficient appropriate evidence to be able to draw reasonable conclusions. Whereas, in Limited assurance engagements, the practitioner obtains sufficient appropriate evidence to be able to draw limited conclusions. Therefore, statement 1 is incorrect. Example of SRE is SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity</p>
Q5.	<p>Which of the following is TRUE about Standards on auditing?</p> <p>(a) These deal mainly with voluntary responsibilities of auditors.</p> <p>(b) These deal mainly with mandatory responsibilities of auditors.</p> <p>(c) Their sole purpose is to help government authorities in augmenting revenues.</p> <p>(d) These deal mainly in carrying out audit according to legal provisions</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (b) These deal mainly with mandatory responsibilities of auditors.</p> <p><b>Explanation:</b> Engagement Standards issued under the authority of Council of ICAI deal with responsibilities of auditor/practitioner.</p>
Q6.	<p>As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", _____ is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.</p> <p>(a) absolute assurance</p> <p>(b) limited assurance</p> <p>(c) reasonable assurance</p> <p>(d) reasonable or absolute assurance</p> <p><b>(Sample MCQs) (ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) reasonable assurance</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• <b>Absolute assurance</b> means that there is absolutely no misstatement in the financial statement and thus financial statements are absolutely reliable and relevant for the user of financial statements.</li> <li>• On the other hand, <b>reasonable assurance</b> is also a high level of assurance but it means that auditor has conducted the audit in a way that he is reasonably sure (to the best possible extent) that financial statements are free from material misstatement but there might be some misstatements that go undetected due to inherent limitations of an audit.</li> </ul>

Q7.	<p>Which of the following is not an assertion about presentation and disclosure?</p> <p>(a) Occurrence and rights and obligations (b) Completeness (c) Classification and understandability (d) Existence</p> <p><b>(Sample MCQs)</b></p>
	<p><b>Correct answer:</b> (d) Existence</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Existence is not an assertion about presentation and disclosure. It is an assertion for account balance.</li> <li>Assertions about presentation and disclosure: Occurrence and rights and obligations, Completeness, Classification and understandability, Accuracy and valuation</li> </ul>
Q8.	<p>Which of the following Assertion is not related to assertion about presentation and disclosure:</p> <p>(a) Occurrence and rights and obligations (b) Completeness (c) Classification and understandability (d) Valuation and allocation</p> <p><b>(Sample MCQs)</b></p>
	<p><b>Correct answer:</b> (d) Valuation and allocation</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Valuation and allocation is not related to assertion about presentation and disclosure. It is an assertion for account balance.</li> <li>Assertions about presentation and disclosure: Occurrence and rights and obligations, Completeness, Classification and understandability, Accuracy and valuation</li> </ul>
Q9.	<p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <p>(a) To obtain reasonable assurance (b) To report on the financial statements (c) Both (a) and (b) above (d) to obtain absolute assurance.</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) Both (a) and (b) above</p> <p><b>Explanation:</b> The objective of the auditor as per SA 200 is to obtain reasonable assurance about whether FS as a whole are free from material misstatement, whether due to fraud or error and to report on FS and communicate as required by SAs.</p>
Q10.	<p>An employee of Fruits and Vegetables Limited was of the opinion that auditor of a company is required to express an opinion. On which one of the following the auditor of a company is required to express an opinion:</p> <p>(a) Only Balance Sheet of the Company. (b) Financial Statements of the Company. (c) Only Profit and Loss Account of the Company. (d) Only Cash Flow Statement of the Company.</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (b) Financial Statements of the Company.</p> <p><b>Explanation:</b> The auditor is required to express an opinion on the Financial Statements. Financial statements include Balance Sheet, Profit and Loss Account and Cash Flow Statement.</p>
Q11.	<p>The auditor of Delicious Sweets Limited was of the opinion that the objective of audit of financial statements of a company is to provide reasonable assurance that financial statements of that company are free from misstatements. Which type of misstatements are mentioned by auditor of Delicious Sweets Limited:</p> <p>(a) Simple</p>

	<p>(b) Material (c) Easy (d) Competent <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Material <b>Explanation:</b> The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from <b>material</b> misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.</p>
Q12.	<p>_____ along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession.</p> <p>(a) Auditing (b) Taxation (c) Finance (d) Law <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) Auditing</p>
Q13.	<p>No business or institution can effectively carry on its activities without the help of proper _____:</p> <p>(a) Audit (b) Record and accounts (c) neither (a) nor (b) (d) both (a) and (b) <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Record and accounts</p>
Q14.	<p>Which of the following is the responsibility of the auditor:</p> <p>(a) Preparation and presentation of the financial statements in accordance with applicable financial reporting (b) Design, implementation and maintenance of internal controls (c) Express an opinion on the Financial Statements (d) To obtain limited assurance <b>(ICAI MCQs) (MTP2, May 2022, 1 mark)</b></p> <p><b>Correct answer:</b> (c) Express an opinion on the Financial Statements <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• The responsibility of the auditor is to obtain reasonable assurance about whether the FSs as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the FSs are prepared, in all material respects, in accordance with AFRE.;</li> <li>• Management is responsible for design, implementation and maintenance of IC and preparation and presentation of the FS as per AFRE.</li> </ul>
Q15.	<p>_____ refers to 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 for the item to be in accordance with the applicable financial reporting framework.</p> <p>(a) Misstatement (b) Error (c) Fraud (d) Any of the above <b>(Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (a) Misstatement <b>Explanation:</b></p>

	<ul style="list-style-type: none"> <li>• Misstatement refers to 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 for the item to be in accordance with the applicable financial reporting framework. Misstatements in the financial statements can arise from either fraud or error.</li> <li>• Fraud can be committed by anyone such as management, TCWG, employees and third parties. Such an act has been committed using unfair means and is an intentional activity (deliberate action) to gain personal benefit directly or indirectly illegally. While errors are acts of unintentional mistakes or negligence which can be detected easily.</li> </ul>
Q16.	<p>One of your junior audit team members is confused with the term 'material misstatement'. You explain to him that a material misstatement is untrue information in a financial statement that could affect the financial decisions of one who relies on the statement. Which of the following would constitute material misstatement?</p> <p>(1) An error of ₹ 5,000 in relation to assets of ₹ 20 lakhs.  (2) A payroll fraud of ₹100 in a company where profit before tax is ₹11,000.  (3) Non-disclosure of a material uncertainty.  (4) Financial statements have been prepared on a going concern basis when the company is in the process of being liquidated.</p> <p>(a) 1 and 2  (b) 3 and 4  (c) 2 and 3  (d) 1 and 4</p> <p><b>(MTP2, May 2019, 2 Marks)</b></p> <p><b>Correct answer:</b> (b) 3 and 4</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• An error of ₹ 5,000 i.e. an unintentional mistake in the financial information does not constitute a material misstatement. Payroll fraud of ₹ 100 is immaterial.</li> <li>• However, Non-disclosure of a material uncertainty and financial statements have been prepared on a going concern basis when the company is in the process of being liquidated would constitute material misstatement as such misstatements can impact the economic decisions of the users of the financial statements.</li> <li>• A material misstatement is information in the financial statements that is sufficiently incorrect that it may impact the economic decisions of the users of the financial statements.</li> <li>• There are some factors that can be considered while deciding if a misstatement is material or not. Factors are: the comparative size of the misstatement, the nature of the misstatement, the relationship to other misstatements, the inherent character of the mistake.</li> </ul>
Q17.	<p>Which of the following is correct :</p> <p>(a) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.  (b) The auditor is expected to and can reduce audit risk to zero and can therefore obtain absolute assurance.  (c) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error.  (d) The auditor is expected to and can reduce audit risk to zero and can therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error.</p> <p><b>(MTP2, May 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (a) the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.</p>
Q18.	<p>M/s KYC &amp; Co. is a reputed Audit firm in Mumbai. They are appointed as Statutory Auditors of Blessed Ltd. Which of the below is the responsibility of M/s KYC &amp; Co.</p> <p>(a) Preparation of financial statements  (b) Designing, implementation and maintenance of internal control system  (c) Reporting on true and fair view of financial statements  (d) Compliance with the applicable law and regulation</p> <p><b>(RTP, Nov 2020, NA)</b></p>

	<p><b>Correct answer :</b> (c) Reporting on true and fair view of financial statements</p> <p><b>Explanation:</b> The responsibility of M/s KYC &amp; Co. i.e. audit firm is to express opinion as to whether the financial statements exhibit a true and fair view of the affairs of the entity. The management is responsible for preparation of financial statements, designing, implementation and maintenance of internal control systems and compliance with the applicable law and regulation.</p>
Q19.	<p>The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are :</p> <p>(a) Management (b) those charged with governance (c) audit committee (d) board of directors</p> <p><b>(RTP, May 2021, NA) (MTP1, May 2021, 1 Mark ) (RTP, Nov 2021, NA) (RTP, Nov 2023, NA) (MTP2, Nov 2023, 1 mark)</b></p> <p><b>Correct answer:</b> (b) those charged with governance</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Management : The person(s) with executive responsibility for the conduct of the entity's operations. Management is responsible for the day to day work and implementing the policies framed by TCWG.</li> <li>• Those charged with governance: TCWG are responsible for strategic decisions. TCWG supervises the work done by the management and is responsible for approving the financial statements. TCWG is a higher authority. For example - Board of Directors, corporate trustee</li> <li>• Management and TCWG can be the same in some entities, say in small organisations.</li> </ul>
Q20.	<p>_____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.</p> <p>(a) Assertions (b) Positive Confirmation (c) Written representation (d) Audit Evidence.</p> <p><b>(MTP1, May 2021, 1 Mark)</b></p> <p><b>Correct answer:</b> (a) Assertion</p> <p><b>Explanation:</b> 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 the potential misstatements that may occur</p>
Q21.	<p>Owing to the _____ limitations of an audit, there is _____ risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.</p> <p>(a) Inherent, unavoidable (b) Inherent, complete (c) Management, unavoidable (d) Regulatory, control</p> <p><b>(MTP1, May 2022, 1 mark)</b></p> <p><b>Correct answer:</b> (a) Inherent, unavoidable</p>
Q22.	<p>Consider the following statements pertaining to nature and meaning of "assertions":-</p> <p>Statement I: Assertions are representations by the management which are present in financial statements.</p> <p>Statement II : The assertions have to be necessarily explicit.</p> <p>Which of the following is correct?</p> <p>(a) Only Statement I is true. (b) Only Statement II is true. (c) Both statements I and II are true. (d) Both statements I and II are false.</p> <p><b>(MTP1, May 2022, 1 mark)</b></p>

	<p><b>Correct answer:</b> (a) Only Statement I is true.</p> <p><b>Explanation:</b> 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</p>															
Q23.	<p>With respect to auditing, which of the following statement is correct:</p> <p>(a) Audited financial statements are absolutely free from all material misstatement due to fraud or error.</p> <p>(b) An audit is an official investigation into alleged wrongdoing and auditor has specific legal powers to conduct investigation</p> <p>(c) The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it.</p> <p>(d) An auditor's opinion is an assurance as the future viability of the enterprise or the efficiency or effectiveness of the management.</p> <p><b>(MTP2, May 2023, 1 mark)</b></p>															
	<p><b>Correct answer:</b> (c) The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it.</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"><li>• Statement 1 is incorrect as Audited financial statements are not absolutely free from all material misstatement due to fraud or error. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.</li><li>• Statement 2 is incorrect as an audit is not an official investigation into alleged wrongdoing and the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.</li><li>• Statement 4 is incorrect as the user should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.</li></ul>															
Q24.	<p>Consider the following data appearing in financial statements of a firm: -</p> <table><tr><th>Particular</th><th>Amount in Rs</th><th>Amount in Rs</th></tr><tr><td>Machinery (at cost)</td><td>XXX</td><td>10,00,000</td></tr><tr><td>Less: Depreciation of earlier years</td><td>6,00,000</td><td>XXX</td></tr><tr><td>Less: Depreciation of year</td><td>60,000</td><td>6,60,000</td></tr><tr><td>WDV at end of year</td><td>XXX</td><td>3,40,000</td></tr></table> <p>Read the following statements on basis of above: -</p> <ol style="list-style-type: none"><li>The firm owns machinery.</li><li>The machinery is being utilized in business of firm productively.</li><li>The machinery physically exists.</li></ol> <p>Which of following would be obvious assertions on the basis of above data?</p> <p>(a) Only assertions (i) and (ii) can be inferred.</p> <p>(b) Only assertions (ii) and (iii) can be inferred.</p> <p>(c) Only assertions (i) and (iii) can be inferred.</p> <p>(d) All assertions (i), (ii) and (iii) can be inferred.</p> <p><b>(MTP2, Nov 2022, 1 Mark)</b></p>	Particular	Amount in Rs	Amount in Rs	Machinery (at cost)	XXX	10,00,000	Less: Depreciation of earlier years	6,00,000	XXX	Less: Depreciation of year	60,000	6,60,000	WDV at end of year	XXX	3,40,000
Particular	Amount in Rs	Amount in Rs														
Machinery (at cost)	XXX	10,00,000														
Less: Depreciation of earlier years	6,00,000	XXX														
Less: Depreciation of year	60,000	6,60,000														
WDV at end of year	XXX	3,40,000														
	<p><b>Correct answer:</b> (d) All assertions (i), (ii) and (iii) can be inferred.</p> <p><b>Explanation:</b> The assertions are as follows</p> <ul style="list-style-type: none"><li>• the firm owns the machinery;</li><li>• the historical cost of plant and machinery is ₹ 10 lacs;</li><li>• the machinery physically exists;</li><li>• the asset is being utilized in the business of the company productively;</li><li>• total charge of depreciation on this asset is ₹ 6,60,000 to date on which ₹ 60,000 relates to the year in respect of which the accounts are drawn up; and</li></ul>															



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|  | <ul style="list-style-type: none"><li>• the amount of depreciation has been calculated on a recognised basis and the calculation is correct.</li><li>• The above assertions are implicit</li></ul> |
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## Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

### Part I : Descriptive Questions

#### Auditor's Responsibility to Plan an audit of Financial Statements

Q1.	<p>MG &amp; Co, a firm of auditors, having a standing of 30 years is appointed as a statutory auditor of company engaged in manufacturing of defence equipment. Due to opening of defence sector by government to private players in recent times, many new companies have entered the fray to manufacture sophisticated defence equipment. Considering technical and complex nature of operations, the auditors recognize that involvement of experts in the audit is required. Does consideration for involvement of experts by auditors fall in the domain of planning audit?</p> <p><b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p><b>Involvement of experts while planning an audit:</b></p> <ul style="list-style-type: none"> <li>Planning an audit involves establishing the overall audit <b>strategy</b> for the engagement and developing an audit <b>plan</b></li> <li>While planning an audit, the auditor would have to consider whether involvement of <b>experts</b> is <b>necessary</b>.</li> <li>In the stated case, the company is involved in technical and complex operations. Therefore, while planning an audit, the auditor would have to consider whether involvement of expert is necessary</li> </ul> <p><b>Conclusion:</b> Consideration for involvement of experts by auditors falls <b>within</b> the <b>domain</b> of <b>planning</b>.</p>
Q2.	<p>CA Kartik is planning for audit of a company engaged in manufacturing of cosmetics. Considering nature of operations of the company, he had planned to include testing of controls of the company over purchases, sales and inventories. One fine day, he reaches the corporate office and asks for manuals and required documentation to ensure surprise element in testing. He had never shared with management his intention to carry out above procedures. Is approach of CA Kartik proper?</p> <p><b>(ICAI Study Material- Test Your Understanding)</b></p>
	<p><b>Discussion of elements of planning with entity's management:</b></p> <ul style="list-style-type: none"> <li>The auditor <b>may</b> decide to <b>discuss elements</b> of planning with the entity's <b>management</b> to facilitate the conduct and management of the audit engagement. When discussing matters included in the overall audit strategy or audit plan, care is required in order <b>not</b> to <b>compromise</b> the <b>effectiveness</b> of the audit.</li> <li>In the given case, CA Kartik has reached the office of the company without sharing with management his intention to test the controls. Sharing details of visit to test controls <b>does not compromise effectiveness</b> of audit. It is for the better facilitation and conduct of audit.</li> </ul> <p><b>Conclusion:</b> The approach of CA Kartik is <b>not proper</b>.</p>
Q3.	<p>Discuss how performing preliminary engagement activities as part of planning an audit assists the auditor.</p> <p><b>(ICAI Study Material- Test Your Knowledge)</b></p> <p>As per <b>SA 300</b>, "Planning an audit of Financial Statements", the auditor shall undertake the following activities at the beginning of the current audit engagement</p> <ol style="list-style-type: none"> <li>Performing procedures required by <b>SA 220</b>, "Quality Control for an Audit of Financial Statements" regarding the continuance of the client relationship and the specific audit engagement;</li> <li>Evaluating <b>compliance</b> with <b>ethical</b> requirements, including independence, as required by SA 220 ; and</li> <li>Establishing an <b>understanding</b> of the <b>terms</b> of the engagement, as required by <b>SA 210</b>.</li> </ol> <p>Performing preliminary engagement activities assists the auditor in identifying and evaluating events or circumstances that may affect the auditor's ability to plan and perform audit engagement.</p>
Q4.	<p>Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to the client. <b>(ICAI Study Material- Test Your Knowledge) (Please cover this question with SA 220)</b></p> <p>The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: -</p> <ol style="list-style-type: none"> <li>Obtain relevant <b>information</b> from the firm to <b>identify</b> and evaluate circumstances and relationships that create <b>threats to independence</b></li> <li>Evaluate information on identified <b>breaches</b>, if any, to determine whether they create a threat to independence for the audit engagement</li> </ol>

	<p>iii) Take appropriate <b>action</b> to <b>eliminate</b> such threats or <b>reduce</b> them to an <b>acceptable</b> level by applying <b>safeguards</b>, or, if considered appropriate, to <b>withdraw</b> from the audit engagement.</p> <p>iv) The engagement partner shall promptly <b>report</b> to the <b>firm</b> any inability to resolve the matter for appropriate action.</p>
Q5.	<p>Surya and Chand Ltd is a manufacturing company engaged in the production of miscellaneous electrical goods. Trilochan and Co. has been appointed as the auditors to carry out its audit. Auditor thinks that Planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning benefits the audit of financial statements in several ways. Analyse and Advise explaining the benefits of adequate planning. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>"An adequate planning benefits the audit of financial statements." Discuss. (SA, Nov 2018, 5 Marks) (MTP1, Nov 2022, 4 Marks) (RTP, May 2023, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain the benefits of planning in the audit of financial statements. (RTP, May 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Engagement partner of Audit Firm MKC AND COMPANY thinks that Planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning would benefit the audit of financial statements in several ways. Analyse explaining the benefits of adequate planning. (RTP, Nov 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. Explain clearly those ways. (RTP, Nov 2021, NA) (MTP1, May 2023, 4 marks)</p> <p>Planning an audit involves</p> <ul style="list-style-type: none"> <li>• establishing the overall audit <b>strategy</b> for the engagement and</li> <li>• developing an audit <b>plan</b>.</li> </ul> <p>As per <b>SA 300</b>, "Planning an Audit of Financial Statements", adequate planning benefits the audit of financial statements in several ways, including the following:</p> <ul style="list-style-type: none"> <li>• Helping the auditor to devote appropriate <b>attention</b> to <b>important areas</b> of the audit.</li> <li>• Helping the auditor identify and <b>resolve</b> potential <b>problems</b> on a <b>timely</b> basis.</li> <li>• Helping the auditor properly <b>organize</b> and <b>manage</b> the audit <b>engagement</b> so that it is performed in an <b>effective</b> and <b>efficient</b> manner.</li> <li>• <b>Assisting</b> in the <b>selection</b> of engagement <b>team</b> members with appropriate levels of <b>capabilities</b> and <b>competence</b> to respond to anticipated risks, and the proper assignment of work to them.</li> <li>• Facilitating the <b>direction</b> and <b>supervision</b> of engagement team members and the review of their work.</li> <li>• Assisting, where applicable, in <b>coordination</b> of work done by auditors of components and experts.</li> </ul>
Q6.	<p>"Planning is not a discrete phase of an audit, but rather a continual and iterative process." Discuss. (SA, Nov 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Analyse and Explain. (RTP, Nov 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes the need to consider certain matters prior to the auditor's identification and assessment of the risks of material misstatement. Explain clearly stating those matters also. (RTP, May 2021, NA)</p> <p>As per <b>SA 300</b>, "Planning an Audit of Financial Statements", Planning is <b>not a discrete phase</b> of an audit, but rather a <b>continual</b> and <b>iterative</b> process that often <b>begins shortly after</b> (or in connection with) the <b>completion</b> of the <b>previous audit</b> and <b>continues until the completion</b> of the <b>current audit</b> engagement.</p> <p>Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:</p>

	<ul style="list-style-type: none"> <li>• The <b>analytical procedures</b> to be applied as risk assessment procedures.</li> <li>• Obtaining a general <b>understanding</b> of the <b>legal</b> and <b>regulatory</b> framework applicable to the entity and how the entity is complying with that framework.</li> <li>• The determination of <b>materiality</b>.</li> <li>• The involvement of <b>experts</b>.</li> <li>• The performance of <b>other risk assessment procedures</b>.</li> </ul>
Q7.	<p>Discuss the matters to be considered while establishing overall audit strategy and audit plan for initial audit engagements. (SELF)</p> <ul style="list-style-type: none"> <li>• The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement.</li> <li>• However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements.</li> <li>• For initial audits, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following: <ul style="list-style-type: none"> <li>○ Performing procedures required by <b>SA 220</b> regarding the acceptance of the client relationship and specific audit engagement.</li> <li>○ <b>Unless prohibited</b> by law or regulation, <b>arrangements</b> to be made with the <b>predecessor auditor</b>, for example, to review the predecessor auditor's working papers.</li> <li>○ <b>Other procedures</b> required by the <b>firm's system of quality control</b> for initial audit engagements (for example, review of the overall strategy by senior partner before starting the audit)</li> </ul> </li> </ul>

## Audit Strategy

Q8.	<p>CA Shubhendu is statutory auditor of a social media company. Due to change in information technology regulations by government, it has become mandatory for such companies to constitute "grievance redressal mechanism" for users of social media platform of the company. Failure to comply with regulations can potentially lead to civil and criminal liabilities against the company. Is above factor to be considered by auditor while framing audit strategy? (ICAI Study Material- Test Your Understanding)</p> <p><b>Consideration of changes in law while establishing audit strategy:</b></p> <ul style="list-style-type: none"> <li>• As per <b>SA 300</b> "Planning an Audit of Financial Statements", the auditor shall establish an overall audit <b>strategy</b> that sets the <b>scope, timing</b> and <b>direction</b> of the audit, and that guides the development of the audit <b>plan</b>.</li> <li>• <b>Changes in laws and regulations</b> affecting the company is a <b>factor</b> to be considered while establishing overall audit strategy.</li> <li>• There has been change in information technology regulations applicable to the company. Non-compliance of the same can have implications in the form of civil and criminal liabilities.</li> </ul> <p><b>Conclusion:</b> Matter concerning changes in laws and regulations is to be <b>considered</b> by the <b>auditor</b> while establishing overall audit strategy.</p>
Q9.	<p>The auditor T of Hand Fab Ltd is worried as to management of key resources to be employed to conduct audit. How the audit strategy would be helpful to the auditor? (ICAI Study Material- Illustration)</p> <p style="text-align: center;"><b>OR</b></p> <p>The engagement partner of AST AND ASSOCIATES, firm of Chartered Accountants appointed as auditor of Fabric India Ltd is considering as to management of key resources to be employed to conduct audit. Discuss how overall audit strategy would assist the auditor. (MTP1, May 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Discuss stating the process of establishing the overall audit strategy that would assist the auditor to determine key matters. (RTP, Nov 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources. (SA, May 2019, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p>

	<p>Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall audit strategy assists the auditor to determine such matters as for example - the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters. Explain the other three such matters. (RTP, May 2020, NA)</p>
	<p>The auditor shall establish an overall audit <b>strategy</b> that sets the <b>scope, timing</b> and <b>direction</b> of the audit, and that guides the development of the audit <b>plan</b>. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:</p> <ul style="list-style-type: none"> <li>• The <b>resources to deploy</b> for <b>specific audit areas</b>, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;</li> <li>• The <b>amount of resources</b> to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;</li> <li>• <b>When</b> these resources are to be <b>deployed</b>, such as whether at an interim audit stage or at key cut-off dates; and</li> <li>• <b>How</b> such resources are <b>managed, directed</b> and <b>supervised</b>, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.</li> </ul>
Q10.	<p>In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. (SA, Nov 2019, 4 Marks) (MTP2, Nov 2021, 4 Marks) (MTP2, May 2023, 4 marks)</p> <p style="text-align: center;">OR</p> <p>In establishing the overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement. Explain with examples. (RTP, Nov 2023, NA)</p>
	<p>In establishing the overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:</p> <ul style="list-style-type: none"> <li>• The entity's <b>timetable for reporting</b></li> <li>• Organization of <b>meetings</b> to discuss of <b>nature, timing</b> and <b>extent</b> of audit work with management</li> <li>• Discussion with management regarding the <b>expected type</b> and <b>timing of reports</b> to be issued including the auditor's report</li> <li>• Discussion with management regarding the <b>expected communications</b> on the status of audit work throughout the engagement.</li> <li>• Expected <b>nature</b> and <b>timing of communications</b> among engagement team members, including the nature and timing of team meetings and timing of the <b>review</b> of work performed</li> </ul>
Q11.	<p>"In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement" Explain those considerations in detail. (MTP1, Nov 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy. (MTP2, May 2022, 4 marks) (RTP, Nov 2023, NA)</p>
	<p>As per <b>SA 300</b>, "Planning an Audit of Financial Statements", the auditor shall establish an overall audit <b>strategy</b> that sets the <b>scope, timing</b> and <b>direction</b> of the audit, and that guides the development of the audit <b>plan</b>. In establishing the overall audit strategy, the auditor shall:</p> <ul style="list-style-type: none"> <li>• <b>Identify</b> the <b>characteristics</b> of the engagement that define its scope;</li> <li>• <b>Ascertain</b> the <b>reporting objectives</b> of the engagement to plan the timing of the audit and the nature of the communications required.</li> <li>• Consider the <b>factors</b> that, in the auditor's professional <b>judgment</b>, are <b>significant</b> in <b>directing</b> the engagement team's efforts;</li> <li>• Consider the <b>results of preliminary engagement activities</b> and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and</li> <li>• Ascertain the <b>nature, timing</b> and <b>extent of resources</b> necessary to perform the engagement</li> </ul>

Q12.	<p>In establishing the overall audit strategy, the auditor shall identify the characteristics of the engagement that define its scope. Explain with example. (RTP, May 2023, NA)</p> <p>It is important for an auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy. There are many characteristics of engagement defining its scope. Some of characteristics are as under: -</p> <ul style="list-style-type: none"> <li>• <b>Applicable financial reporting framework</b> applicable to the entity</li> <li>• <b>Nature of business segments</b> to be audited including the need for specialized <b>knowledge</b></li> <li>• <b>Industry</b> specific reporting requirements required by industry regulators</li> <li>• Expected <b>use</b> of audit <b>evidence</b> obtained in <b>previous audits</b></li> </ul>
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## Audit Planning

Q13.	<p>W, the auditor of SKM Ltd. asks its finance and audit head to prepare audit strategy for conducting audit of SKM Ltd. W also insists him to draw detailed audit procedures. On the request of auditor W completes audit strategy as well as audit procedures as prepared by finance head of the company. Subsequently, auditor realizes that effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment (ICAI Study Material - Illustration)</p> <ul style="list-style-type: none"> <li>• The overall audit strategy and the audit plan remain the <b>auditor's responsibility</b>. It is the auditor who is responsible for establishing overall audit strategy and developing audit plan</li> <li>• The auditor <b>may</b> decide to <b>discuss elements of planning</b> with the entity's <b>management</b> to facilitate the conduct and management of the audit engagement. When discussing matters included in the overall audit strategy or audit plan, care is required in order <b>not</b> to <b>compromise the effectiveness</b> of the audit.</li> <li>• In the given case, on the request of auditor, audit strategy as well as audit procedures are prepared by finance head of the company.</li> </ul> <p><b>Conclusion:</b> Approach of W was <b>wrong</b> and he should have prepared overall audit strategy and detailed audit procedures</p>
Q14.	<p>CA Mary, while planning audit of a company, feels that she would inquire from inhouse legal counsel of the company status of pending litigation matters against the company to identify and assess risks of material misstatements. Considering above description, are you able to identify said procedures? Where these identified procedures are included in planning in accordance with SA-300? (ICAI Study Material - Test Your Understanding) (Cover this with Chapter of Audit Evidence)</p> <p>As per <b>SA 300</b> "Planning an Audit of Financial Statement" the audit plan shall be include a description of</p> <ul style="list-style-type: none"> <li>• The <b>nature, timing and extent</b> of planned <b>risk assessment procedures</b>, as determined under SA 315.</li> <li>• The <b>nature, timing and extent</b> of planned <b>further audit procedures</b> at the assertion level, as determined under SA 330.</li> <li>• <b>Other planned audit procedures</b> that are required to be carried out so that the engagement complies with SAs.</li> </ul> <p>In the given case, the auditor would like to inquire from in-house legal counsel of the company as to the status of pending litigation matters against the company to identify and assess the risks of material misstatements.</p> <p>The objective of planned inquiry of inhouse legal counsel is to identify and assess risk of material misstatement.</p> <p><b>Conclusion:</b> <b>Planned risk assessment procedures</b> are included in the audit plan in accordance with SA 300.</p>
Q15.	<p>An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure. (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> <li>• The documentation of the overall audit strategy is a <b>record</b> of the <b>key decisions</b> considered necessary to properly plan the audit and to <b>communicate significant matters</b> to the engagement team.</li> <li>• The documentation of the audit plan is a record of the planned nature, timing and extent of <b>risk assessment procedures</b> and <b>further audit procedures</b> at the assertion level in response to the assessed risks. It also serves as a record of the <b>proper planning</b> of the audit procedures that can be reviewed and approved prior to their performance.</li> <li>• A record of the <b>significant changes</b> to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate <b>response</b> to the</li> </ul>

	<p>significant changes occurring during the audit.</p> <p>An auditor of a company cannot conduct an audit in an effective and efficient manner or demonstrate that the audit was planned and carried out in compliance with SAs if the audit strategy and plan are not documented.</p>
Q16.	<p>SA 300 states that auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Discuss few factors affecting such supervision and review of work of engagement team members. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Explain the factors due to which above varies. (MTP1, May 2020, 4 Marks) (RTP, Nov 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>"The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors." Explain. (RTP, Nov 2021, NA) (RTP, Nov 2022, NA)</p> <p>The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work.</p> <p>The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:</p> <ul style="list-style-type: none"> <li>• The <b>size</b> and <b>complexity</b> of the entity.</li> <li>• The <b>area</b> of the audit.</li> <li>• The <b>assessed risks of material misstatement</b></li> <li>• The <b>capabilities</b> and <b>competence</b> of the individual team members performing the audit work.</li> </ul>
Q17.	<p>The auditor shall document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. Explain (RTP, Nov 2018, NA) (MTP1, Nov 2018, 5 Marks) (RTP, Nov 2020, NA)</p> <p><b>Documentation of Audit plan:</b></p> <ul style="list-style-type: none"> <li>• The auditor shall <b>document</b>: <ul style="list-style-type: none"> <li>◦ the overall audit <b>strategy</b>;</li> <li>◦ the audit <b>plan</b>; and</li> <li>◦ any <b>significant changes</b> made during the audit engagement to the overall audit strategy or the audit plan, and the <b>reasons</b> for such changes.</li> </ul> </li> <li>• The documentation of the overall audit strategy is a <b>record</b> of the <b>key decisions</b> considered necessary to properly plan the audit and to <b>communicate significant matters</b> to the engagement team.</li> <li>• The documentation of the audit plan is a record of the planned nature, timing and extent of <b>risk assessment procedures</b> and <b>further audit procedures</b> at the assertion level in response to the assessed risks. It also serves as a record of the <b>proper planning</b> of the audit procedures that can be reviewed and approved prior to their performance.</li> <li>• A record of the <b>significant changes</b> to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate <b>response</b> to the significant changes occurring during the audit.</li> </ul>
Q18.	<p>The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. Explain (RTP, Nov 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. Explain. (RTP, Nov 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Plans should be further developed and revised as necessary during the course of the audit. Explain. (RTP, May 2020, NA)</p> <ul style="list-style-type: none"> <li>• The auditor shall <b>update</b> and <b>change</b> the overall audit <b>strategy</b> and the audit <b>plan</b> as necessary during the course of the audit as a result of <ul style="list-style-type: none"> <li>◦ <b>unexpected events</b>,</li> <li>◦ <b>changes in conditions</b>, or</li> </ul> </li> </ul>

	<ul style="list-style-type: none"> <li>the audit <b>evidence obtained</b> from the results of audit procedures,</li> <li>the auditor may need to <b>modify</b> the audit plan &amp; planned nature, timing and extent of <b>further audit procedures</b>, based on the revised consideration of assessed risks.</li> <li>This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.</li> <li>For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls</li> </ul>
Q19.	<p>The establishment of the overall audit strategy and the detailed audit plan are closely interrelated. Explain (MTP1, May 2019, 3 Marks)</p> <ul style="list-style-type: none"> <li>Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.</li> <li>Audit <b>strategy</b> determines <b>scope, timing and direction</b> of audit. Audit plan describes how the strategy is going to be implemented.</li> <li>The audit <b>plan</b> is <b>more detailed</b> than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.</li> <li>The establishment of the overall audit strategy and the detailed audit plan are <b>not necessarily discrete or sequential processes</b>, but are <b>closely interrelated</b> since changes in one may result in consequential changes to the other</li> </ul>
Q20.	<p>Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampurna Fabrics Ltd. Discuss the matters to be described in such an audit plan. (RTP, May 2022, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The audit plan includes the nature, timing and extent of audit procedures to be performed by engagement team members. Explain. (RTP, Nov 2023, NA)</p> <p>As per <b>SA 300</b> "Planning an Audit of Financial Statement", the auditor shall develop an audit plan that shall include a description of :</p> <ul style="list-style-type: none"> <li>The nature, timing and extent of planned <b>risk assessment procedures</b>, as determined under SA 315</li> <li>The nature, timing and extent of planned <b>further audit procedures</b> at the assertion level, as determined under SA 330</li> <li><b>Other planned audit procedures</b> that are required to be carried out so that the engagement complies with SAs.</li> </ul> <p>The audit <b>plan</b> is <b>more detailed</b> than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.</p> <p>Planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures</p>
Q21.	<p>Explain what do you mean by documentation of audit plan. Discuss the purpose served by it and also elaborate the tools used by the auditor to reflect the particular engagement circumstances (RTP, Nov 2022, NA)</p> <ul style="list-style-type: none"> <li>The documentation of the audit plan is a <b>record</b> of the planned nature, timing and extent of <b>risk assessment procedures</b> and <b>further audit procedures</b> at the assertion level in response to the assessed risks.</li> <li>It also serves as a record of the <b>proper planning</b> of the audit procedures that can be reviewed and approved prior to their performance.</li> <li>The auditor may use <b>standard</b> audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.</li> </ul>

## Audit Programme

Q22.	Rohit, undergoing practical training, is part of an engagement team conducting audit of a company engaged in manufacturing of paints. He has been provided with audit programme pertaining to sales. It lists out various items to be
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	<p>checked and verified by him including invoices, rate lists, posting in debtors accounts, correlation of invoices with e-way bills on sample basis etc. During verification, he notices that many e-way bills have been cancelled by the company within 24 hours of their generation in month of March. There is no specific instruction in audit programme in this regard. He keeps mum. Is attitude of Rohit proper? <b>(ICAI Study Material- Test Your Understanding)</b></p> <p><b>Assistant to keep an open mind:</b></p> <ul style="list-style-type: none"> <li>• The <b>assistants</b> engaged should be encouraged to keep an <b>open mind</b> beyond the programme given to him.</li> <li>• They should be instructed to note and <b>report significant matters</b> coming to their notice, to seniors or to the partners or proprietor of the firm.</li> <li>• In the given case, Rohit notices that many e-way bills have been canceled by the company within 24 hours of their generation in the month of March.</li> </ul> <p><b>Conclusion:</b> Attitude of Rohit is <b>not proper</b>. Reasons for cancellation of many e-way bills in the month of March need to be looked into. Matter should be informed to the engagement partner.</p>
Q23.	<p>"Purported disadvantages of an audit programme can be overcome". Do you agree? <b>(ICAI Study Material- Test Your Knowledge)</b></p> <p>Purported disadvantages of the audit programme may be eliminated by</p> <ul style="list-style-type: none"> <li>• imaginative <b>supervision</b> of the work carried on by the assistants;</li> <li>• the auditor must have a receptive <b>attitude</b> as regards the assistants;</li> <li>• the assistants should be encouraged to <b>observe</b> matters <b>objectively</b> and bring <b>significant matters</b> to the notice of supervisor/principal.</li> </ul>
Q24.	<p>Evolving one audit programme applicable to all audit engagements under all circumstances is not practicable. Explain <b>(RTP, May 2018, NA) (RTP, May 2019, NA) (RTP, Nov 2020, NA)</b></p> <p><b>One Audit Programme – Not Practicable For All Businesses</b></p> <ul style="list-style-type: none"> <li>• All businesses are not same</li> <li>• They vary in <b>nature, size, capital raised</b> and on other parameters also</li> <li>• Some might have a formal and working <b>internal control</b>, while some may not have internal control at all.</li> <li>• Applicability of <b>different laws</b> and <b>regulation</b> also differentiate the scope of services to be given by auditor</li> <li>• Because of the reasons for variations mentioned above it is not possible to develop one audit program applicable to all businesses under all circumstances.</li> <li>• Every audit programme must have <b>details</b> of the <b>nature of work</b> to be <b>done</b> as per the nature, size and other parameters of the business. This will help in saving time and special matters and situations will not be overlooked.</li> </ul>
Q25.	<p>Arpana Hospitals Ltd having Gross Professional Charges of ₹ 50 crores is engaged in providing healthcare services. STP &amp; Co., a firm of auditors is appointed as its auditors. Advise what special points to be kept in mind for the purpose of construction of an Audit programme. Explain. <b>(RTP, May 2018, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>List out the points that should be kept in mind by the auditor for the purpose of constructing an audit programme. <b>(SA, May 2019, 3 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Discuss the points to be considered by auditor for the purpose of constructing an audit programme. <b>(SA, Nov 2019, 4 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. Explain stating clearly the points to be kept in mind while developing an audit programme. <b>(RTP, Nov 2022, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>XYZ &amp; associates are appointed as the statutory auditors of Fisco Ltd. for the FY 2022 -23. While constructing the audit programme, the engagement partner, CA X, should keep in mind various points. List such points. <b>(MTP2, Nov 2022, 4 Marks)</b></p>

	<ul style="list-style-type: none"> <li>While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit.</li> <li>However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence.</li> <li>The auditor should also consider the <b>timing</b> of the procedures, the <b>coordination</b> of any assistance expected from the client, the <b>availability</b> of <b>assistants</b>, and the involvement of other auditors or experts.</li> <li>Further, the auditor normally has flexibility in deciding when to perform audit procedures.</li> <li>However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.</li> <li>For the purpose of programme construction, the following points should be kept in mind: <ul style="list-style-type: none"> <li>Stay within the <b>scope</b> and <b>limitation</b> of the assignment.</li> <li>Prepare a <b>written audit programme</b> setting forth the <b>procedures</b> that are needed to implement the audit plan.</li> <li>Determine the <b>evidence reasonably available</b> and <b>identify</b> the <b>best evidence</b> for deriving the necessary satisfaction.</li> <li>Apply only those <b>steps</b> and <b>procedures</b> which are <b>useful</b> in accomplishing the verification purpose in the specific situation.</li> <li>Include the audit <b>objectives</b> for <b>each area</b> and <b>sufficient details</b> which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.</li> <li>Consider all <b>possibilities</b> of <b>error</b>.</li> <li><b>Co-ordinate</b> the <b>procedures</b> to be applied to related items</li> </ul> </li> </ul>
Q26.	<p>The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed. Explain (RTP, May 2019, NA)</p> <p><b>Periodic Review of The Audit Programme</b></p> <ul style="list-style-type: none"> <li><b>Periodic review</b> of the audit programme is required to assess whether the same continues to be <b>adequate</b> for obtaining requisite <b>knowledge</b> and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an <b>obsolete</b> programme and, for this <b>negligence</b>, the whole audit may be held as <b>negligently</b> conducted and the auditor may have to face <b>legal</b> consequences.</li> <li>The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's <b>operations</b> and internal <b>control</b> under periodic review so that <b>inadequacies</b> or redundancies of the programme may be <b>removed</b>. However, as a basic feature, audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc.</li> <li>Every assistant shall always complete the specific task in accordance with the work instructions, unless the principal modifies the programme formally. Many people think that the audit programme becomes more <b>rigid</b> as a result of this. This is untrue provided the periodic review is undertaken to keep the programme as <b>up-to date</b> as possible and by encouraging the assistants on the job to observe all salient features of the various accounting functions of the client.</li> </ul>
Q27.	<p>In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. An auditor picks up evidence from a variety of fields. Analyse and explain with the help of examples. (RTP, Nov 2020, NA) (Study this with Audit Evidence)</p> <p>In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. In this process, an auditor would be in a position to identify the evidence that brings the highest satisfaction to him about the appropriateness or otherwise of the assertion.</p> <p>An auditor picks up evidence from a variety of fields and it is generally of the following broad types:</p> <ul style="list-style-type: none"> <li><b>Documentary</b> examination,</li> <li><b>Physical</b> examination,</li> <li>Statements and explanation of <b>management</b>, officials and employees,</li> <li>Statements and explanations of <b>third parties</b>,</li> <li>Arithmetical <b>calculations</b> by the <b>auditor</b>,</li> <li>State of <b>internal controls</b> and internal checks,</li> <li><b>Inter-relationship</b> of the various accounting data,</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Subsidiary</b> and memorandum records,</li> <li>• <b>Minutes</b>,</li> <li>• Subsequent <b>action</b> by the client and by others.</li> </ul> <p>Example</p> <ul style="list-style-type: none"> <li>• For cash in hand, the best evidence is 'count'</li> <li>• For investment pledged with a bank, the banker's certificate.</li> <li>• For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to, to obtain greater satisfaction about the reliability of the assertion.</li> </ul> <p>The auditor, however, has to place appropriate weight on each piece of evidence and accordingly should prescribe the priority of verification. It is true that in all cases one procedure may not bring the highest satisfaction and it may be dangerous for the auditor to ignore any evidence that is available. By the word "available" we do not mean that the evidence available with the client is the only available evidence. The auditor should know what normally should be available in the context of the transaction having regard to the circumstances and usage</p>
Q28.	<p>M/s TP &amp; Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind ? Guide them. (SA, Dec 2021, 4 marks)</p> <p><b>The Assistant Engaged - Be Encouraged To Keep An Open Mind</b></p> <ul style="list-style-type: none"> <li>• Initially, the audit programme must specify the <b>minimum essential work</b> to be carried out based on the auditor's <b>understanding</b> of <b>nature, size</b> and <b>composition</b> of the business, understanding of the <b>internal control</b> and considering scope of the audit work.</li> <li>• With the progress of the audit, alteration should be made in the programme as and when the situation requires, there may be circumstances which were left out originally, but are found relevant for the particular concern.</li> <li>• Even some areas which were earlier included can be dropped or the extent of checking can be reduced.</li> <li>• The users of the audit program, that is the <b>assistants</b> working on them, must be motivated to keep an <b>open mind</b> and not to stick only to the points mentioned in the audit program, they must be <b>encouraged to report</b> any <b>significant matters</b> to the seniors with appropriate authority on a timely basis.</li> </ul> <p>In the given case, the attitude of assistants of TP &amp; Co. is <b>not justified</b>. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified</p>
Q29.	<p>CA Vikas Jain discussed with his audit team about advantages and disadvantages of audit programme. He explained to his team that –"work may become mechanical" as disadvantage of the audit programme. Discuss explaining the disadvantages of an audit programme (MTP1, May 2022, 4 marks)</p> <p>The disadvantages are:</p> <ul style="list-style-type: none"> <li>• The work may become <b>mechanical</b> and particular parts of the programme may be <b>carried out without any understanding</b> of the object of such parts in the whole audit scheme.</li> <li>• The programme often tends to become <b>rigid</b> and <b>inflexible</b> following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.</li> <li>• <b>Inefficient assistants may take shelter</b> behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.</li> <li>• A hard and fast audit programme may <b>kill</b> the <b>initiative</b> of <b>efficient</b> and enterprising assistants</li> </ul>
Q30.	<p>List the advantages of an audit programme. (SELF)</p> <p>The advantages of an audit programme are:</p> <ol style="list-style-type: none"> <li>a. It provides the assistant carrying out the audit with a total and <b>clear set of instructions</b> of the work generally to be done.</li> <li>b. It is essential, particularly for major audits, to provide a <b>total perspective</b> of the work to be performed.</li> </ol>

- c. **Selection** of **assistants** for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- d. **Without** a written and predetermined programme, work is necessarily to be carried out on the basis of some '**mental**' plan. In such a situation there is always a **danger** of **ignoring** or **overlooking certain books and records**. Under a properly framed programme, such danger is significantly less and the audit can proceed systematically.
- e. The assistants, by putting their signature on programme, accept the **responsibility** for the **work** carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- f. The principal can **control** the **progress** of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- g. It serves as a **guide** for **audits** to be carried out in the succeeding year.
- h. A properly drawn up audit programme **serves** as **evidence** in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of a professional auditor.

## Part II: Correct/Incorrect Questions

Q1.	Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management. (ICAI Study Material- Test Your Knowledge)
	<b>Incorrect.</b> The <b>auditor</b> shall establish an overall audit <b>strategy</b> that sets the <b>scope, timing</b> and <b>direction</b> of the audit, and that guides the development of the audit <b>plan</b> .
Q2.	Planning is a discrete phase of an audit. (ICAI Study Material- Test Your Knowledge) (RTP, Nov 2019, NA) (MTP1, May 2023, 2 marks)
	<b>Incorrect.</b> Planning is <b>not</b> a <b>discrete</b> phase of an audit, but rather a <b>continual</b> and <b>iterative</b> process that often <b>begins shortly after</b> (or in connection with) the <b>completion</b> of the <b>previous audit</b> and <b>continues until</b> the <b>completion</b> of the <b>current audit</b> engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.
Q3.	The audit plan is more detailed than the overall audit strategy. (ICAI Study Material- Test Your Knowledge) (SA, Nov 2020, 2 Marks)
	<b>Correct.</b> The audit <b>plan</b> is <b>more detailed</b> than the overall audit <b>strategy</b> that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
Q4.	The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other. (ICAI Study Material- Test Your Knowledge) (MTP2, May 2018, 2 Marks)
	<b>OR</b>
	Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy. The establishment of the overall audit strategy and the detailed audit plan are closely inter-related. (RTP, May 2023, NA)
	<b>Correct.</b> Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are <b>not necessarily discrete or sequential processes</b> , but are <b>closely inter-related</b> since changes in one may result in consequential changes to the other.
Q5.	A detailed Audit Programme once prepared for a business can be used for all business under all circumstances. (ICAI Study Material- Test Your Knowledge) (MTP1, Nov 2020, 2 Marks) (MTP2, Nov 2022, 2 Marks)
	<b>Incorrect.</b> Businesses vary in <b>nature, size</b> and <b>composition</b> ; work which is suitable to one business may not be suitable to others; efficiency and operation of <b>internal controls</b> and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme

	applicable to all business under all circumstances is <b>not practicable</b> .
Q6.	<p>Planning is not a discrete phase of an audit, but rather a continual and iterative process. (RTP, Nov 2018, NA) (RTP, May 2019, NA)</p> <p><b>Correct.</b> As per SA 300, "Planning an Audit of Financial Statements", planning is <b>not a discrete</b> phase of an audit, but rather a <b>continual</b> and <b>iterative</b> process that often <b>begins shortly after</b> (or in connection with) the <b>completion</b> of the <b>previous</b> audit and <b>continues until</b> the <b>completion</b> of the <b>current</b> audit engagement.</p>
Q7.	<p>There is no relation between Audit Plans and knowledge of the client's business (RTP, Nov 2018, NA) (RTP, May 2019, NA)</p> <p><b>Incorrect.</b> The auditor should plan his work to enable him to conduct an <b>effective</b> audit in an <b>efficient</b> and <b>timely</b> manner. Plans should be based on <b>knowledge</b> of the client's business</p>
Q8.	<p>A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit. (SA, Nov 2018, 2 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor should update and revise the audit plan as and when required, however, the overall audit strategy once established cannot be changed during the course of audit. (MTP1, May 2021, 2 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same. (SA, May 2022, 2 Marks) (MTP2, May 2023, 2 marks)</p> <p><b>Incorrect.</b> The auditor shall <b>update</b> and <b>change</b> the overall audit <b>strategy</b> and the audit <b>plan</b> as <b>necessary</b> during the course of the audit. As a result of <b>unexpected events</b>, <b>changes in conditions</b>, or the audit <b>evidence obtained</b> from the results of audit procedures, the auditor may need to <b>modify</b> the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.</p>
Q9.	<p>The auditor need not discuss elements of planning with the entity's management in any case. (RTP, Nov 2019, NA)</p> <p><b>Incorrect.</b> The auditor <b>may</b> decide to <b>discuss elements</b> of <b>planning</b> with the entity's <b>management</b> to facilitate the conduct and management of the audit engagement.</p>
Q10.	<p>Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically. (SA, Nov 2019, 2 Marks)</p> <p><b>Correct.</b> <b>Without</b> a written and predetermined <b>programme</b>, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a <b>danger</b> of <b>ignoring</b> or <b>overlooking certain books and records</b>. Thus under a properly framed programme, the danger is significantly <b>less</b> and the audit can proceed systematically.</p>
Q11.	<p>Overall audit plan sets the scope, timing and direction of the audit, and guides the development of the more detailed audit strategy. (RTP, Nov 2020, NA)</p> <p><b>Incorrect.</b> Overall audit <b>strategy</b> sets the <b>scope, timing</b> and direction of the <b>audit</b>, and guides the development of the more detailed audit <b>plan</b>.</p>
Q12.	<p>It is not necessary for the auditor to periodically review the audit programme. (SA, Nov 2020, 2 Marks)</p> <p><b>Incorrect.</b> There should be <b>periodic review</b> of the audit programme to assess whether the same continues to be <b>adequate</b> for obtaining requisite <b>knowledge</b> and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an <b>obsolete</b> programme and for this <b>negligence</b>, the whole audit may be held as <b>negligently conducted</b> and the auditor may have to face <b>legal</b> consequences.</p>
Q13.	Audit notes can serve as a guide in framing Audit programme (MTP2, May 2021, 2 Marks)

	<b>Correct.</b> Audit <b>notes</b> can serve as a <b>guide</b> in <b>framing</b> audit <b>programmes</b> in the future as they indicate the <b>weaknesses</b> in the system of the client which specially need to be watched.
Q14.	Evolving one audit programme applicable to all business under all circumstances is not practicable (MTP2, Nov 2021, 2 Marks) (MTP1, May 2022, 2 marks)
	<b>Correct.</b> Businesses vary in <b>nature, size</b> and <b>composition</b> ; work which is suitable to one business may not be suitable to others; efficiency and operation of <b>internal controls</b> and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is <b>not practicable</b> .
Q15.	Development of an audit plan is important before the establishment of the overall audit strategy to address the various matters. (RTP, Nov 2022, NA)
	<b>Incorrect.</b> As per <b>SA 300</b> , "Planning an Audit of Financial Statements", the auditor shall establish an overall audit <b>strategy</b> that sets the <b>scope, timing</b> and <b>direction</b> of the audit, and that guides the development of the audit <b>plan</b> . Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
Q16.	The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. (MTP1, Nov 2022, 2 Marks)
	<b>Correct.</b> The auditor can formulate his entire audit programme <b>only</b> after he has had a satisfactory <b>understanding</b> of the <b>internal control</b> systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy, and the object of the audit may be altogether lost in the mass of entries and vouchers.
Q17.	Understanding the Internal Control of a company will not help the auditor in developing an Audit Programme. (MTP1, May 2023, 2 marks)
	<b>Incorrect.</b> Understanding the <b>Internal Control</b> of a company will <b>help</b> in <b>developing</b> an Audit <b>Programme</b> because it will assist the auditor and his team to understand as to <b>how much they can rely on internal control</b> of the company and what audit <b>procedures</b> would be <b>appropriate</b> to be used during the course of audit
Q18.	The "documentation of the overall audit strategy" is a record of the audit evidences considered necessary to properly plan the audit and to assign various audit functions to the engagement team. (SA, May 2023, 2 marks)
	<b>Incorrect.</b> The documentation of the overall audit strategy is a <b>record of the key decisions</b> considered necessary to properly plan the audit and to <b>communicate significant matters</b> to the engagement team and not a record of audit evidence.
Q19.	The overall audit strategy is more detailed than the audit plan (MTP1, Nov 2023, 2 marks)
	<b>Incorrect:</b> The audit <b>plan</b> is <b>more detailed</b> than the overall audit <b>strategy</b> that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources.

### Part III: Multiple Choice Questions

Q1.	Which of the following is not considered in planning an audit generally? (a) Understanding of legal and regulatory framework of an entity (b) Need to consider determination of materiality (c) Evaluating audit evidence (d) Need to consider involvement of expert (ICAI Study Material- Test Your Knowledge)
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	<b>Correct answer:</b> (c) Evaluating audit evidence
Q2.	<p>Which of the following is true about audit plan?</p> <p>(a) Once an audit plan has been finalized for an engagement, changes cannot be made to it.</p> <p>(b) Audit plan includes scope, timing and direction of planned risk assessment procedures.</p> <p>(c) Changes in audit plan cannot lead to change in audit strategy.</p> <p>(d) Audit plan has to be documented by auditor.</p> <p><b>(ICAI Study Material- Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (d) Audit plan has to be documented by auditor.
Q3.	<p>Which of the following is not included in an audit programme normally?</p> <p>(a) Extent of checking</p> <p>(b) Date of checking</p> <p>(c) Nature or type of procedure</p> <p>(d) Planning of risk assessment procedures</p> <p><b>(ICAI Study Material- Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (d) Planning of risk assessment procedures
Q4.	<p>Which of the following is not an advantage of an audit programme?</p> <p>(a) It acts as a guide for audit of coming years.</p> <p>(b) It fixes responsibility of assistants.</p> <p>(c) It serves as a shelter for assistants.</p> <p>(d) It serves a proof of work done by auditor</p> <p><b>(ICAI Study Material- Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (c) It serves as a shelter for assistants.
Q5.	<p>Which of the following is most important principle for formulating an audit plan?</p> <p>(a) Gaining knowledge of client's workforce</p> <p>(b) Gaining knowledge of client's business</p> <p>(c) Gaining knowledge of client's vendors</p> <p>(d) Gaining knowledge of tax laws applicable to client</p> <p><b>(ICAI Study Material- Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (b) Gaining knowledge of client's business
Q6.	<p>When planning the audit,</p> <p>(a) the auditor considers what would make the financial information materially misstated.</p> <p>(b) the auditor need not consider what would make the financial information materially misstated.</p> <p>(c) the auditor need not consider what would make the financial information materially misstated at planning stage</p> <p>(d) the auditor needs to consider what would make the financial information materially misstated while conducting audit only</p> <p><b>(Sample MCQs) (ICAI MCQs) (MTP1, May 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (a) the auditor considers what would make the financial information materially misstated.
Q7.	<p>Planning an audit involves</p> <p>(a) establishing the overall audit strategy for the engagement and developing an audit plan.</p> <p>(b) establishing the overall audit plan for the engagement and developing an audit strategy.</p> <p>(c) establishing the overall audit plan for the engagement</p> <p>(d) developing an audit strategy.</p> <p><b>(ICAI MCQs) (MTP1, Nov 2019, 1 Mark)</b></p>

	<b>Correct answer:</b> (a) establishing the overall audit strategy for the engagement and developing an audit plan.
Q8.	<p>The auditor shall develop an audit plan that shall include a description of:</p> <p>(a) The nature, timing and extent of planned risk assessment procedures</p> <p>(b) The nature, timing and extent of planned further audit procedures at the assertion level.</p> <p>(c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.</p> <p>(d) All of the above</p> <p><b>(ICAI MCQs)</b></p>
	<b>Correct answer:</b> (d) All of the above
Q9.	<p>Once the overall audit strategy has been established, _____ can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.</p> <p>(a) audit strategy</p> <p>(b) audit plan</p> <p>(c) audit plan and audit strategy</p> <p>(d) audit note book</p> <p><b>(Sample MCQs) (ICAI MCQs)</b></p>
	<b>Correct answer:</b> (b) audit plan
Q10.	<p>Planning an audit involves establishing the overall audit strategy for the engagement and</p> <p>(a) developing an audit plan.</p> <p>(b) developing an audit program</p> <p>(c) developing detailed strategy</p> <p>(d) any of the above</p> <p><b>(Sample MCQs)</b></p>
	<b>Correct answer:</b> (a) developing an audit plan
Q11.	<p>Statement 1: The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential process but are closely inter-related.</p> <p>Statement 2: The auditor shall establish an overall audit strategy that guides the development of audit plan.</p> <p>(a) only Statement 1 is correct</p> <p>(b) Only Statement 2 is correct</p> <p>(c) Both Statements 1 &amp; 2 are correct</p> <p>(d) Both Statements 1 &amp; 2 are incorrect</p> <p><b>(ICAI MCQs)</b></p>
	<b>Correct answer:</b> (c) Both Statements 1 & 2 are correct
Q12.	<p>Which of the following is not addressed by the overall audit strategy :</p> <p>(a) scope of the audit</p> <p>(b) timing of the audit</p> <p>(c) direction of the audit</p> <p>(d) monitoring of the audit</p> <p><b>(ICAI MCQs)</b></p>
	<b>Correct answer:</b> (d) monitoring of the audit
Q13.	<p>The overall audit strategy and the audit plan remain the _____ responsibility</p> <p>(a) auditor's</p> <p>(b) management's</p> <p>(c) those charged with governance.</p>



	<p>(d) both management and those charged with governance. <b>(ICAI MCQs) (MTP1, May 2023, 1 mark)</b></p> <p><b>Correct answer:</b> (a) auditor's</p>
Q14.	<p>Which of the following is correct:</p> <p>(a) The auditor shall establish an audit plan that sets the scope, timing and direction of the audit, and that guides the development of the overall audit strategy.</p> <p>(b) The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and there is no need to guide the development of the audit plan.</p> <p>(c) The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.</p> <p>(d) The auditor shall establish an audit plan that sets the scope, timing and direction of the audit, and that there is no need to guide the development of the overall audit strategy. <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (c) The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.</p>
Q15.	<p>_____ sets the scope, timing &amp; direction of the audit and guides the development of the more detailed plan.</p> <p>(a) Audit Programme</p> <p>(b) Overall Audit Strategy</p> <p>(c) Completion Memorandum</p> <p>(d) Audit Plan <b>(ICAI MCQs) (MTP1, May 2022, 1 mark)</b></p> <p><b>Correct answer:</b> (b) Overall Audit Strategy</p>
Q16.	<p>Planning is _____ process of an audit that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement:</p> <p>(a) continuous</p> <p>(b) discrete</p> <p>(c) neither continuous nor discrete</p> <p>(d) strategic <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) continuous</p>
Q17.	<p>CA R illustrated to his team that the utility of the Audit Programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under recurrent assessment. Which attribute of the Audit Programme is highlighted here?</p> <p>(a) Static Review</p> <p>(b) Mechanical Review</p> <p>(c) Periodic Review</p> <p>(d) Obsolete Review <b>(ICAI MCQs) (MTP1, Nov 2021, 2 Marks)</b></p> <p><b>Correct answer:</b> (c) Periodic Review</p>
Q18.	<p>With reference to SA 300, the auditor shall document:</p> <p>(a) The overall audit strategy</p> <p>(b) The audit plan</p> <p>(c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.</p> <p>(d) All of the above</p>

	<p><b>(MTP2, May 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (d) All of the above</p>
Q19.	<p>According to SA 300,</p> <p>(a) planning is not a continual and iterative phase of an audit, but rather a discrete process</p> <p>(b) planning is not a discrete phase of an audit, but rather a continual and iterative process</p> <p>(c) planning is not continual and iterative process</p> <p>(d) planning is not a discrete phase of an audit</p> <p><b>(MTP1, Nov 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (b) planning is not a discrete phase of an audit, but rather a continual and iterative process</p>
Q20.	<p>The auditor shall update and change _____ as necessary during the course of the audit.</p> <p>(a) overall strategy</p> <p>(b) the overall audit strategy and the audit plan</p> <p>(c) audit plan</p> <p>(d) audit program</p> <p><b>(MTP1, May 2020, 2 Marks)</b></p> <p><b>Correct answer:</b> (b) the overall audit strategy and the audit plan</p>
Q21.	<p>Which of the following statements is MOST APPROPRIATE?</p> <p>(a) Audit programme is a detailed plan of audit strategy</p> <p>(b) Audit programme cannot be reviewed</p> <p>(c) Audit programme is a detailed plan of applying audit procedures</p> <p>(d) Audit programme is relevant for year for which it is prepared, it is useless for subsequent years.</p> <p><b>(RTP, Nov 2022, NA)</b></p> <p><b>Correct answer:</b> (c) Audit programme is a detailed plan of applying audit procedures</p> <p><b>Explanation:</b> An audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.</p>
Q22.	<p>CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of the following is not likely to be an appropriate audit procedure to be included in audit plan for the above said company?</p> <p>(a) Verification of turnover of company</p> <p>(b) Verification of cost of raw material consumed</p> <p>(c) Examination of company's accounting policy for revenue recognition</p> <p>(d) Verification of contract notes with brokers</p> <p><b>(MTP2, Nov 2023, 1 mark)</b></p> <p><b>Correct answer:</b> (b) Verification of cost of raw material consumed</p> <p><b>Explanation:</b> Since the company operates in the service industry, verification of the cost of raw materials consumed is not a relevant audit procedure.</p>

## Chapter 3 - Audit Risk and Risk Assessment

### Part I : Descriptive Questions

#### Audit Risk

Q1.	Jo Jo Limited is planning to list on Bombay Stock Exchange next year. As an auditor of Jo Jo Limited, identify any one reason of increased audit risk due to listing of the company next year. <b>(ICAI Study Material - Test Your Understanding)</b>
	Jo Jo Limited is planning to list on Bombay Stock Exchange next year. There is a greater chance of misstatements in the financial statements due to planned listing next year. There could be a possibility of <b>intentional manipulation</b> of financial statements so that good response is received to proposed issue. Therefore, there is <b>increased audit risk</b> i.e., risk of expressing <b>inappropriate opinion</b> by the auditor when <b>financial statements</b> are <b>materially misstated</b> .
Q2.	Wear & Tear Private Limited is a "start-up" engaged in providing holistic solutions to problem of paddy stubble burning mainly catering to needs of farmers of North western India. Due to importance given by governments to this issue, companies have entered in the market in past few years. Many of these companies have not been successful and have gone bust. As an auditor of the company, can you spot the component of risks of material misstatement involved in above? <b>(ICAI Study Material - Test Your Understanding)</b>
	It has been stated that many companies engaged in providing holistic solutions to problem of stubble burning have not been successful. It shows that line of activity is inherently risky. Therefore, there is a greater possibility of misstatements. The component of risks of material misstatement involved is " <b>inherent risk</b> ."
Q3.	A company has devised a control that its inventory of perishable goods is stored in appropriate conditions in a controlled environment to prevent any damages to inventory. Responsibility is fixed on two persons to monitor environment using sensors and to report on deviations. Identify the component of risks of material misstatement involved as an auditor of the company. <b>(ICAI Study Material - Test Your Understanding)</b>
	The company has devised a control that its inventory of perishable goods is stored in appropriate conditions and responsibility is fixed on two persons to monitor environment using sensors and to report on deviations. There is a possibility that persons given responsibility do not perform their work and report deviations. The component of risks of material misstatement is " <b>control risk</b> "
Q4.	Shree Foods Private Limited is engaged in manufacturing of garlic bread. The auditors of company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Which risk is being alluded to? <b>(ICAI Study Material - Test Your Understanding)</b>
	There is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition. The risk alluded to is " <b>detection risk</b> ".
Q5.	A Partnership Firm of Chartered Accountants HT and Associates was appointed to audit the books of accounts of Wind and Ice Limited for the financial year 2023-24. There was a risk that HT and Associates would give an inappropriate audit opinion if the financial statements of Wind and Ice Limited are materially misstated. State the Risk mentioned in the question <b>(ICAI Study Material - Illustration)</b>
	The risk mentioned in the question is known as <b>Audit Risk</b> , because risk that auditor of a company will give an <b>inappropriate audit opinion</b> if the <b>financial statements</b> of that company are <b>materially misstated</b> is known as Audit Risk.
Q6.	XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc. There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis. Discuss the types of inherent, control and detection risks as perceived by the auditor <b>(ICAI Study Material - Illustration)</b>
	<ul style="list-style-type: none"> <li>• <b>Inherent Risk:</b> Because items may have been misappropriated by employees, therefore, risk to the auditor is that <b>inventory records</b> would be <b>inaccurate</b>.</li> <li>• <b>Control Risk:</b> There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still <b>collusion</b> among employees may be</li> </ul>

	<p>there and risk to auditor would again be that inventory records would be inaccurate.</p> <ul style="list-style-type: none"> <li>• <b>Detection Risk:</b> Auditor <b>checks</b> the <b>efficiency</b> and <b>effectiveness</b> of various <b>control</b> systems in place. He would do that by making observation, inspection, inquiries, etc. In addition to these, the auditor would also employ <b>sampling techniques</b> to check few sales transactions from beginning to end. However, despite all these procedures, the auditor <b>may not detect</b> the items which have been <b>stolen</b> or <b>misappropriated</b>.</li> </ul>
Q7.	<p>"Risk of material misstatement consists of two components" Explain clearly defining risk of material misstatement. (ICAI Study Material - Test Your knowledge)</p> <p>The risk of material misstatement at assertion level comprises of two components i.e., <b>inherent risk and control risk</b>. Both inherent risk and control risk are the <b>entity's risks</b> and they exist independently of the audit of financial statements. Inherent risk and control risk are influenced by the client. These are entity's risks and are not influenced by the auditor.</p> <ul style="list-style-type: none"> <li>• Inherent risk is the <b>susceptibility</b> of an <b>account balance</b> or <b>class of transactions</b> to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, <b>assuming</b> that there were <b>no</b> related <b>internal controls</b>.</li> <li>• Control risk is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will <b>not</b> be <b>prevented</b>, or <b>detected</b> and <b>corrected</b>, on a <b>timely</b> basis by the entity's <b>internal control</b>.</li> </ul>
Q8.	<p>The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2019, NA)</p> <p><b>Combined Assessment of the Risk of Material Misstatement</b></p> <ul style="list-style-type: none"> <li>• The SAs <b>do not</b> ordinarily refer to inherent risk and control risk <b>separately</b>, but rather to a <b>combined assessment</b> of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.</li> <li>• The assessment of the risks of material misstatement may be expressed in <b>quantitative</b> terms, such as in percentages, or in <b>non-quantitative</b> terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.</li> <li>• It can be concluded from the above that <b>Risk of Material Misstatement = Inherent Risk x Control Risk</b></li> </ul>
Q9.	<p>The assessment of risks is a matter of professional judgment. Explain stating clearly what is not included in Audit Risk? (MTP1, Nov 2018, 5 Marks)</p> <p><b>Assessment of Risks - Matter of Professional Judgement</b></p> <ul style="list-style-type: none"> <li>• Audit risk is the risk that the auditor expresses an <b>inappropriate opinion</b> when the <b>FSs</b> are <b>materially misstated</b>. Audit risk is a function of the <b>risks of material misstatement</b> and <b>detection risk</b>.</li> <li>• The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit.</li> <li>• The assessment of risks is a <b>matter of professional judgment, rather than a matter capable of precise measurement</b>.</li> </ul> <p><b>What is not included in Audit Risk?</b></p> <ul style="list-style-type: none"> <li>• Audit risk does not include the risk that the auditor might <b>express</b> an <b>opinion</b> that the <b>financial statements are materially misstated when they are not</b>. This risk is ordinarily insignificant.</li> <li>• Audit risk is a technical term related to the process of auditing; it does <b>not</b> refer to the <b>auditor's business risks</b> such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.</li> </ul>
Q10.	<p>The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels. (RTP, Nov 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Risk of material misstatement refers to the risk that the financial statements are materially misstated prior to audit. Discuss the levels at which this risk exists. (RTP, Nov 2023, NA)</p> <p>The risks of material misstatement may exist at two levels:</p> <ul style="list-style-type: none"> <li>• <b>The overall financial statement level-</b> Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate <b>pervasively</b> to the financial statements as a whole and <b>potentially affect</b></li> </ul>

	<p>many assertions.</p> <ul style="list-style-type: none"> <li>• <b>The assertion level for classes of transactions, account balances, and disclosures</b> - Risks of material misstatement at the assertion level are assessed in order to determine the <b>nature, timing, and extent</b> of <b>further audit procedures</b> necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an <b>opinion</b> on the financial statements at an acceptably low level of audit risk</li> </ul>
Q11.	<p>You are appointed as an auditor of Gama Ltd. Your audit assistant wants to understand the meaning of Audit Risk. Explain him the meaning of Audit Risk with example. Also guide him as to what is not included in Audit Risk. (SA, May 2023, 4 marks)</p> <p>Audit risk means the risk that the auditor gives an <b>inappropriate</b> audit <b>opinion</b> when the <b>financial statements</b> are <b>materially misstated</b>. Audit risk is a function of the <b>risks of material misstatement</b> and <b>detection risk</b>. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.</p> <p><b>Example:</b> Gama Limited purchased a Plant and Machinery for ₹ 2 Crores in the financial year 2023-2024. The accountant of Gama limited debited ₹ 2 crores in the repair and maintenance account in the statement of Profit and loss instead of taking it to the balance sheet as PPE and claim depreciation on it. While auditing the accounts of this company the auditor may not notice this and consequently may not report anything regarding the plant and machinery. Therefore, the opinion given by the auditor would be inappropriate resulting in audit risk.</p> <p><b>What is not included in Audit Risk?</b></p> <ul style="list-style-type: none"> <li>• Audit risk does not include the risk that the auditor might express an <b>opinion</b> that the <b>financial statements are materially misstated when they are not</b>. This risk is ordinarily insignificant.</li> <li>• Further, audit risk is a technical term related to the process of auditing. It does <b>not</b> refer to the <b>auditor's business risks</b> such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.</li> </ul>

### Risks that require special audit consideration

Q12.	<p>"As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor. Explain the above in context of SA-315." (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.</p> <p>In the context of significant risk, explain the factors to be considered by the auditor in exercising judgment as to which risks are significant risks. (RTP, Nov 2021, NA) (MTP1, Nov 2023, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>In exercising judgment as to which risks are significant risks, the auditor shall consider various factors. Explain. (MTP2, Nov 2022, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>As a part of Risk assessment, the auditor shall determine whether any of the risks identified are in the auditor's judgement a significant risk. Mention any three guiding factors to judge as to which risks are significant risks ? (SA, May 2023, 3 marks)</p> <p>In exercising judgment as to which risks are significant risks, the auditor shall consider the following-</p> <ul style="list-style-type: none"> <li>• Whether the risk is a risk of <b>fraud</b>;</li> <li>• Whether the risk is related to recent <b>significant economic, accounting</b> or <b>other developments</b> like changes in regulatory environment etc. and therefore requires specific attention;</li> <li>• The <b>complexity</b> of transactions;</li> <li>• Whether the risk involves significant transactions with <b>related parties</b>;</li> <li>• The degree of <b>subjectivity</b> in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and</li> <li>• Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be <b>unusual</b>.</li> </ul>
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Q13.	<p>Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail (RTP, Nov 2021, NA) (MTP2, Nov 2023, 3 marks)</p>
	<p><b>Risks of Material Misstatement– Greater for Significant Non-Routine Transactions:</b></p> <p>Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:</p> <ul style="list-style-type: none"> <li>• Greater <b>management intervention</b> to specify the accounting treatment.</li> <li>• Greater <b>manual intervention</b> for data collection and processing.</li> <li>• <b>Complex</b> calculations or accounting principles.</li> <li>• The <b>nature</b> of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.</li> </ul> <p><b>Risks of material misstatement– Greater for Significant Judgmental Matters:</b></p> <p>Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:</p> <ul style="list-style-type: none"> <li>• Accounting principles for accounting estimates or revenue recognition may be subject to <b>differing interpretations</b>.</li> <li>• Required judgment may be <b>subjective</b> or <b>complex</b>, or require assumptions about the effects of future events, for example, judgment about fair value.</li> </ul>
Q14.	<p>Auditor or Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is the view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions (SA, Dec 2021, 3 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>What is understood by “non-routine” transactions? Briefly outline why risks of material misstatement is greater for such transactions. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Risk of Material Misstatement – Greater for Significant Non-Routine Transactions:</b></p> <p>Significant risks often relate to significant <b>non- routine</b> transactions or <b>judgmental</b> matters. Non-routine transactions are transactions that are <b>unusual</b>, due to <b>either size</b> or <b>nature</b>, and that therefore occur <b>infrequently</b>.</p> <p>Risks of Material Misstatement– Greater for Significant Non-Routine Transactions</p> <p>Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:</p> <ul style="list-style-type: none"> <li>• Greater <b>management intervention</b> to specify the accounting treatment.</li> <li>• Greater <b>manual intervention</b> for data collection and processing.</li> <li>• <b>Complex</b> calculations or accounting principles.</li> <li>• The <b>nature</b> of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.</li> </ul> <p>Keeping in view above, view of the Auditor of Sunshine Ltd is <b>correct</b>.</p>

### SA 315 Identifying and assessing the risk of material misstatement through understanding the entity and its environment

Q15.	<p>The auditor shall identify and assess the risks of material misstatement at both levels to provide a basis for designing and performing further audit procedures. For the purpose of Identifying and assessing the risks of material misstatement the auditor shall Identify risks, assess the identified risks, relate the identified risks and consider the likelihood of misstatement. Explain the above in detail. (MTP2, Nov 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall identify risks throughout the process of obtaining an understanding of the entity and its environment. Explain in detail along with other relevant points. (RTP, Nov 2020, NA)</p>
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	<p style="text-align: center;"><b>OR</b></p> <p>Discuss the steps to be taken by the auditor for the purpose of Identifying and assessing the risks of material misstatement as per SA 315. <b>(MTP1, Nov 2022, 4 Marks)</b></p>
	<p><b>Identify and assess the risks of material misstatement:</b></p> <p>The auditor shall identify and assess the risks of material misstatement at:</p> <ul style="list-style-type: none"> <li>the <b>financial statement</b> level -</li> <li>the <b>assertion level</b> for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures</li> </ul> <p>For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:</p> <ul style="list-style-type: none"> <li><b>Identify risks</b> throughout the process of obtaining an <b>understanding</b> of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;</li> <li>Assess the identified risks, and <b>evaluate</b> whether they <b>relate more pervasively to the financial statements</b> as a whole and potentially affect many assertions;</li> <li><b>Relate the identified risks to what can go wrong at the assertion level</b>, taking account of relevant controls that the auditor intends to test; and</li> <li>Consider the <b>likelihood of misstatement</b>, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.</li> </ul>

## Risk assessment procedures

Q16.	<p>On perusing financial statements of Jo Jo Limited put up for audit, it is observed by the auditor that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year). Identify what kind of risk assessment procedures are being performed by auditor? Has it any relation with listing of the company next year on Bombay Stock Exchange? <b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p>It is noticed by the auditor that the current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year). The auditor is using "<b>analytical procedures</b>" as risk assessment procedures. Current ratio has improved from previous year. There could be a possibility of misstatement in current assets and current liabilities. It is possible that improvement in current ratio is artificial due to misstatements and has been done to secure good response to the proposed issue of company next year.</p>
Q17.	<p>Discuss how "analytical procedures" performed as "risk assessment procedures" can be useful to an auditor <b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p style="text-align: center;"><b>OR</b></p> <p>Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Explain in detail. <b>(RTP, Nov 2020, NA)</b></p>
	<p style="text-align: center;"><b>OR</b></p> <p>Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware. Explain <b>(RTP, Nov 2023, NA)</b></p>
	<ul style="list-style-type: none"> <li>Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks.</li> <li>Analytical procedures performed as risk assessment procedures may include <b>both financial and non-financial</b> information.</li> <li>Analytical procedures may help <b>identify</b> the existence of <b>unusual transactions</b> or events, and amounts, ratios, and trends that might indicate matters that have audit implications.</li> <li>Unusual or unexpected relationships that are identified may assist the auditor in <b>identifying risks of material misstatement</b>, especially risks of material misstatement due to fraud.</li> <li>However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases,</li> </ul>

	consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.
Q18.	<p>"Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority. Explain with the help of examples." (RTP, Nov 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The risk assessment procedures shall include the Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. Explain giving at least three examples. (MTP1, Nov 2022, 3 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Management is often in the best position to perpetrate fraud. As an auditor you are suspecting existence or suspicion of fraud from management. Give any three examples of "others within the entity" to whom direct inquiries can be made. (SA, May 2023, 3 marks)</p> <p><b>Inquiries of Management and Others Within the Entity:</b> Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.</p> <p>Examples</p> <ul style="list-style-type: none"> <li>• Inquiries directed towards <b>those charged with governance</b> may help the auditor <b>understand</b> the environment in which the financial statements are prepared.</li> <li>• Inquiries directed toward <b>internal audit personnel</b> may provide information about <b>internal audit procedures</b> performed during the year relating to the design and effectiveness of the entity's internal control</li> <li>• Inquiries of <b>employees</b> involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the <b>appropriateness</b> of the <b>selection</b> and <b>application</b> of certain <b>accounting policies</b>.</li> <li>• Inquiries directed toward <b>in-house legal counsel</b> may provide information about such matters as litigation, compliance with laws and regulations, knowledge of <b>fraud</b> or suspected fraud.</li> <li>• Inquiries directed towards <b>marketing</b> or <b>sales personnel</b> may provide information about changes in the entity's marketing <b>strategies</b>, sales <b>trends</b>, or contractual arrangements with its customers.</li> <li>• Inquiries directed to the <b>risk management function</b> may provide information about <b>operational</b> and <b>regulatory risks</b> that may affect financial reporting.</li> <li>• Inquiries directed to <b>information systems</b> personnel may provide information about system changes, system or control failures, or other information system- related risks.</li> </ul>
Q19.	<p>CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations (SA, July 2021, 3 Marks)</p> <p>Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.</p> <p>Examples of audit procedures which include observation or inspection of the following:</p> <ul style="list-style-type: none"> <li>• <b>Entity's operations</b></li> <li>• <b>Documents</b> (such as business plans and strategies), records, and internal control manuals.</li> <li>• <b>Reports</b> prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)</li> <li>• The entity's <b>premises</b> and plant facilities</li> </ul>

## Understanding the Entity and its Environment

Q20.	The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed. (ICAI Study Material - Illustration)
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	Obtaining an understanding of the entity and its environment, including the entity's internal control is a <b>continuous, dynamic process</b> of gathering, updating and analysing information throughout the audit. The auditor should proceed accordingly.
Q21.	<p>While auditing the books of accounts of Heavy Material Limited for the financial year 2022-23, a team member of the auditor of Heavy Material Limited showed no inclination towards understanding the business and the business environment of the above mentioned company. Is the approach of team member of the auditor of Heavy Material Limited correct or incorrect? Also give reason for your answer. (ICAI Study Material - Illustration)</p> <p>The approach of team member of the auditor of Heavy Material Limited is <b>incorrect</b> because understanding the business and the business environment of company whose audit is to be conducted is very important, as it helps in <b>planning</b> the audit and <b>identifying areas</b> requiring <b>special attention</b> during the course of the audit of that company.</p>
Q22.	<p>Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment. (ICAI Study Material - Illustration)</p> <p>While <b>understanding</b> the entity and its environment, <b>internet sales</b> is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area.</p>
Q23.	<p>In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment". (MTP1, Nov 2019, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. Explain in context with relevant SA, knowledge to be obtained by the auditor in establishing overall plan. Also explain how such an understanding would be helpful to the auditor. (RTP, May 2021, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>CA D has been appointed as an auditor of LMP Ltd. Before developing an overall audit plan, CA D wants to get an understanding and knowledge of the Client's business including applicable financial reporting framework. Guide CA D in understanding of the same with reference to the relevant Standard on Auditing. (SA, May 2023, 4 marks)</p> <p>As per <b>SA 315</b> – "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the following:</p> <ul style="list-style-type: none"> <li>• <b>Relevant industry, regulatory, and other external factors</b> including the applicable financial reporting framework</li> <li>• The <b>nature</b> of the entity, including:             <ul style="list-style-type: none"> <li>○ its <b>operations</b>;</li> <li>○ its <b>ownership</b> and <b>governance structures</b>;</li> <li>○ the <b>types</b> of <b>investments</b> that the entity is making and plans to make and</li> <li>○ the way that the entity is <b>structured</b> and how it is financed;</li> </ul> </li> <li>• The entity's <b>selection</b> and <b>application</b> of <b>accounting policies</b>, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.</li> <li>• The entity's <b>objectives</b> and <b>strategies</b>, and those related <b>business risks</b> that may result in risks of material misstatement.</li> <li>• The <b>measurement</b> and <b>review</b> of the <b>entity's financial performance</b>.</li> </ul>
Q24.	<p>Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples. (RTP, May 2020, NA)</p> <ul style="list-style-type: none"> <li>• <b>Relevant industry factors</b> include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments.</li> </ul>

	<ul style="list-style-type: none"> <li>Examples of matters the auditor may consider include market and competition, whether entity is engaged in seasonal activities, product technology relating to the entity's products.</li> <li><b>Relevant regulatory factors</b> include the regulatory environment. The regulatory environment includes, among other matters, the applicable financial reporting framework and the legal and political environment. <ul style="list-style-type: none"> <li>Examples of matters the auditor may consider include accounting principles and industry specific practices, regulatory framework for a regulated industry, legislation and regulation that significantly affect the entity's operations, including direct supervisory activities, taxation, government policies currently affecting the conduct of the entity's business, environmental requirements affecting the industry and the entity's business.</li> </ul> </li> <li>Examples of <b>other external factors</b> affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation etc.</li> </ul>
Q25.	<p>Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples. (RTP, May 2020, NA) (RTP, Nov 2023, NA)</p> <p>Obtaining an understanding of the entity and its environment, including the entity's internal control, is a <b>continuous, dynamic process</b> of gathering, updating and analysing information throughout the audit. The understanding establishes a <b>frame of reference</b> within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:</p> <ul style="list-style-type: none"> <li>Assessing <b>risks of material misstatement</b> of the financial statements;</li> <li>Determining <b>materiality</b> in accordance with SA 320;</li> <li>Considering the <b>appropriateness</b> of the selection and application of <b>accounting policies</b>;</li> <li>Identifying <b>areas</b> where <b>special audit consideration</b> may be <b>necessary</b>, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;</li> <li>Developing <b>expectations</b> for use when performing <b>analytical procedures</b>;</li> <li>Evaluating the <b>sufficiency</b> and <b>appropriateness</b> of audit <b>evidence</b> obtained, such as the appropriateness of assumptions and of management's oral and written representations.</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. (ICAI Study Material - Test Your Knowledge) (RTP, May 2018, NA) (MTP2, Nov 2023, 2 marks)</p> <p><b>Incorrect.</b> Inherent risk is the <b>susceptibility</b> of an <b>account balance</b> or <b>class of transactions</b> to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, <b>assuming</b> that there were <b>no</b> related <b>internal controls</b>.</p> <p>Control risk, on the other hand is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will <b>not</b> be <b>prevented</b>, or <b>detected</b> and <b>corrected</b>, on a <b>timely</b> basis by the <b>entity's internal control</b>.</p>
Q2.	<p>The assessment of risks is a matter capable of precise measurement. (MTP1, May 2018, 2 Marks) (MTP1, Nov 2018, 2 Marks) (MTP1, May 2019, 2 Marks) (RTP, Nov 2019, NA)</p> <p><b>Incorrect.</b> The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of <b>professional judgment, rather than a matter capable of precise measurement</b>.</p>
Q3.	<p>Obtaining an understanding of the entity and its environment, including the entity's internal control is a one time process of gathering, updating and analysing information before the audit. (MTP2, May 2018, 2 Marks)</p> <p><b>Incorrect.</b> Obtaining an understanding of the entity and its environment, including the entity's internal control is a <b>continuous, dynamic process</b> of gathering, updating and analysing information throughout the audit. The understanding establishes a <b>frame of reference</b> within which the auditor plans the audit and exercises professional judgment throughout the audit.</p>

Q4.	The assessment of risks is a matter of professional judgement. <b>(MTP2, Nov 2018, 2 Marks)</b>
	<b>Correct.</b> The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement
Q5.	The SAs ordinarily refer to inherent risk and control risk separately. <b>(RTP, Nov 2018, NA) (RTP, May 2019, NA)</b>
	<b>Incorrect.</b> The SAs <b>do not</b> ordinarily refer to inherent risk and control risk <b>separately</b> , but rather to a <b>combined assessment</b> of the “risks of material misstatement”. However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in <b>quantitative</b> terms, such as in percentages, or in <b>non-quantitative</b> terms.
Q6.	Judgemental matters are transactions that are unusual due to either its size or nature and that therefore occur infrequently. <b>(SA, Nov 2018, 2 Marks)</b>
	<b>Incorrect.</b> Significant risks often relate to significant <b>non-routine transactions or judgemental</b> matters. <b>Non-routine transactions</b> are transactions that are <b>unusual</b> , due to either <b>size</b> or <b>nature</b> , and that therefore occur <b>infrequently</b> . Judgemental matters may include the <b>development</b> of accounting <b>estimates</b> for which there is significant measurement <b>uncertainty</b> . Thus judgemental matters are not always unusual due to their size or nature.
Q7.	There is no relation between Inherent risk, Control risk and Detection risk. <b>(MTP1, Nov 2019, 2 Marks)</b> <b>OR</b> There is direct relationship between detection risks and the combined level of inherent and control risks. <b>(RTP, Nov 2023, NA)</b>
	<b>Incorrect.</b> There is an <b>inverse relationship</b> between <b>detection risks</b> and the <b>combined level of inherent and control risks</b> . When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.
Q8.	For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion. <b>(SA, Nov 2019, 2 Marks) (MTP2, May 2023, 2 marks)</b>
	<b>Incorrect.</b> The auditor shall perform risk assessment procedures to provide a basis for the <b>identification</b> and <b>assessment</b> of <b>risks of material misstatement</b> at the financial statement and assertion levels. Risk assessment procedures by themselves, however, <b>do not provide sufficient appropriate audit evidence</b> on which to base the audit opinion.
Q9.	Risk assessment procedures are not performed to obtain an understanding of the entity and its environment. <b>(RTP, May 2020, NA)</b>
	<b>Incorrect.</b> Risk assessment procedures refer to the audit procedures <b>performed</b> to <b>obtain an understanding</b> of the <b>entity</b> and its <b>environment</b> , including the entity's internal control, to <b>identify</b> and <b>assess</b> the <b>risks of material misstatement</b> , whether due to fraud or error, at the financial statement and assertion levels.
Q10.	Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates. <b>(SA, Nov 2020, 2 Marks)</b>
	<b>Correct.</b> Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following: <ul style="list-style-type: none"> <li>Accounting principles for accounting estimates or revenue recognition may be subject to <b>differing interpretations</b>.</li> <li>Required judgment may be <b>subjective</b> or <b>complex</b>, or require assumptions about the effects of future events, for example, judgment about fair value.</li> </ul>
Q11.	The SAs do not ordinarily refer to inherent risk and control risk separately. <b>(MTP2, Nov 2021, 2 Marks) (MTP1, May 2022, 2 marks)</b>

	<b>Correct.</b> The SAs <b>do not</b> ordinarily refer to inherent risk and control risk <b>separately</b> , but rather to a <b>combined assessment</b> of the “risks of material misstatement”. However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in <b>quantitative</b> terms, such as in percentages, or in <b>nonquantitative</b> terms.
Q12.	There is an inverse relationship between detection risks and the combined level of inherent and control risks (MTP2, May 2022, 2 marks) (RTP, Nov 2022, NA)
	<b>Correct.</b> There is an <b>inverse</b> relationship between <b>detection risks</b> and the <b>combined level of inherent and control risks</b> . For example, when inherent and control risks are high, acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risks and still reduce audit risks to an acceptably low level.
Q13.	According to SA 315, the objective of the auditor is to identify and assess the risk of material misstatement, whether due to fraud or error, only at assertion level. (RTP, May 2023, NA)
	<b>Incorrect.</b> According to SA 315, the objective of the auditor is to <b>identify</b> and <b>assess</b> the <b>risk of material misstatement</b> , whether due to fraud or error, <b>at the financial statement and assertion levels</b> , through understanding the entity and its environment, including the entity's internal control

### Part III: Multiple Choice Questions

Q1.	Components of risk of material misstatement at the assertion level are : (a) Inherent risk and detection risk (b) inherent risk and control risk (c) control risk and detection risk (d) inherent risk, control risk and detection risk (Sample MCQs) (ICAI MCQs)
	<b>Correct answer:</b> (b) inherent risk and control risk <b>Explanation:</b> <ul style="list-style-type: none"> <li>• Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components - inherent risk and control risk</li> <li>• Meaning of Inherent Risk - it is assumed that there is a risk within the entity irrespective of whether controls are present or not</li> <li>• Meaning of Control risk - controls placed by the management are not able to prevent, detect and correct material misstatements</li> </ul>
Q2.	Audit risk is a function of the (a) risks of material misstatement and detection risk (b) audit risk and detection risk. (c) control risk and detection risk. (d) inherent risk and detection risk. (Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP2, May 2021, 2 Marks)
	<b>Correct answer:</b> (a) risks of material misstatement and detection risk <b>Explanation:</b> Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment. Audit Risk = Risk of Material Misstatement and Detection Risk, where Risk of Material Misstatement = inherent and control risk.
Q3.	Risk of material misstatement may be defined as the risk (a) that the financial statements are materially misstated after audit (b) that the financial statements are materially misstated during audit. (c) that the financial statements are materially misstated prior to audit.

	<p>(d) All of the above  <b>(Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)(MTP2, May 2021, 2 Marks) (MTP2, Nov 2021, 2 Marks)</b></p> <p><b>Correct answer:</b> (c) that the financial statements are materially misstated prior to audit.  <b>Explanation:</b> Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components - inherent risk and control risk.</p>
Q4.	<p>The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls is -</p> <p>(a) Control Risk  (b) Inherent Risk  (c) Detection Risk  (d) Audit Risk  <b>(Sample MCQs) (ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Inherent Risk  <b>Explanation:</b> Meaning of different terms are explained below:</p> <ul style="list-style-type: none"> <li>• Inherent risk- it is assumed that there is a risk within the entity irrespective of whether controls are present or not</li> <li>• Control risk - controls placed by the management are not able to prevent, detect and correct material misstatements</li> <li>• Detection risk - auditor's procedures may not be able to detect the risk.</li> <li>• Audit Risk - risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.</li> </ul>
Q5.	<p>The assessment of risks is a</p> <p>(a) matter capable of precise measurement rather than matter of professional judgment  (b) matter of professional judgment, rather than a matter capable of precise measurement.  (c) matter of professional judgement as well as capable of precise measurement sometimes.  (d) None of the above  <b>(Sample MCQs) (ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) matter of professional judgment, rather than a matter capable of precise measurement.</p>
Q6.	<p>For a given level of audit risk, the acceptable level of detection risk bears _____relationship to the assessed risks of material misstatement at the assertion level.</p> <p>(a) direct.  (b) Inverse  (c) no relationship  (d) either (a) or (c)  <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Inverse  <b>Explanation:</b> For example, if an entity has a low ROMM (IR*CR), that means the auditor shall do less checking, which means fewer samples have been drawn from the population, which also means a high materiality level would be set. Less checking means that there is a major portion that is not checked by an auditor or that many errors are undetected. (If a high materiality level is set, transactions or account balances below the materiality level are not checked.) So, the detection risk here is high, i.e., the auditor's procedures may not be able to detect the risk.</p>
Q7.	<p>Risk of material misstatement has _____ components</p> <p>(a) one  (b) two  (c) three  (d) four  <b>(ICAI MCQs)</b></p>

	<b>Correct answer:</b> (b) two
Q8.	<p>Controls can be_____related to an assertion.</p> <p>(a) directly</p> <p>(b) indirectly</p> <p>(c) directly or indirectly</p> <p>(d) no relationship between controls and assertion.</p> <p><b>(ICAI MCQs)</b></p>
	<b>Correct answer:</b> (c) directly or indirectly
Q9.	<p>The assessment of the risks of material misstatement may be expressed in</p> <p>(a) quantitative terms, such as in percentages, or in non-quantitative terms.</p> <p>(b) quantitative terms, such as in percentages,</p> <p>(c) non-quantitative terms.</p> <p>(d) None of the above</p> <p><b>(Sample MCQs) (ICAI MCQs) (MTP1, Nov 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (a) quantitative terms, such as in percentages, or in non-quantitative terms
Q10.	<p>_____refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.</p> <p>(a) Audit assessment procedures</p> <p>(b) substantive procedures</p> <p>(c) test of control</p> <p>(d) Risk assessment procedures</p> <p><b>(Sample MCQs) (ICAI MCQs) (RTP, Nov 2019, NA) (RTP, May 2022, NA)</b></p>
	<b>Correct answer:</b> (d) Risk assessment procedures
Q11.	<p>SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement -</p> <p>(a) at the financial statement levels only.</p> <p>(b) at the assertion levels only.</p> <p>(c) at the financial statement and assertion levels.</p> <p>(d) at the financial statement or assertion levels.</p> <p><b>(ICAI MCQs) (MTP1, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (c) at the financial statement and assertion levels
Q12.	<p>Which of the following is incorrect for the purpose of Identifying and assessing the risks of material misstatement, the auditor shall :</p> <p>(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;</p> <p>(b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions</p> <p>(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and</p> <p>(d) Not consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.</p> <p><b>(ICAI MCQs) (MTP1, May 2023, 1 mark)</b></p>
	<b>Correct answer:</b> (d) Not consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement

Q13.	<p>The risks of material misstatement at the assertion level consist of two components:</p> <ul style="list-style-type: none"><li>(a) Inherent risk and detection risk</li><li>(b) control risk and detection risk</li><li>(c) audit risk and detection risk</li><li>(d) Inherent risk and control risk</li></ul> <p><b>(MTP1, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (d) Inherent risk and control risk</p>
Q14.	<p>The risk that the financial statements are materially misstated prior to audit is called-</p> <ul style="list-style-type: none"><li>(a) Risk of material misstatement</li><li>(b) detection risk</li><li>(c) audit risk</li><li>(d) significant risk</li></ul> <p><b>(MTP1, May 2021, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (a) Risk of material misstatement</p>

## Chapter 3A - Internal Control

### Part I : Descriptive Questions

#### Internal Control- Meaning, Benefits and Limitations

Q1.	Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard. (ICAI Study Material - Illustration)
	<p><b>Understanding Internal Controls:</b></p> <ul style="list-style-type: none"> <li>The auditor shall <b>obtain</b> an <b>understanding</b> of <b>internal control</b> relevant to the audit.</li> <li>Although most controls relevant to the audit are likely to relate to <b>financial reporting</b>, not all controls that relate to financial reporting are relevant to the audit.</li> <li>It is a matter of the auditor's <b>professional judgment</b> whether a control, individually or in combination with others, is relevant to the audit.</li> </ul>
Q2.	<p>The team member of the auditor of Simple and Easy Limited was of the view that understanding the internal control of the company would not help them in any manner in relation to audit procedures to be applied while conducting the audit (ICAI Study Material - Illustration)</p> <p><b>Understanding Internal Controls:</b></p> <p>The view of the team member of the auditor is <b>incorrect</b> because <b>understanding</b> the <b>internal control</b> of the company would help the auditor and his team members in <b>designing</b> the <b>nature, timing</b> and <b>extent</b> of audit <b>procedures</b> to be applied while conducting the audit of the company</p>
Q3.	<p>Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p> <ul style="list-style-type: none"> <li>Internal control over safeguarding of assets against <b>unauthorised</b> acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives.</li> <li>The auditor's consideration of such controls is generally limited to those relevant to the <b>reliability</b> of <b>financial reporting</b>. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit.</li> <li>Safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.</li> </ul> <p><b>Objectives of Internal Control are :</b></p> <ul style="list-style-type: none"> <li>transactions are executed in accordance with management's general or specific <b>authorization</b>;</li> <li>all transactions are promptly <b>recorded</b> in the <b>correct amount</b> in the appropriate <b>accounts</b> and in the accounting <b>period</b> in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;</li> <li>assets are <b>safeguarded</b> from <b>unauthorised access</b>, use or disposition; and</li> <li>the recorded assets are <b>compared</b> with the existing assets at reasonable intervals and appropriate <b>action</b> is taken with regard to any <b>differences</b>.</li> </ul>
Q4.	<p>Auditor GR and Associates have been appointed to conduct audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditors do not think that it would be necessary to understand internal controls. Advise the auditor in this regard explaining clearly the benefits of understanding the internal control. (RTP, May 2021, NA)</p> <p>The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.</p>



	<p><b>Benefits of Understanding the Internal Control:</b> An understanding of internal control assists the auditor in:</p> <ul style="list-style-type: none"> <li>identifying <b>types</b> of <b>potential misstatements</b>;</li> <li>identifying <b>factors</b> that affect the <b>risks</b> of material misstatement, and</li> <li>designing the <b>nature, timing</b>, and <b>extent</b> of <b>further audit procedures</b>.</li> </ul>
Q5.	<p>Briefly discuss the limitations of Internal Control (<b>SA, May 2018, 6 Marks</b>) (<b>MTP2, May 2019, 4 Marks</b>) (<b>RTP, May 2023, NA</b>)</p> <p>Limitations of Internal Control:</p> <ul style="list-style-type: none"> <li><b>Internal control can provide only reasonable assurance:</b> Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.</li> <li><b>Human judgment in decision-making:</b> Realities that human judgment in decision making can be faulty and that breakdowns in internal control can occur because of human error.</li> <li><b>Lack of understanding the purpose:</b> Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.</li> <li><b>Collusion among People:</b> Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition.</li> <li><b>Judgements by Management:</b> Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.</li> <li><b>Limitations in case of Small Entities:</b> Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties. On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured.</li> </ul>
Q6.	<p>ABC Ltd. has many divisions and branches across the country. They have an internal control system which is well established maintained by the management on a regular basis. Explain the meaning of internal control as per SA-315 and also state the benefits of understanding the internal controls of a company (<b>SA, Nov 2022, 3 marks</b>)</p> <p><b>Meaning and benefits of understanding Internal Control:</b></p> <p><b>Meaning of Internal Control:</b> As per <b>SA 315</b>, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the internal control may be defined as "the process <b>designed, implemented</b> and <b>maintained</b> by those charged with governance, management and other personnel to provide <b>reasonable</b> assurance about the achievement of an entity's objectives with regard to</p> <ul style="list-style-type: none"> <li>reliability of <b>financial reporting</b>,</li> <li>effectiveness and efficiency of <b>operations</b>,</li> <li>safeguarding of <b>assets</b>, and</li> <li>compliance with applicable <b>laws</b> and <b>regulations</b>.</li> </ul> <p><b>Benefits of Understanding the Internal Control:</b> An understanding of internal control assists the auditor in:</p> <ul style="list-style-type: none"> <li>identifying <b>types</b> of <b>potential misstatements</b>;</li> <li>identifying <b>factors</b> that affect the <b>risks</b> of material misstatement, and</li> <li>designing the <b>nature, timing</b>, and <b>extent</b> of <b>further audit procedures</b>.</li> </ul>

## Components of Internal Control

Q7.	<p>CA Smriti is auditor of a company. As part of audit, she is going through company policies and practices regarding employee recruitment, training, orientation and related matters. She seems to be very much interested in finding out whether company hires best candidates from applicant pool. Identify what she is trying to do? How gaining knowledge about this aspect is useful to her as an auditor? (<b>ICAI Study Material - Test Your Understanding</b>)</p>
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	<p>The study of company policies and practices regarding employee recruitment, training, orientation and related matters including hiring of best candidates is part of understanding the <b>HR function</b> of the company. It, in turn, helps in <b>understanding</b> the <b>control environment</b> of the company. By gaining such a knowledge, she can better understand <b>internal control</b> of the company.</p>
Q8.	<p>During the audit of company, CA Smriti is keen to find out whether there exists a proper system of segregation of duties in the company. She wants to be sure that a person responsible for recording a transaction is different from the person authorising it. Discuss what she is trying to do and how its understanding is significant to her as an auditor. (ICAI Study Material - Test Your Understanding)</p> <ul style="list-style-type: none"> <li>• She is keen to find out whether there exists a proper system of segregation of duties in the company.</li> <li>• She is gaining an understanding of internal control of the company. In particular, she is understanding “<b>control activities</b>”.</li> <li>• When a person recording a transaction is different from one authorizing it, she gains confidence that there exists a system for preventing misstatements.</li> <li>• It helps her in gaining insight into the <b>internal control</b> system of the company.</li> </ul>
Q9.	<p>“The auditor shall obtain an understanding of the control environment” Explain stating what is included in control environment. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor of XYZ Ltd, engaged in FMCG (Fast Moving Consumable Goods) obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:</p> <ol style="list-style-type: none"> <li>Management has created and maintained a culture of honesty and ethical behavior; and</li> <li>The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.</li> </ol> <p>Advise what is included in the control environment. Also explain the elements of the control environment. (RTP, May 2018, NA) (MTP1, May 2018, 6 Marks) (MTP1, Nov 2018, 5 Marks) (MTP1, May 2019, 6 Marks) (MTP1, May 2020, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behaviour and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control. Advise what is included in control environment. Also explain the elements of control environment. (RTP, Nov 2019, NA)</p> <p><b>What is included in the Control Environment?</b></p> <p>The control environment includes:</p> <ul style="list-style-type: none"> <li>• the <b>governance</b> and <b>management</b> functions and</li> <li>• the <b>attitudes, awareness, and actions</b> of those charged with governance and management.</li> </ul> <p>The control environment sets the <b>tone</b> of an organization, influencing the control consciousness of its people.</p> <p><b>Elements of the Control Environment:</b></p> <ol style="list-style-type: none"> <li>1. <b>Communication and enforcement of integrity and ethical values</b> – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.</li> <li>2. <b>Commitment to competence</b> – Matters such as management’s consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.</li> <li>3. <b>Participation by those charged with governance</b> – It includes attributes of those charged with governance such as their independence from management, their experience and stature, the extent of their involvement and the information they receive and the scrutiny of activities</li> <li>4. <b>Management’s philosophy and operating style</b> – Characteristics such as management’s:       <ul style="list-style-type: none"> <li>• Approach to taking and managing business risks.</li> <li>• Attitudes and actions toward financial reporting.</li> <li>• Attitudes toward information processing and accounting functions and personnel.</li> </ul> </li> <li>5. <b>Organisational structure</b> – The framework within which an entity’s activities for achieving its objectives are planned, executed, controlled, and reviewed.</li> </ol>

	<p>6. <b>Assignment of authority and responsibility</b> - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.</p> <p>7. <b>Human resource policies and practices</b> – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.</p>
Q10.	<p>The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting” Explain. (ICAI Study Material- Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>Define Monitoring of Controls and in respect of monitoring of controls, answer the following questions:</p> <ol style="list-style-type: none"> <li>How monitoring of controls would be helpful in assessing the effectiveness of controls?</li> <li>How can management accomplish monitoring of controls?</li> <li>What is included in the Management’s monitoring activities?</li> </ol> <p>(RTP, Nov 2022, NA)</p> <p>Monitoring of controls is a process to assess the effectiveness of internal control performance over time.</p> <ol style="list-style-type: none"> <li>Monitoring of controls helps in assessing the <b>effectiveness</b> of controls on a <b>timely</b> basis and taking necessary <b>remedial</b> actions.</li> <li>Management accomplishes monitoring of controls through <b>ongoing activities, separate evaluations, or a combination</b> of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.</li> <li>Management’s monitoring activities may include using information from <b>communications</b> from <b>external</b> parties such as customer complaints and regulator comments that may indicate <b>problems</b> or highlight areas in need of <b>improvement</b></li> </ol>
Q11.	<p>“A satisfactory control environment is not an absolute deterrent to fraud although it may help reduce the risk of fraud.” Explain. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain. (RTP, May 2019, NA)</p> <p><b>Satisfactory Control Environment - not an absolute deterrent to fraud:</b></p> <p>The existence of a satisfactory control environment can be a <b>positive factor</b> when the auditor assesses the risks of material misstatement. However, although it may help <b>reduce the risk of fraud</b>, a satisfactory control environment is <b>not an absolute deterrent to fraud</b>. Deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud.</p> <p>For example, management’s failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As per SA 330, the control environment also influences the <b>nature, timing, and extent</b> of the auditor’s <b>further procedures</b>.</p> <p>The control environment in itself <b>does not prevent, or detect and correct, a material misstatement</b>. It may, however, influence the auditor’s evaluation of the <b>effectiveness of other controls</b> (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor’s assessment of the risks of material misstatement.</p>
Q12.	<p>The auditor of PQR Ltd, a company engaged in the manufacturing of Auto parts obtains an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. Auditor is of the view that he requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. Advise explaining the meaning of control activities. Also identify and explain the control activities which are relevant to the audit (MTP2, May 2018, 6 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. Explain in detail stating clearly the meaning of control activities and also discuss control activities that are relevant to the audit. (RTP, May 2021, NA)</p> <p><b>Control Activities - Component of Internal Control</b></p>

	<p>The auditor shall obtain an <b>understanding</b> of control activities relevant to the audit, which the auditor considers <b>necessary</b> to <b>assess the risks</b> of material misstatement. An audit requires an understanding of only those control activities related to a <b>significant class of transactions</b>, account <b>balance</b>, and <b>disclosure</b> in the financial statements and the assertions which the auditor finds relevant in his risk assessment process.</p> <p>Control activities are the <b>policies</b> and <b>procedures</b> that help ensure that <b>management directives</b> are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. Examples of specific control activities include those relating to the following</p> <ul style="list-style-type: none"> <li>• Authorization</li> <li>• Segregation of Duties</li> <li>• Physical controls</li> <li>• Information processing</li> <li>• Performance reviews</li> </ul> <p>Control activities that are relevant to the audit are:</p> <ul style="list-style-type: none"> <li>• Control activities that relate to <b>significant risks</b> and those that relate to risks for which substantive procedures <b>alone do not provide sufficient appropriate audit evidence</b>.; or</li> <li>• Those that are considered to be <b>relevant</b> in the <b>judgment</b> of the auditor.</li> <li>• As part of the risk assessment, the auditor shall <b>determine</b> whether any of the risks identified are, in the auditor's <b>judgment</b>, a <b>significant risk</b>.</li> </ul>
Q13.	<p>The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control. (MTP1, Nov 2020, 4 Marks) (MTP1, Nov 2021, 3 Marks) (RTP, May 2023, NA) (MTP1, May 2023, 3 marks)</p> <p>The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:</p> <ul style="list-style-type: none"> <li>• The <b>control environment</b>;</li> <li>• The <b>entity's risk assessment process</b>;</li> <li>• <b>Monitoring of controls</b>.</li> <li>• <b>Control activities</b>; and</li> <li>• The <b>information system</b>, including the related business processes, relevant to financial reporting, and communication;</li> </ul>
Q14.	<p>The auditor shall obtain an understanding of major activities that the entity uses to monitor internal control over financial reporting. Discuss "Monitoring of control" as a component of internal control. (SA, Nov 2020, 4 Marks)</p> <p><b>Monitoring of Controls: Component of Internal Control</b></p> <p>The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting. Monitoring of controls is a process to assess the effectiveness of internal control performance over time.</p> <ul style="list-style-type: none"> <li>• Monitoring of controls helps in assessing the <b>effectiveness</b> of controls on a <b>timely</b> basis and taking necessary <b>remedial</b> actions.</li> <li>• Management accomplishes monitoring of controls through <b>ongoing activities, separate evaluations, or a combination</b> of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.</li> <li>• Management's monitoring activities may include using information from <b>communications</b> from <b>external parties</b> such as customer complaints and regulator comments that may indicate <b>problems</b> or highlight areas in need of <b>improvement</b>.</li> <li>• Management's monitoring of control is often accomplished by <b>management's or the owner-manager's close involvement</b> in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.</li> </ul>
Q15.	<p>The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard. (RTP, May 2021, NA) (MTP2, May 2022, 4 marks)</p>

	<p style="text-align: center;"><b>OR</b></p> <p>The auditor obtains an understanding of the information system, including the related business processes, relevant to financial reporting to gain insight of this important component of internal control. What are the specific areas in respect of which auditor gains such understanding? <b>(MTP1, Nov 2023, 4 marks)</b></p>
	<p>The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as:</p> <ul style="list-style-type: none"> <li>• The classes of <b>transactions</b> in the entity's operations that are significant to the financial statements;</li> <li>• The <b>procedures</b> by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;</li> <li>• The related <b>accounting records</b>, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;</li> <li>• How the <b>information system captures events and conditions</b> that are significant to the financial statements;</li> <li>• The <b>financial reporting process</b> used to prepare the entity's financial statements;</li> <li>• Controls surrounding <b>journal entries</b>.</li> </ul>
Q16.	<p>Explain what understanding should an auditor obtain regarding an entity's risk assessment process (one of the components of the internal control of the entity). <b>(MTP2, Nov 2022, 3 Marks)</b></p>
	<p><b>The Entity's Risk Assessment Process– Component of Control Environment</b></p> <p>The auditor shall obtain an understanding of whether the entity has a process for:</p> <ul style="list-style-type: none"> <li>• <b>Identifying</b> business risks relevant to financial reporting objectives;</li> <li>• <b>Estimating</b> the <b>significance</b> of the risks;</li> <li>• Assessing the <b>likelihood</b> of their occurrence; and</li> <li>• Deciding about <b>actions</b> to address those risks.</li> </ul> <p>The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment .</p>
Q17.	<p>Z Ltd. is a manufacturer of ready-made garments. During the year 2022-23, they have opened two new branches and there is a substantial increase in their sales. The management has appointed CA R to review the internal control system of the company as they feel that there are lapses in the control environment of the company. What is included in the control environment and what will the auditor evaluate in order obtain an understanding of the control environment? <b>(SA, Nov 2022, 3 marks)</b></p>
	<p>The control environment includes:</p> <ul style="list-style-type: none"> <li>• the <b>governance and management</b> functions and</li> <li>• the <b>attitudes, awareness, and actions</b> of those charged with governance and management .</li> </ul> <p>The control environment sets the <b>tone</b> of an organization, influencing the control consciousness of its people.</p> <p>The auditor shall obtain an <b>understanding</b> of the <b>control environment</b>. As part of obtaining this understanding, the auditor shall evaluate whether:</p> <ul style="list-style-type: none"> <li>• Management has created and maintained a culture of <b>honesty</b> and <b>ethical</b> behavior; and</li> <li>• The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.</li> </ul>

### Are all Controls Relevant to the audit?

Q18.	<p>Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as materiality, the significance of the related risk etc. Explain in detail. <b>(RTP, May 2021, NA) (MTP1, May 2022, 3 marks)</b></p>
	<p style="text-align: center;"><b>OR</b></p> <p>Explain the matters which should be included for factors relevant to the auditors' judgement about whether a control is relevant to the audit. <b>(RTP, Nov 2022, NA)</b></p>

	<p>There is a <b>direct</b> relationship between an <b>entity's objectives</b> and the <b>controls</b> implemented to provide reasonable assurance about their achievement. The entity's objectives, and therefore controls, relate to financial reporting, operations and compliance; however, <b>not all</b> of these objectives and controls are <b>relevant</b> to the auditor's risk assessment.</p> <p>Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:</p> <ul style="list-style-type: none"> <li>• <b>Materiality.</b></li> <li>• The significance of the related <b>risk</b>.</li> <li>• The <b>size</b> of the entity.</li> <li>• The <b>nature</b> of the entity's business, including its organisation and ownership characteristics.</li> <li>• The diversity and <b>complexity</b> of the entity's operations.</li> <li>• Applicable <b>legal</b> and <b>regulatory</b> requirements.</li> <li>• The circumstances and the applicable <b>component</b> of internal <b>control</b>.</li> <li>• The <b>nature</b> and <b>complexity</b> of the <b>systems</b> that are part of the entity's internal control, including the use of service organisations.</li> <li>• Whether, and how, a specific control, <b>individually</b> or in <b>combination</b> with others, <b>prevents</b>, or <b>detects</b> and <b>corrects</b>, material misstatement.</li> </ul>
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## Nature and Extent of the Understanding of Relevant Controls

Q19.	Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls (RTP, May 2018, NA)
	<p>Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-</p> <ul style="list-style-type: none"> <li>• <b>Inquiring</b> of entity personnel</li> <li>• <b>Observing</b> the application of specific controls.</li> <li>• <b>Inspecting</b> documents and reports.</li> <li>• <b>Tracing transactions</b> through the information system relevant to financial reporting</li> </ul>

## Evaluation of Internal Control System

Q20.	<p>Zomba Products Private limited is a small company. The control systems in the company are rudimentary. How, you as an auditor of the company, would proceed to evaluate internal control of the company? (ICAI Study Material - Test Your Understanding)</p> <p>In a small company, control systems are basic and <b>not formalized</b>. Therefore, auditor should proceed to evaluate internal control using narrative record.</p>
Q21.	<p>Mr. Y, one of the team member of the auditors of What and Where Limited was very keen in knowing whether the internal control of the company would safeguard the company's assets. Advise Mr. Y. (ICAI Study Material - Illustration)</p> <p>The review of internal controls will enable the auditors to know whether the controls adequately <b>safeguard</b> the <b>assets</b>.</p>
Q22.	<p>Mr. H, a team member of the auditor of There and Here Limited was of the view that evaluation of internal control of the company would help in identifying the areas where internal control is weak. Advise. (ICAI Study Material - Illustration)</p> <p>The review of internal controls will enable the auditor to know what are the areas <b>where control is weak</b> and <b>where it is excessive</b>.</p>
Q23.	<p>In order to evaluate the Internal Control of Your and My Limited, a team member of the auditors used a method according to which, number of questions relating to internal control of the company were required to be answered by the employees of the company. After obtaining the answers there was a discussion relating to those answers between team member of the auditor and employees of the company for a clear picture. State the method of evaluation of internal control as discussed above. (ICAI Study Material - Illustration)</p>

	<p>The method of evaluation of internal control used in the above question is known as <b>Internal Control Questionnaire</b> because in questionnaire method, a number of questions relating to internal control of a company are required to be <b>answered</b> by <b>employees</b> of that <b>company</b> and when answers to the questions are obtained, there is a discussion relating to those answers between team members of the auditors and employees of that company for a clear picture.</p>
Q24.	<p>Healthy and Useful Limited is into small manufacturing as well as trading business. For the purpose of evaluating the internal control of Healthy and Useful Limited, a team member of the auditors of the company used a method according to which the whole description of internal control that was operating in the said company was to be recorded. Identify the method of evaluation of internal control as mentioned above. (ICAI Study Material - Illustration)</p> <p>The method of evaluation of internal control referred above is known as <b>Narrative Record</b> because in Narrative Record method, a whole <b>description</b> of internal <b>control</b> operating in an entity is recorded. Narrative Record method is also appropriate for small manufacturing as well as trading business as is mentioned in the question above case.</p>
Q25.	<p>A Flow Chart is a graphic presentation of each part of the company's system of internal control. Explain elaborating each and every aspect about flow chart. (RTP, Nov 2018, NA)</p> <p><b>Flow Chart:</b></p> <ul style="list-style-type: none"> <li>• It is a <b>graphic presentation</b> of each part of the company's system of internal control.</li> <li>• It is the most <b>concise</b> way of recording the auditor's review of the system.</li> <li>• It <b>minimises</b> the amount of <b>narrative explanation</b> and thereby achieves a presentation not possible in any other form.</li> <li>• It gives <b>bird's eye view</b> of the system and the flow of transactions.</li> <li>• This will help him to <b>understand</b> and <b>evaluate</b> the internal <b>controls</b> in the correct perspective and identify deficiencies</li> </ul>
Q26.	<p>The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. Analyse and explain. (RTP, Nov 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The extent and the nature of the audit programme is substantially influenced by the internal control system in operation. Analyse and explain. (RTP, Nov 2019, NA)</p> <ul style="list-style-type: none"> <li>• The auditor can formulate his entire audit programme only after he has had a <b>satisfactory understanding</b> of the internal <b>control systems</b> and their actual operation.</li> <li>• It would be better if the auditor can undertake the <b>review</b> of the internal control system of the client. He will also be in a position to bring to the <b>notice</b> of the <b>management</b> the <b>weaknesses</b> of the system and to suggest measures for <b>improvement</b>. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.</li> <li>• A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the <b>appropriate audit procedure</b> to be applied in different areas to be covered in the audit programme.</li> <li>• In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction</li> </ul>
Q27.	<p>So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor. (RTP, May 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The review of internal controls will enable the auditor to know the areas where control is weak. Explain stating clearly the benefits of evaluation of internal control to the auditor. (RTP, Nov 2022, NA)</p> <p><b>Benefits of Evaluation of Internal Control to the Auditor</b></p> <p>The review of internal controls will enable the auditor to know:</p>

	<ul style="list-style-type: none"> <li>• whether <b>errors</b> and <b>frauds</b> are likely to be located in the ordinary course of operations of the business;</li> <li>• whether an <b>adequate internal control system</b> is in use and <b>operating</b> as planned by the management;</li> <li>• whether an effective <b>internal auditing department</b> is operating;</li> <li>• whether any <b>administrative control</b> has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);</li> <li>• whether the controls adequately <b>safeguard the assets</b>;</li> <li>• how far and how <b>adequately the management is discharging its function</b> in so far as correct <b>recording of transactions</b> is concerned;</li> <li>• how <b>reliable</b> the <b>reports, records</b> and the <b>certificates</b> to the management can be;</li> <li>• the <b>extent</b> and the <b>depth</b> of the <b>examination</b> that he needs to carry out in the different areas of accounting;</li> <li>• what would be <b>appropriate audit technique</b> and the <b>audit procedure</b> in the given circumstances;</li> <li>• what are the areas where <b>control is weak</b> and <b>where it is excessive</b>; and</li> <li>• whether some worthwhile <b>suggestions</b> can be given to improve the control system.</li> </ul>
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## Part II: Correct/Incorrect Questions

Q1.	<p>Maintenance of Internal Control System is the responsibility of the Statutory Auditor. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Incorrect.</b> The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. Maintenance of Internal Control System is <b>responsibility of management</b> because internal control is the <b>process designed, implemented and maintained</b> by those charged with governance/management to provide <b>reasonable</b> assurance about the achievement of entity's objectives.</p>
Q2.	<p>Satisfactory Control environment is not an absolute deterrent to fraud. (SA, May 2019, 2 Marks)</p> <p><b>Correct.</b> The existence of a Satisfactory Control environment can be a <b>positive factor</b> when an auditor assesses the risk of material misstatement. However, although it may help <b>reduce the risk of fraud</b>, a satisfactory Control environment is <b>not an absolute deterrent to fraud</b>.</p>
Q3.	<p>Satisfactory Control environment is an absolute deterrent to fraud. (MTP1, Nov 2021, 2 Marks)</p> <p><b>Incorrect.</b> The existence of a Satisfactory Control environment can be a <b>positive factor</b> when an auditor assesses the risk of material misstatement. However, although it may help <b>reduce the risk of fraud</b>, a satisfactory Control environment is <b>not an absolute deterrent to fraud</b>.</p>
Q4.	<p>Internal control cannot eliminate risk of material misstatements in the financial statements. (SA, Dec 2021, 2 marks)</p> <p><b>Correct.</b> Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management. However, internal control can <b>only reduce</b> but <b>not eliminate</b> risks of material misstatement in the financial statements. This is because of the <b>inherent limitations</b> of internal control. There is a possibility of human errors or mistakes, or of controls being circumvented by collusion. Accordingly, some control risk will always exist.</p>
Q5.	<p>Control environment can prevent, detect and correct a material misstatement. (MTP2, May 2022, 2 marks) (RTP, May 2023, NA) (RTP, Nov 2023, NA)</p> <p><b>Incorrect.</b> The control environment in itself <b>does not prevent, or detect and correct, a material misstatement</b>. It may, however, influence the auditor's evaluation of the <b>effectiveness of other controls</b> (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement</p>
Q6.	<p>Inappropriate management can override internal controls of any organization. (SA, May 2022, 2 Marks)</p> <p><b>Correct.</b> Controls can be circumvented by the <b>collusion</b> of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and</p>



	conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.
Q7.	The internal control questionnaire is a series of instructions/ questions which a member of the auditing staff must follow and/or answer. <b>(MTP2, Nov 2022, 2 Marks)</b>
	<b>Incorrect.</b> Check list is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. Internal control <b>questionnaire</b> is a <b>comprehensive series</b> of questions concerning internal control. The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees.
Q8.	Narrative record is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer <b>(MTP1, May 2023, 2 marks)</b>
	<b>Incorrect.</b> Check list is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. Narrative record is a <b>complete</b> and <b>exhaustive description</b> of the system as found in operation by the auditor.

### Part III: Multiple Choice Questions

Q1.	<p>The management of Magoo Ltd. has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. CA. Olive has been appointed as an auditor of the company for current Financial Year 2023-24. Before starting the audit, she wants to evaluate the internal control system of Magoo Ltd. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, CA. Olive decided to use internal control questionnaire to know and assimilate the system and evaluate the same. Which of the following questions need not be framed under internal control questionnaire relating to purchases?</p> <p>(a) Are authorized signatories for purchases limited to elected officials?</p> <p>(b) Are payments approved only on original invoices?</p> <p>(c) Does authorized officials thoroughly review the documents before signing cheques?</p> <p>(d) Are monthly bank reconciliations implemented for each and every bank accounts of the company?</p> <p><b>(Sample MCQS)(RTP, May 2019, NA)</b></p>
	<b>Correct answer:</b> (d) Are monthly bank reconciliations implemented for each and every bank accounts of the company?
Q2.	<p>A company is engaged in manufacturing of wooden furniture. The auditor of company notes that company has identified emerging risks pertaining to probable reduction in demand of company's products due to procurement of imported furniture from South East Asian nations. It has also estimated how significant are those risks and their possibility of happening. Besides, it has also formulated an action plan to deal with the situation, in case these risks materialize. Which of the following options would be most appropriate to describe above situation?</p> <p>(a) An example of audit risk for auditor</p> <p>(b) An example of component of internal control of company</p> <p>(c) An example of control risk of company</p> <p>(d) An example of inherent risk for auditor</p> <p><b>(MTP2, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (b) An example of component of internal control of company</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>The given case explains "The entity's risk assessment process", one of the components of the internal control of the entity.</li> <li>Regarding entity's risk assessment process, the auditor shall obtain an understanding of whether the entity has a process for: (a) Identifying business risks relevant to financial reporting objectives; (b) Estimating the significance of the risks; (c) Assessing the likelihood of their occurrence; and (d) Deciding about actions to address those risks.</li> </ul>
Q3.	To evaluate the Internal Control of Kingsway Limited, a team member of the auditors used a method according to which, number of questions relating to internal control of the company were required to be answered by the employees of the company. After obtaining the answers there was a discussion relating to those answers between team member of the

auditor and employees of the company for a clear picture. State the method of evaluation of internal control as discussed above.

- (a) Narrative record
- (b) Check List
- (c) Internal Control questionnaire
- (d) Flow chart

**(MTP1, Nov 2023, 1 mark)**

**Correct answer:** (c) Internal Control questionnaire

**Explanation:**

- Internal Control Questionnaire is a comprehensive series of questions concerning internal control. The auditor sends a questionnaire to the client for completion by relevant staff; any inconsistencies found are clarified through discussion, leading to a report on deficiencies and improvement recommendations.
- **The difference between check list and Questionnaire:** Both include a detailed series of instructions generally in Yes/No form. However, in the checklist junior or article assistant is required to ask questions from the client and fill the response and a questionnaire is usually issued to the client and the client is requested to get it filled by their employees.

## Chapter 3B - Response to the Assessed Risk

### Part I : Descriptive Questions

#### Testing of Internal Control

Q1.	<p>A Chartered accountant during course of audit of a company finds that cash is not deposited into bank frequently although concerned staff of company was required to do so. Further, the official responsible for ensuring performance of above function, has also not paid any attention to it. Discuss what does it represent from auditor's perspective.</p> <p><b>(ICAI Study Material - Test Your Understanding)</b></p>
	<ul style="list-style-type: none"> <li>• Cash is not deposited into bank frequently, although, concerned staff of company was required to do so.</li> <li>• Further, the official responsible for ensuring performance of above function, has also not paid any attention to it.</li> <li>• It means that control is not working as planned.</li> <li>• It would not be able to prevent misstatement and very purpose of control is defeated. It represents a "<b>control deficiency</b>"</li> </ul>
Q2.	<p>XYZ &amp; Associates, Chartered Accountants, while evaluating the operating effectiveness of internal controls, detects deviation from controls. In such a situation, state the specific inquiries to be made by an auditor to understand these matters and their potential consequences. <b>(SA, May 2018, 5 Marks) (MTP1, May 2021, 4 Marks)</b></p> <p><b>Evaluating the Operating Effectiveness of Controls:</b></p> <p>When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.</p> <p>When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make <b>specific inquiries</b> to understand these matters and their potential consequences, and shall determine whether:</p> <ul style="list-style-type: none"> <li>• The tests of controls that have been performed provide an <b>appropriate basis</b> for reliance on the controls;</li> <li>• <b>Additional</b> tests of controls are necessary; or</li> <li>• The <b>potential risks</b> of misstatement need to be addressed using substantive procedures.</li> </ul> <p>A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control</p>
Q3.	<p>A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls. Explain and also state when will the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls. <b>(RTP, Nov 2018, NA) (RTP, Nov 2020, NA)</b></p> <p>Test of controls may be defined as an audit procedure designed to evaluate the <b>operating effectiveness of controls</b> in <b>preventing, or detecting and correcting</b>, material <b>misstatements</b> at the assertion level.</p> <p>The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:</p> <ul style="list-style-type: none"> <li>• He expects that the <b>controls</b> are <b>operating effectively</b>, or</li> <li>• <b>Substantive procedures alone cannot provide sufficient appropriate audit evidence</b> at the assertion level.</li> </ul> <p>A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.</p>
Q4.	<p>Discuss the various points which auditor needs to consider in determining whether it is appropriate to use audit evidence about operating effectiveness of controls obtained in previous audit, and if so, the length of the time period that may elapse before retesting. <b>(SA, Nov 2019, 4 Marks) (MTP2, May 2023, 4 marks)</b></p>

	<p>In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:</p> <ul style="list-style-type: none"> <li>• The effectiveness of <b>other elements of internal control</b>, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;</li> <li>• The risks arising from the <b>characteristics</b> of the <b>control</b>, including whether it is manual or automated;</li> <li>• The effectiveness of <b>general IT-controls</b>;</li> <li>• The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in <b>previous audits</b>, and whether there have been personnel changes that significantly affects the application of the control;</li> <li>• Whether the lack of a change in a particular control poses a risk due to <b>changing circumstances</b>; and</li> <li>• The <b>risks</b> of material misstatement and the extent of <b>reliance</b> on the control</li> </ul>
Q5.	<p>When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Discuss the matters the auditor may consider in determining the extent of test of controls. (RTP, Nov 2020, NA)</p> <p>When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of test of controls include the following:</p> <ul style="list-style-type: none"> <li>• The <b>frequency</b> of the performance of the control by the entity during the period.</li> <li>• The <b>length of time</b> during the audit period that the auditor is relying on the operating effectiveness of the control.</li> <li>• The <b>expected rate of deviation</b> from a control.</li> <li>• The <b>relevance</b> and <b>reliability</b> of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.</li> <li>• The <b>extent to which audit evidence is obtained</b> from tests of other controls related to the assertion</li> </ul>

## Tests of Details

Q6.	<p>Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. Analyse and explain. (RTP, Nov 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>"A multinational co. wants to appoint you to carry the statutory audit." Discuss with reference to SA 330 the substantive procedures to be performed to assess the risk of material misstatement. (SA, Nov 2018, 6 Marks)</p> <p><b>Substantive procedures to be performed to assess the risk of material misstatement:</b></p> <ul style="list-style-type: none"> <li>• Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.</li> <li>• Depending on the <b>circumstances</b>, the auditor may determine that: <ul style="list-style-type: none"> <li>○ Performing <b>only</b> substantive <b>analytical procedures</b> will be <b>sufficient</b> to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.</li> <li>○ <b>Only tests of details</b> are appropriate.</li> <li>○ A <b>combination</b> of substantive analytical procedures and tests of details are most responsive to the assessed risks.</li> </ul> </li> <li>• Substantive analytical procedures are generally <b>more applicable</b> to <b>large volumes</b> of transactions that tend to be predictable over time.</li> <li>• The <b>nature</b> of the <b>risk</b> and <b>assertion</b> is relevant to the design of tests of details. <ul style="list-style-type: none"> <li>○ For example, tests of details related to the <b>existence or occurrence assertion</b> may involve selecting from items <b>contained in a financial statement amount and obtaining the relevant audit evidence</b>.</li> <li>○ On the other hand, tests of details related to the <b>completeness assertion</b> may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.</li> </ul> </li> <li>• Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from <b>tests of controls are unsatisfactory</b>.</li> </ul>
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- In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

## Internal Financial Controls as per Regulatory Requirements

Q7.	<p>Explain the meaning of internal financial controls as per the Companies Act, 2013. Also explain its objectives. (MTP2, Nov 2021, 4 Marks)</p> <p>Section 134(5)(e) explains the meaning of internal financial controls as, “the <b>policies</b> and <b>procedures</b> adopted by the company for ensuring the <b>orderly</b> and <b>efficient conduct</b> of its business, including adherence to company’s policies, the <b>safeguarding</b> of its <b>assets</b>, the <b>prevention</b> and <b>detection</b> of frauds and errors, the <b>accuracy</b> and <b>completeness</b> of the accounting records, and the <b>timely</b> preparation of <b>reliable</b> financial <b>information</b>.”</p> <p>From the above definition, it is clear that internal financial controls are the policies and procedures adopted by the company for:</p> <ul style="list-style-type: none"> <li>• ensuring the <b>orderly</b> and <b>efficient conduct</b> of its business, including adherence to company’s policies,</li> <li>• the <b>safeguarding</b> of its <b>assets</b>,</li> <li>• the <b>prevention</b> and <b>detection</b> of frauds and errors,</li> <li>• the <b>accuracy</b> and <b>completeness</b> of the accounting records, and</li> <li>• the <b>timely</b> preparation of <b>reliable</b> financial <b>information</b>.</li> </ul>
Q8.	<p>Explain the meaning of Internal Financial Controls clearly stating reporting requirement (with reference to audit) on adequacy of internal financial controls. Also discuss about its (reporting requirement on adequacy of internal financial controls) applicability on various types of Companies. (RTP, May 2022, NA)</p> <p>Section 134(5)(e) explains the meaning of internal financial controls as, “the <b>policies</b> and <b>procedures</b> adopted by the company for ensuring the <b>orderly</b> and <b>efficient conduct</b> of its business, including adherence to company’s policies, the <b>safeguarding</b> of its <b>assets</b>, the <b>prevention</b> and <b>detection</b> of frauds and errors, the <b>accuracy</b> and <b>completeness</b> of the accounting records, and the <b>timely</b> preparation of <b>reliable</b> financial <b>information</b>.”</p> <p>Section 143(3)(i) of the Companies Act 2013 requires an auditor to <b>report</b> whether the <b>company</b> has <b>adequate internal financial controls with reference to financial statements</b> in place and the <b>operating effectiveness</b> of such controls.</p> <p>However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall <b>not</b> be applicable to a private company which is a–</p> <ul style="list-style-type: none"> <li>• <b>One person</b> company; or <b>Small</b> company; or</li> <li>• Company having <b>turnover less than ₹ 50 crore</b> as per latest audited financial statement and having aggregate <b>borrowings</b> from banks or financial institutions or anybody corporate at <b>any</b> point of time during the financial year <b>less than ₹ 25 crore</b>.</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Correct.</b> Tests of Control are performed to obtain audit evidence about the <b>effectiveness</b> of:</p> <ul style="list-style-type: none"> <li>• the design of the accounting and internal control systems that is whether, they are suitably designed to <b>prevent</b> or <b>detect</b> or <b>correct</b> material misstatements and</li> <li>• the <b>operation</b> of the internal controls <b>throughout</b> the period.</li> </ul>
Q2.	<p>Inquiry alone is sufficient to test the operating effectiveness of controls. (ICAI Study Material - Test Your Knowledge) (SA, May 2018, 2 Marks)</p> <p><b>Incorrect.</b> <b>Inquiry alone is not sufficient</b> to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry.</p>

	Inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.
Q3.	When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk. (RTP, Nov 2018, NA) (RTP, May 2019, NA)
	<b>Incorrect.</b> When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall <b>perform substantive procedures</b> that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall <b>include tests of details</b> .
Q4.	'Test of Control' may be defined as an audit procedure designed to detect material misstatements at the assertion level. (MTP1, Nov 2019, 2 Marks)
	<b>Incorrect.</b> <b>Substantive procedure</b> may be defined as an audit procedure designed to detect material misstatements at the assertion level whereas ' <b>tests of controls</b> ' is an audit procedure designed to evaluate the <b>operating effectiveness</b> of controls in <b>preventing</b> , or <b>detecting</b> and <b>correcting</b> , material misstatements at the assertion level.
Q5.	The auditor's reporting on internal financial control will be applicable with respect to interim financial statements. (SA, Nov 2019, 2 marks) (MTP2, May 2023, 2 marks)
	<b>Incorrect.</b> <b>Section 143(3)(i)</b> of the Companies Act 2013 requires the auditors' report to state whether the company has <b>adequate internal financial controls</b> with reference to FS in place and the <b>operating effectiveness</b> of such controls. It may be noted that auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in <b>case of reporting on financial statements</b> prepared under the Act and reported under Section 143. Accordingly, reporting on internal financial controls will <b>not be applicable with respect to interim financial statements</b> , such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

### Part III: Multiple Choice Questions

Q1.	Who is responsible for maintaining effective internal financial controls? (a) Statutory auditor (b) Audit Committee (c) Management (d) Shareholders (ICAI Study Material - Test Your Knowledge)
	<b>Correct answer:</b> (c) Management <b>Explanation:</b> The directors and management have primary responsibility of implementing and maintaining an effective internal controls framework and auditors are expected to evaluate, validate and report on the design and operating effectiveness of internal financial controls
Q2.	Because the assessment of the risk of material misstatement takes account of internal control, (a) the extent of substantive procedures may need to be increased irrespective of the results from tests of controls. (b) the extent of substantive procedures may need to be increased when the results from tests of controls are satisfactory. (c) the extent of substantive procedures may need to be decreased when the results from tests of controls are unsatisfactory. (d) the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. (Sample MCQs) (ICAI MCQs)
	<b>Correct answer:</b> (d) the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory
Q3.	When deviations from controls upon which the auditor intends to rely are detected,

	<p>(a) the auditor shall not make any inquiries to understand these matters and their potential consequences</p> <p>(b) the auditor shall make specific inquiries to understand these matters and their potential consequences</p> <p>(c) the auditor shall make general inquiries to understand these matters and their potential consequences</p> <p>(d) the auditor shall make both general as well as specific inquiries to understand these matters and their potential consequences</p> <p><b>(Sample MCQs) (ICAI MCQs) (RTP, Nov 2019, NA)</b></p>
	<p><b>Correct answer:</b> (b) the auditor shall make specific inquiries to understand these matters and their potential consequences</p>
Q4.	<p>When more persuasive audit evidence is needed regarding the effectiveness of a control,</p> <p>(a) it may be appropriate to increase the extent of testing of the control and reduce the extent of the degree of reliance on controls</p> <p>(b) it may be appropriate to decrease the extent of testing of the control as well as the degree of reliance on controls.</p> <p>(c) it may be appropriate to decrease the extent of testing of the control and increase the extent of the degree of reliance on controls.</p> <p>(d) it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.</p> <p><b>(Sample MCQs) (RTP, Nov 2019, NA)</b></p>
	<p><b>Correct answer:</b> (d) it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls</p>
Q5.	<p>Who is mainly responsible for implementation of internal financial controls in a company?</p> <p>(a) Auditors</p> <p>(b) Directors</p> <p>(c) Employees</p> <p>(d) Regulators</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (b) Directors</p> <p><b>Explanation:</b> The directors and management have primary responsibility of implementing and maintaining an effective internal controls framework and auditors are expected to evaluate, validate and report on the design and operating effectiveness of internal financial controls</p>
Q6.	<p>The Guidance Note on Audit of Internal Financial Controls over Financial Reporting has been issued by?</p> <p>(a) ICAI</p> <p>(b) SEBI</p> <p>(c) MCA</p> <p>(d) RBI</p> <p><b>(ICAI MCQs) (MTP1, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (a) ICAI</p>
Q7.	<p>Who among the following is required to comply with Section 149(8) read with Schedule IV to the companies Act,2013?</p> <p>(a) Board of Directors</p> <p>(b) Audit Committee</p> <p>(c) Statutory Auditor</p> <p>(d) Independent Directors</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) Independent Directors</p> <p><b>Explanation:</b> As per Section 149(8) of the Act, the company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for Independent Directors. As per this code , the role and functions of Independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible</p>

Q8.	<p>The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring:</p> <ul style="list-style-type: none"> <li>(a) reliability of financial reporting</li> <li>(b) effectiveness and efficiency of operations</li> <li>(c) compliance with applicable laws and regulations</li> <li>(d) All of the above</li> </ul> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) All of the above</p>
Q9.	<p>The company and _____ shall abide by the provisions specified in Schedule IV which lays down the Code for Independent Directors</p> <ul style="list-style-type: none"> <li>(a) independent directors</li> <li>(b) women directors</li> <li>(c) board of directors</li> <li>(d) executive directors</li> </ul> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (a) independent directors</p> <p><b>Explanation:</b> As per Section 149(8) of the Act, the company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for Independent Directors. As per this code, the role and functions of Independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible</p>
Q10.	<p>In designing and performing test of controls, the auditor shall perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:</p> <ul style="list-style-type: none"> <li>(i) How the controls were applied at relevant times during the period under audit.</li> <li>(ii) The consistency with which they were applied.</li> <li>(iii) By whom or by what means they were applied.</li> </ul> <p>Which of the following is correct?</p> <ul style="list-style-type: none"> <li>(a) (i) and (ii)</li> <li>(b) (ii) and (iii)</li> <li>(c) (i),(ii) and (iii)</li> <li>(d) (i) and (iii)</li> </ul> <p><b>(ICAI MCQs) (MTP1, May 2022, 1 mark)</b></p>
	<p><b>Correct answer:</b> (c) (i),(ii) and (iii)</p>
Q11.	<p>Statement 1: Audit procedures consist of Risk Assessments Procedures and other procedures.</p> <p>Statement 2: Substantive procedures consist of test of details and analytical procedures.</p> <ul style="list-style-type: none"> <li>(a) Only Statement 1 is correct</li> <li>(b) Only Statement 2 is correct</li> <li>(c) Both 1 &amp; 2 are correct</li> <li>(d) Both 1 &amp; 2 are incorrect</li> </ul> <p><b>(RTP, May 2020, NA) (MTP1, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (c) Both 1 &amp; 2 are correct</p>
Q12.	<p>The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring:</p> <ul style="list-style-type: none"> <li>(i) Reliability of financial reporting</li> <li>(ii) Compliance with applicable laws and regulations</li> <li>(iii) Safeguarding of assets.</li> <li>(iv) Effectiveness and efficiency of operations</li> <li>(v) Prevention and detection of frauds</li> </ul>



	<p>Which statement is correct?</p> <p>(a) (i),(ii)and (iv)</p> <p>(b) (i),(iii) (v) and(ii)</p> <p>(c) (i),(ii),(iii) and (iv)</p> <p>(d) (i), (ii),(iii),(iv)and (v)</p> <p><b>(MTP1, Nov 2023, 1 mark)</b></p>
	<p><b>Correct answer:</b> (d) (i), (ii),(iii),(iv)and (v)</p> <p><b>Explanation:</b> The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring: Reliability of financial reporting, Effectiveness and efficiency of operations, Compliance with applicable laws and regulations, Safeguarding of assets, Prevention and detection of frauds</p>
Q13.	<p>Financial statements of a company have been put up for audit before the auditor. On going through financial statements, he wants to verify some major bills debited in "Machinery repair" account. The purpose of it is to ensure that bills are entered correctly and their classification is proper. As regards verification of bills debited in "Machinery repair" account, identify what he intends to perform?</p> <p>(a) Tests of Controls</p> <p>(b) Tests of transactions</p> <p>(c) Tests of balances</p> <p>(d) Risk assessment procedures</p> <p><b>(MTP1, Nov 2023, 1 mark)</b></p>
	<p><b>Correct answer:</b> (b) Tests of transactions</p> <p><b>Explanation:</b> Tests of details are further classified into tests of transactions i.e., vouching and tests of balances i.e., verification. For example, a purchase transaction may be verified by examining the related purchase invoice, goods received note, inward gate entry register. Such tests of transactions help in establishing the authenticity of transactions recorded in books of accounts</p>

## Chapter 3C - Materiality

### Part I : Descriptive Questions

#### What is meant by materiality?

Q1.	<p>CA A. Raja is auditor of Build Well Forgings Private Limited having a revenue of ₹ 25 crore. The company has been sanctioned a term loan of ₹ 50 lacs from a bank. However, as at end of the year, only ₹ 1 lac was availed due to delay in procurement of asset. The financial statements of the company do not disclose nature of security against which loan has been taken. Schedule III of Companies Act, 2013 requires disclosure in this respect. Discuss, whether, non-disclosure of nature of security is material for auditor (<b>ICAI Study Material - Test Your Understanding</b>)</p> <p>If there is any statutory requirement of disclosure, it is to be considered material. Schedule III <b>mandates disclosure</b> of <b>nature</b> of <b>security</b> in relation to loan. The amount involved is irrelevant</p>
Q2.	<p>One of the team members of auditors of Highly Capable Limited was of the view that Materiality and Audit Risk are only considered at planning stage of an audit. Comment as an auditor (<b>ICAI Study Material - Illustration</b>)</p> <p>The concept of materiality is applied by the auditor <b>both</b> in <b>planning</b> and <b>performing</b> the <b>audit</b>, and in <b>evaluating</b> the effect of <b>identified misstatements</b> on the audit and of <b>uncorrected misstatements</b>, if any, on the financial statements and in forming the opinion in the auditor's report.</p>
Q3.	<p>Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain (<b>RTP, May 2021, NA</b>)</p> <p>Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:</p> <ol style="list-style-type: none"> <li>1. <b>Misstatements</b>, including omissions, are considered to be material if they, individually or in the aggregate, could <b>reasonably be expected</b> to <b>influence</b> the <b>economic decisions</b> of <b>users</b> taken on the basis of the <b>financial statements</b>;</li> <li>2. Judgments about materiality are made in the light of <b>surrounding circumstances</b>, and are affected by the <b>size</b> or <b>nature</b> of a misstatement, or a combination of both; and</li> <li>3. Judgments about matters that are material to users of the financial statements are based on a consideration of the <b>common financial information needs</b> of <b>users</b> as a <b>group</b>. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.</li> </ol>
Q4.	<p>What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. Explain. (<b>RTP, Nov 2021, NA</b>)</p> <ul style="list-style-type: none"> <li>• <b>SA 320</b> on "Materiality in Planning and Performing an Audit" requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit. When planning the audit, the auditor considers what would make the financial information materially misstated.</li> <li>• The auditor's preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to <b>examine</b> and whether to use <b>sampling</b> and <b>analytical procedures</b>. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit <b>opinion</b> at an acceptably <b>low</b> degree of audit <b>risk</b>.</li> <li>• It may be noted that the auditor's assessment of materiality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures. At the planning stage, the auditor needs to consider the materiality for the financial statements as a whole. The auditor has to carry out a <b>preliminary identification</b> of significant components and material classes of transactions, account balances and disclosure which he plans to examine.</li> <li>• What could be considered material for all situations <b>cannot be defined precisely</b> and an amount or transaction material in one situation may not be material in other situation. For example, ₹ 5,000 may be material for a small entity, but even ₹ 100,000 may not be material for a large entity</li> </ul>
Q5.	<p>While conducting the audit of Smart TV Ltd, engagement team of HTR &amp; Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk. (<b>RTP, May 2022, NA</b>)</p>

Audit risk is the risk that the auditor expresses an **inappropriate** audit **opinion** when the financial statements are **materially misstated**. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- **Identifying** and **assessing** the **risks** of material misstatement;
- Determining the nature, timing and extent of **further audit procedures**; and
- Evaluating the effect of **uncorrected misstatements**, if any, on the financial statements and in forming the opinion in the auditor's report.

## Determination of materiality- a matter of professional judgment

- Q6. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, explain the auditor's assumptions about users of the financial statements. (RTP, May 2021, NA)
- The auditor's determination of materiality is a matter of **professional judgment**, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:
- Have a **reasonable knowledge** of **business** and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
  - **Understand** that financial statements are **prepared, presented** and **audited to levels of materiality**;
  - Recognize the **uncertainties** inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
  - Make **reasonable economic decisions** on the basis of the information in the financial statements.

## Benchmarking

- Q7. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Discuss stating the factors that may affect the identification of an appropriate benchmark (RTP, May 2018, NA)
- OR**
- With Ref. to SA 320 "Materiality in planning and performing an audit" Indicate the factors which may effect the identification of an appropriate benchmark while determining materiality for the financial statements as a whole. (SA, Nov 2020, 4 Marks)
- OR**
- You are being appointed as the auditor of Track Ltd. for the first time. You want to determine the materiality level and for that you have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of an appropriate benchmark? (RTP, May 2022, NA)
- OR**
- An auditor has to exercise professional judgement in determining materiality. Explain the factors that may affect the identification of an appropriate benchmark in determining materiality for the financial statements as whole. (SA, May 2023, 3 marks)
- Determining materiality involves the exercise of **professional judgment**. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:
- The **elements** of the **financial statements**. Example - assets, liabilities, equity, revenue, expenses;
  - Whether there are items on which the **attention** of the **users** of the particular entity's financial statements tends to be focused Example - for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets.
  - The **nature** of the entity, where the entity is at in its **life cycle**, and the industry and economic environment in which the entity operates;
  - The entity's **ownership structure** and the way it is financed and Example- if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings);
  - The relative **volatility** of the **benchmark**.

## Revision of Materiality

Q8.	Materiality for the financial statements as a whole may need to be revised as a result of a change in circumstances that occurred during the audit. Explain with the help of example. (MTP1, Nov 2019, 3 Marks)
	<p><b>Revision in Materiality level as the Audit Progresses:</b></p> <ul style="list-style-type: none"> <li>Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a <ul style="list-style-type: none"> <li>change in <b>circumstances</b> that occurred during the audit (for example, a decision to dispose of a major part of the entity's business),</li> <li><b>new information</b>, or</li> <li><b>change</b> in the <b>auditor's understanding</b> of the entity and its operations as a result of performing further audit procedures.</li> </ul> </li> <li>If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.</li> <li>If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is <b>necessary to revise performance materiality</b>, and whether the nature, timing and extent of the <b>further audit procedures</b> remain appropriate.</li> </ul>

## Documenting the Materiality

Q9.	Is materiality required to be documented by the auditor? What factors have to be considered this regard? (ICAI Study Material - Test Your Knowledge)
	<p>The audit documentation shall include the following amounts and the factors considered in their determination:</p> <ol style="list-style-type: none"> <li><b>Materiality</b> for the financial statements as a whole</li> <li>If applicable, the <b>materiality level</b> or levels for particular classes of transactions, account balances or disclosures</li> <li><b>Performance materiality</b> and</li> <li>Any <b>revision</b> of (a)-(c) as the audit progressed</li> </ol>

## Part II: Correct/Incorrect Questions

Q1.	There is a direct relationship between materiality and the degree of audit risk. (ICAI Study Material - Test Your Knowledge) (RTP, May 2018, NA)
	<p><b>Incorrect.</b> There is an <b>inverse</b> relationship between <b>materiality</b> and the degree of <b>audit risk</b>. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.</p>
Q2.	Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular class of transactions, account balances or disclosures) does not need any revision. (MTP2, May 2018, 2 Marks)
	<p><b>Incorrect.</b> Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of</p> <ul style="list-style-type: none"> <li>a change in <b>circumstances</b> that occurred during the audit (for example, a decision to dispose of a major part of the entity's business),</li> <li><b>new information</b>, or</li> <li>a <b>change</b> in the <b>auditor's understanding</b> of the entity and its operations as a result of performing further audit procedures</li> </ul>
Q3.	Determining materiality involves the exercise of professional judgement. (SA, Jan 2021, 2 Marks)
	<p><b>Correct.</b> Determining materiality involves the exercise of <b>professional judgment</b>. A percentage is often applied to a chosen</p>

	benchmark as a starting point in determining materiality for the financial statements as a whole.
Q4.	When establishing the overall audit strategy, the auditor need not determine materiality for the financial statements as a whole. (RTP, May 2021, NA)
	<b>Incorrect.</b> When establishing the overall audit strategy, the auditor shall <b>determine materiality</b> for the financial statements as a whole.
Q5.	The concept of materiality is an important and relevant consideration for the auditor in financial statement. (MTP1, Nov 2021, 2 Marks) (MTP1, Nov 2022, 2 Marks)
	<b>Correct.</b> The concept of materiality is <b>fundamental</b> to the process of <b>accounting</b> . It covers <b>all</b> the <b>stages</b> from recording to classification and presentation. It is very important for the auditor who has to constantly judge whether a particular item is <b>material</b> or not and ensure that a material item is disclosed <b>separately</b> and distinctly.
Q6.	When profit before tax from continuing operations is non-volatile, other benchmarks will be appropriate (SA, Dec 2021, 2 marks)
	<b>Incorrect.</b> Profit before tax from continuing operations is often used for <b>profit-oriented entities</b> . When profit before tax from continuing operations is volatile, <b>other benchmarks</b> may be more <b>appropriate</b> , such as <b>gross profit or total revenues</b> .
Q7.	Materiality is not a matter of size. (SA, May 2022, 2 Marks) (MTP2, May 2023, 2 marks)
	<b>Incorrect.</b> Financial statements should disclose <b>all 'material items'</b> , i.e., the items the knowledge of which might influence the <b>decisions</b> of the <b>user</b> of the financial statement. Materiality is <b>not always a matter of relative size</b> . For example -a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future. In certain cases, quantitative limits of materiality are specified.
Q8.	If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality. (MTP2, Nov 2022, 2 Marks)
	<b>Correct.</b> Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in <b>circumstances</b> that occurred during the audit, <b>new information</b> , or a <b>change</b> in the <b>auditor's understanding</b> of the entity and its operations as a result of performing further audit procedures.
Q9.	A company should disclose in its Annual Report, the shares in the company held by each shareholder holding more than 10 percent shares specifying the number of shares held. (SA, Nov 2022, 2 marks)
	<b>Incorrect.</b> Schedule III to the Companies Act, 2013 requires the company to disclose- "shares in the company held by each shareholder holding <b>more than 5%</b> shares specifying the number of shares held" in notes to accounts

### Part III: Multiple Choice Questions

Q1.	Which of the following is true regarding materiality? (a) It is unaffected by nature of an item. (b) It is unaffected by requirements of law or regulations. (c) It is not a matter of professional judgment. (d) It is not always a matter of relative size. (ICAI Study Material - Test Your Knowledge)
	<b>Correct answer:</b> (d) It is not always a matter of relative size. <b>Explanation:</b>

	<ul style="list-style-type: none"> <li>• If there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount. Hence, it is affected by requirements of law or regulations. It is also affected by the nature of an item.</li> <li>• The auditor's determination of materiality is a matter of professional judgment.</li> <li>• Materiality is not always a matter of relative size. For example, a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future.</li> </ul>
Q2.	<p>SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor</p> <p>(a) should not consider materiality and its relationship with audit risk while conducting an audit.</p> <p>(b) should consider materiality and its relationship with audit risk while conducting an audit.</p> <p>(c) should not consider materiality but should consider its relationship with audit risk while conducting an audit.</p> <p>(d) should consider materiality but need not consider its relationship with audit risk while conducting an audit.</p> <p><b>(Sample MCQs) (ICAI MCQs) (MTP1, May 2019, 1 Mark) (MTP1, May 2021, 2 Marks)</b></p> <p><b>Correct answer:</b> (b) should consider materiality and its relationship with audit risk while conducting an audit.</p> <p><b>Explanation:</b> Materiality and audit risk are considered throughout the audit, in particular, when identifying and assessing ROMM, determining NTE of further audit procedures; and evaluating the effect of uncorrected misstatements, if any, on the FS and in forming the opinion in the auditor's report</p>
Q3.	<p>Determining a percentage to be applied to a chosen benchmark (in relation to materiality) involves the exercise of _____</p> <p>(a) Independence</p> <p>(b) Professional Judgment</p> <p>(c) Professional skepticism</p> <p>(d) All of the above</p> <p><b>(Sample MCQs)(ICAI MCQs) (MTP2, May 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (b) Professional Judgment</p> <p><b>Explanation:</b> Determining materiality involves the exercise of professional judgment</p>
Q4.	<p>Which of the following is not an example of benchmarks in determining materiality for the Financial Statements as whole:</p> <p>(a) Profit before tax</p> <p>(b) total revenue</p> <p>(c) audit programme</p> <p>(d) total equity</p> <p><b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (c) audit programme</p> <p><b>Explanation:</b> Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value.</p>
Q5.	<p>The concept of materiality is applied by the auditor :</p> <p>(a) in planning and performing the audit</p> <p>(b) in evaluating the effect of identified misstatements on the audit</p> <p>(c) both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit</p> <p>(d) none of the above is correct</p> <p><b>(MTP1, Nov 2020, 2 Marks) (RTP, May 2021 NA) (MTP1, Nov 2022, 1 Mark)</b></p> <p><b>Correct answer:</b> (c) both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit</p> <p><b>Explanation:</b> The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report</p>

## Chapter 3D - Automated Environment

### Part I : Descriptive Questions

#### Meaning and Key features of an Automated Environment

Q1.	<p>Explain the meaning of an automated environment. Also discuss the key features of an automated environment. (RTP, May 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The fundamental principle of an automated environment is the ability to carry out business with less manual intervention. Explain. (MTP1, May 2019, 3 marks)</p> <hr/> <p><b>Meaning and Features of an Automated Environment</b></p> <ul style="list-style-type: none"> <li>• An automated environment refers to a business environment where the <b>processes, operations, accounting</b> and even <b>decisions</b> are carried out by using <b>computer</b> systems – also known as Information Systems (IS) or Information Technology (IT) systems.</li> <li>• The fundamental principle of an automated environment is the ability to <b>carry out business with less manual intervention and more system driven</b>.</li> <li>• The <b>complexity</b> of a business environment <b>depends</b> on the level of <b>automation</b> i.e., if a business environment is more automated, it is likely to be more complex.</li> <li>• For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.</li> </ul> <p><b>Key features of an automated environment are as follows:</b></p> <ul style="list-style-type: none"> <li>• <b>Faster</b> business operations</li> <li>• <b>Accuracy</b> in data processing and computation</li> <li>• Ability to process large <b>volumes</b> of transactions</li> <li>• <b>Integration</b> between business operations</li> <li>• Better <b>security</b> and <b>controls</b></li> <li>• Less prone to <b>human errors</b></li> <li>• Provides <b>latest</b> information</li> <li>• <b>Connectivity</b> and <b>Networking</b> capability</li> </ul>
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#### Understanding and documenting automated environment

Q2.	<p>Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls. Explain stating the points that an auditor should consider to obtain an understanding of the company's automated environment. (RTP, May 2018, NA) (MTP1, Nov 2019, 4 marks) (MTP1, Nov 2023, 3 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>In an audit of financial statements, an auditor is required to understand the entity and its business, including IT as per SA 315. Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls. Advise some of the points that an auditor should consider to obtain an understanding of the company's automated environment (MTP2, May 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain some of the points that an auditor should consider to obtain an understanding of the company's automated environment. (SA, May 2018, 5 Marks) (RTP, Nov 2019, NA) (MTP1, Nov 2021, 4 marks) (MTP1, May 2022, 4 Marks) (RTP, Nov 2022, NA) (RTP, Nov 2023, NA)</p> <hr/> <p><b>Understanding and Documenting Automated Environment:</b></p> <p>In an audit of financial statements, an auditor is required to understand the entity and its business, including IT as per SA 315. Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.</p>
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	<p>Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment</p> <ul style="list-style-type: none"> <li>• <b>Information systems</b> being used (one or more application systems and what they are)</li> <li>• their <b>purpose</b> (financial and non-financial)</li> <li>• <b>Location</b> of IT systems - local vs global</li> <li>• <b>Architecture</b> (desktop based, client-server, web application, cloud based)</li> <li>• <b>Version</b> (functions and risks could vary in different versions of same application)</li> <li>• <b>Interfaces</b> within systems (in case multiple systems exist)</li> <li>• <b>In-house vs Packaged</b></li> <li>• <b>Outsourced</b> activities (IT maintenance and support)</li> <li>• <b>Key persons</b> (CIO, CISO, Administrators)</li> </ul> <p>The understanding of a company's IT environment that is obtained should be documented</p>
Q3.	<p>When the company is working in an automated environment, it is not necessary for its auditor to understand its automated environment and depends upon the professional judgement of the auditor as to whether gaining knowledge of company's IT systems is required or not. Do you agree with this statement? <b>(SA, May 2022, 3 Marks)</b></p> <p>Statement given is <b>incorrect</b>. When the company is working in an automated environment, it is necessary for its auditor to understand its automated environment</p> <p>Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment</p> <ul style="list-style-type: none"> <li>• <b>Information systems</b> being used (one or more application systems and what they are)</li> <li>• their <b>purpose</b> (financial and non-financial)</li> <li>• <b>Location</b> of IT systems - local vs global</li> <li>• <b>Architecture</b> (desktop based, client-server, web application, cloud based)</li> <li>• <b>Version</b> (functions and risks could vary in different versions of same application)</li> <li>• <b>Interfaces</b> within systems (in case multiple systems exist)</li> <li>• <b>In-house vs Packaged</b></li> <li>• <b>Outsourced</b> activities (IT maintenance and support)</li> <li>• <b>Key persons</b> (CIO, CISO, Administrators)</li> </ul>

### Understanding the Risks that arise from the use of IT and IT Systems

Q4.	<p>The auditor should understand and consider the risks that may arise from the use of Information Technology (IT) Systems. <b>(SA, May 2018, 5 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should consider the risks that arise from the use of IT systems. Explain. <b>(MTP1, Nov 2018, 5 Marks) (RTP, Nov 2019, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Which are specific risks to the company's internal control having IT environment? <b>(SA, May 2019, 4 Marks) (RTP, Nov 2022, NA)</b></p> <p>Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems. Given below are some such risks that should be considered,</p> <ul style="list-style-type: none"> <li>• <b>Inaccurate processing of data, processing inaccurate data</b>, or both</li> <li>• <b>Unauthorized access</b> to data</li> <li>• <b>Direct data changes</b> (backend changes)</li> <li>• Excessive access / <b>Privileged</b> access (super users)</li> <li>• <b>Lack</b> of adequate <b>segregation</b> of <b>duties</b></li> <li>• <b>Unauthorized changes</b> to systems or programs</li> <li>• <b>Failure</b> to make <b>necessary changes</b> to systems or programs</li> <li>• <b>Loss of data</b></li> </ul>
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Q5.	<p>Discuss the impact of IT related risks on Substantive Audit, Controls and Reporting (<b>RTP, May 2018, NA</b>)</p> <p style="text-align: center;"><b>OR</b></p> <p>Describe how risks in the IT system if not mitigated could have an impact on the audit.  <b>(SA, Nov 2020, 3 marks) (RTP, Nov 2021, NA) (MTP2, Nov 2021, 3 marks) (MTP1, Nov 2022, 3 Marks) (MTP1, May 2023, 3 marks)</b></p>
	<p><b>Impact of IT related risks:</b></p> <p><b>Impact on substantive checking</b>  The auditor may <b>not</b> be able to <b>rely</b> on the <b>reports, data</b> obtained from systems where such risk exists. This means all forms of data, information or reports that the auditor obtains from the system for the purpose of audit has to be thoroughly tested and corroborated for <b>completeness</b> and <b>accuracy</b>. It could lead to increased substantive checking i.e., detailed checking.</p> <p><b>Impact on controls</b>  It can lead to <b>non-reliance</b> on automated <b>controls</b>, system <b>calculations</b> and accounting <b>procedures</b> built into applications. It may result in <b>additional</b> audit <b>work</b>.</p> <p><b>Impact on reporting</b>  Due to <b>regulatory requirements</b> in respect of <b>internal financial controls</b> in case of companies, it may lead to <b>modification</b> of auditor's report in some instances</p>

## Types of Controls in an Automated Environment

Q6.	<p>Discuss relationship between "General IT controls" and "application controls" in an automated environment.  <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>General IT Controls vs. Application Controls:</b></p> <ul style="list-style-type: none"> <li>• These two categories of control over IT systems are <b>interrelated</b>.</li> <li>• The relationship between the application controls and the General IT Controls is such that <b>General IT Controls are needed to support the functioning of application controls</b>, and both are needed to ensure complete and accurate information processing through IT systems.</li> </ul>
Q7.	<p>Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives. Discuss the activities performed by Data Center and Network operations. Also explain the meaning of General IT Controls in detail. (<b>RTP, May 2021, NA</b>)</p> <p>General IT controls are policies and procedures that relate to many applications and support the <b>effective functioning</b> of <b>application controls</b>. They apply to mainframe, miniframe, and end-user environments. General IT-controls that maintain the <b>integrity</b> of information and security of data commonly include controls over the following:</p> <ol style="list-style-type: none"> <li>Data center and network operations</li> <li>Program change</li> <li>Access security</li> <li>Application system acquisition, development, and maintenance (Business Applications)</li> </ol> <p>These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.</p> <p><b>Data Center and Network Operations</b>  <b>Objective:</b> To ensure that <b>production systems</b> are <b>processed</b> to <b>meet financial reporting objectives</b></p> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>• overall management of computer operation activities,</li> <li>• preparing, scheduling and executing of batch jobs,</li> <li>• monitoring, storage and retention of backups.</li> <li>• Such controls also help in performance monitoring of operating system, database and networks.</li> </ul>

	<ul style="list-style-type: none"> <li>Matters such as BCP (Business continuity plan) and DRP (Disaster recovery plan) which deal with recovery from failures are also taken care of by such type of controls</li> </ul>
Q8.	<p>Explain the objective and enlist the activities involved in the General IT Controls over "Program Change" (MTP2, Nov 2022, 3 Marks)</p> <p><b>Program Change</b>  <b>Objective:</b> To ensure that <b>modified systems continue to meet financial reporting objectives.</b></p> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>change management process,</li> <li>recording, managing and tracking change requests,</li> <li>making and testing changes</li> </ul>
Q9.	<p>In an automated environment, General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. One such area is access security. What is the objective of access security and what are the activities included in it? (SA, Nov 2022, 3 marks)</p> <p><b>Access Security in Automated Environment:</b>  <b>Objective of access security:</b> The objective of Access Security is to ensure that <b>access</b> to programs and data is <b>authenticated</b> and <b>authorized</b> to meet financial reporting objectives.</p> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>security organization &amp; management,</li> <li>security policies &amp; procedures,</li> <li>application security,</li> <li>data security,</li> <li>operating system security,</li> <li>network security,</li> <li>physical security</li> </ul>

## Testing methods

Q10.	<p>Discuss the different ways testing is performed in an automated environment (MTP1, May 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. However, which audit test to use, when and in what combination is a matter of professional judgement. Discuss stating the different ways testing is performed in an automated environment. (MTP2, Nov 2018, 5 Marks)</p> <p><b>The following are different ways testing is performed in an automated environment :</b></p> <p>There are basically four types of audit tests that should be used- <b>inquiry, observation, inspection</b> and <b>reperformance</b>. <b>Inquiry</b> is the <b>most efficient</b> audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. <b>Inquiry alone is not sufficient.</b></p> <p><b>Reperformance</b> is <b>most effective</b> as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time.</p> <p>Generally, applying <b>inquiry in combination with inspection gives the most effective and efficient audit evidence.</b></p> <p>Which audit test to use, when and in what combination is a matter of <b>professional judgment</b> and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed, etc.</p>
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	<p>The auditor should <b>document</b> the nature of test (or combination of tests) applied along with the judgements in the audit file as required by SA 230.</p> <p>When testing in an automated environment, some of the more common methods are as follows:</p> <ul style="list-style-type: none"> <li>• Obtain an <b>understanding</b> of how an automated <b>transaction</b> is <b>processed</b> by doing a <b>walkthrough</b> of one end-to-end transaction using a combination of inquiry, observation and inspection.</li> <li>• Observe how a <b>user processes</b> transactions under <b>different scenarios</b>.</li> <li>• Inspect the <b>configuration</b> defined in an application</li> </ul>
Q11.	<p>Explain some of the commonly used methods for testing in an automated environment.(RTP, May 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Discuss the common methods applied by the auditor when testing in an automated environment is done by him (SA, Jan 2021, 4 marks)</p> <p>When testing in an automated environment, some of the more common methods are as follows:</p> <ul style="list-style-type: none"> <li>• Obtain an <b>understanding</b> of how an automated <b>transaction</b> is <b>processed</b> by doing a <b>walkthrough</b> of one end-to-end transaction using a combination of inquiry, observation and inspection.</li> <li>• Observe how a <b>user processes</b> transactions under <b>different scenarios</b>.</li> <li>• Inspect the <b>configuration</b> defined in an application.</li> </ul>

### Audit Approach in an Automated Environment

Q12.	<p>The directors and management have primary responsibility of implementing and maintaining an effective internal controls framework and auditors are expected to evaluate, validate and report on the design and operating effectiveness of internal financial controls. Explain the framework which helps the auditors in fulfilling this responsibility (Old ICAI Study Material)</p> <p>The Guidance note on Audit of Internal Financial Controls over Financial Reporting issued by the Institute of Chartered Accountants of India provides a framework that auditors should follow to fulfill their responsibility. The below is a summary of this controls based audit approach :-</p> <ul style="list-style-type: none"> <li>• <b>Risk Assessment</b> <ul style="list-style-type: none"> <li>○ Identify <b>significant accounts</b> and <b>disclosures</b></li> <li>○ <b>Qualitative</b> and <b>Quantitative</b> considerations</li> <li>○ Relevant Financial Statement <b>Assertions</b></li> <li>○ Identify likely <b>sources</b> of misstatement</li> <li>○ Consider <b>risk</b> arising from use of IT systems</li> </ul> </li> <li>• <b>Understand and Evaluate</b> <ul style="list-style-type: none"> <li>○ <b>Document</b> understanding of business processes using Flowcharts/ Narratives</li> <li>○ Prepare <b>Risk and Control Matrices</b> (RCM)</li> <li>○ <b>Understand</b> design of <b>controls</b> by performing walkthroughs of end-to-end process</li> <li>○ Process wide considerations for Entity Level Controls, <b>Segregation of Duties</b></li> <li>○ <b>IT General Controls, Application Controls</b></li> </ul> </li> <li>• <b>Test for Operating Effectiveness</b> <ul style="list-style-type: none"> <li>○ Assess <b>NTE</b> of <b>controls testing</b></li> <li>○ Assess <b>reliability</b> of <b>source data</b>; completeness of population</li> <li>○ <b>Testing</b> of key <b>reports</b> and <b>spreadsheets</b></li> <li>○ <b>Sample testing</b></li> <li>○ Consider <b>competence</b> and <b>independence</b> of staff/team performing controls testing</li> </ul> </li> <li>• <b>Reporting</b> <ul style="list-style-type: none"> <li>○ <b>Evaluate</b> Control <b>Deficiencies</b></li> <li>○ <b>Significant deficiencies</b>, Material Weaknesses</li> <li>○ <b>Remediation</b> of control weaknesses</li> <li>○ <b>Internal Controls Memo</b> (ICM) or Management Letter</li> </ul> </li> </ul>
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○ Auditor's report

## Data Analytics

- Q13. A company functions in an automated environment. Discuss in what areas data analytics can be useful for auditor of the company (**ICAI Study Material - Test Your Knowledge**)
- OR**
- In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. Explain stating uses of Data analytics. (**RTP, Nov 2018, NA**) (**MTP2, May 2019, 4 marks**)
- OR**
- While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc., analyse various functions that can be performed even by the auditor also using Data Analytics tools and techniques in the audit process to obtain good results (**SA, Nov 2020, 4 marks**) (**MTP1, Nov 2023, 3 marks**)
- OR**
- Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform check completeness of data and population that is used in either test of controls or substantive audit tests. Explain in detail stating all the relevant points. (**RTP, May 2020, NA**)
- OR**
- Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform Fraud investigation. Explain the other relevant points in the above context i.e. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform. (**MTP1, Nov 2020, 4 marks**)
- OR**
- Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the selection of audit samples. Explain giving other relevant points also in the above context of data analytics (**RTP, May 2021, NA**)
- OR**
- While auditing in an automated environment how data analytics can be used in testing electronic records and data residing in IT systems using spread sheets and specialised audit tools? (**SA, May 2023, 3 marks**)
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- In today's digital age when companies rely more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. A famous businessman recently said, "Data is the new Oil".
- Data analytics is the **combination** of **processes, tools** and **techniques** that are used to **tap vast amounts** of electronic **data** to **obtain meaningful information**. The companies can benefit immensely from the use of data analytics in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc., even auditors can make use of similar tools and techniques in the audit process and obtain good results.
- The tools and techniques that auditors use in applying the principles of data analytics are known as **Computer Assisted Auditing Techniques** (CAATs)
- Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform the following,
- check **completeness** of data and population that is used in either test of controls or substantive audit tests
  - **selection** of audit **samples** – random sampling, systematic sampling
  - **re-computation** of balances – reconstruction of trial balance from transaction data
  - **reperformance** of mathematical calculations – depreciation, bank interest calculation.
  - **analysis** of **journal entries** as required by SA 240
  - **fraud** investigation
  - evaluating impact of **control deficiencies**

## Assess and Report Audit Findings

Q14.	<p>Foreceful Limited is a company dealing in mobile spare parts and having its showrooms in almost all the states in the country. For FY 2023-24, the company transferred its accounts from manual to computerized system (SAP). PQR &amp; Co., Chartered Accountants have specialization in the system audit and have been appointed as the system auditor. PQR &amp; Co., at the end of the audit concludes that there are certain findings or exceptions in IT environment and IT controls of the company which needs to be assessed and reported. Mention those points of consideration (SA, July 2021, 3 marks) (MTP2, May 2023, 3 marks)</p>
	<p style="text-align: center;"><b>OR</b></p> <p>The Auditor of HK Limited completed the audit of the company in an automated environment. Management of the company requested the auditor to give an idea about any exceptions observed in IT environment that need to be assessed. How the auditor should consider this request and report in light of an audit perspective? (SA, May 2022, 3 Marks)</p>
	<p>At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including <b>management</b> and <b>those charged with governance</b> viz., Board of directors, Audit committee.</p> <p>Some points to consider are as follows:</p> <ul style="list-style-type: none"> <li>• Are there any <b>weaknesses</b> in IT controls?</li> <li>• What is the <b>impact</b> of these weaknesses on overall audit?</li> <li>• <b>Report deficiencies to management</b> – Internal Controls Memo or Management Letter.</li> <li>• Communicate in <b>writing</b> any significant deficiencies to <b>Those Charged With Governance</b>.</li> </ul> <p>The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.</p>

## Part II: Correct/Incorrect Questions

Q1.	<p>The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. (MTP1, May 2018, 2 Marks) (MTP2, Nov 2018, 2 marks) (MTP1, May 2019, 2 marks)</p>
	<p><b>Correct.</b> The fundamental principle of an automated environment is the ability to <b>carry out business with less manual intervention and more system driven</b>. The <b>complexity</b> of a business environment <b>depends</b> on the level of <b>automation</b> i.e., if a business environment is more automated, it is likely to be more complex.</p>
Q2.	<p>Application controls include manual controls only that operate at a business process level. (MTP1, May 2018, 2 Marks) (MTP1, Nov 2018, 2 marks) (MTP2, Nov 2018, 2 marks)</p>
	<p><b>Incorrect.</b> Application controls include <b>both automated or manual</b> controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the <b>completeness, accuracy</b> and <b>integrity</b> of data in those systems.</p>
Q3.	<p>Evaluation and assessment of audit findings and control deficiencies does not involve application of professional judgment. (MTP2, May 2018, 2 marks)</p>
	<p style="text-align: center;"><b>OR</b></p> <p>Audit findings and control deficiencies can be evaluated or assessed arbitrarily. (SA, May 2022, 2 marks)</p>
	<p><b>Incorrect.</b> Evaluation and assessment of audit findings and control deficiencies involves applying <b>professional judgment</b> that include considerations for <b>quantitative</b> and <b>qualitative</b> measures. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.</p>
Q4.	<p>When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method. (SA, Nov 2018, 2 Marks) (MTP1, Nov 2021, 2 marks) (MTP2, Nov 2021, 2 marks)</p>
	<p><b>Incorrect.</b> There are basically four types of audit tests that should be used in an automated environment. They are <b>inquiry, observation, inspection</b> and <b>re-performance</b>. <b>Inquiry</b> is the <b>most efficient</b> audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. <b>Inquiry alone is not sufficient</b>. Applying <b>inquiry in combination with inspection gives the most effective and efficient audit evidence</b>.</p>

Q5.	<p>The Complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be less complex. (SA, Jan 2021, 2 marks) (MTP2, May 2023, 2 marks)</p> <p><b>Incorrect.</b> The fundamental principle of an automated environment is the ability to <b>carry out business with less manual intervention and more system driven</b>. The <b>complexity</b> of a business environment <b>depends</b> on the <b>level of automation</b> i.e., if a business environment is more automated, it is likely to be more complex.</p> <p>If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered <b>more complex</b> to audit. On the other hand, if a company is using off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.</p>
Q6.	<p>With reference to General IT control, the objective of Data Center and Network Operations is to ensure that systems are developed, configured and implemented to meet financial reporting objectives. (SA, July 2021, 2 marks) (MTP1, Nov 2023, 2 marks)</p> <p><b>Incorrect.</b> Objective of Data Center and Network Operations is to ensure that <b>production systems</b> are <b>processed to meet financial reporting objectives</b>. Objective of <b>Application system acquisition, development, and maintenance</b> is to ensure that systems are <b>developed, configured and implemented to meet financial reporting objectives</b>.</p>
Q7.	<p>All automated environments are not complex. (MTP2, Nov 2021, 2 marks) (MTP1, May 2022, 2 Marks)</p> <p><b>Correct.</b> The <b>complexity</b> of an automated environment <b>depends</b> on various factors including the nature of business, level of <b>automation</b>, volume of transactions, use of ERP and so on. There could be an environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.</p>
Q8.	<p>A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as meaningful data. (MTP2, Nov 2021, 2 marks) (MTP1, May 2022, 2 Marks)</p> <p><b>Incorrect.</b> A <b>combination of processes, tools and techniques</b> that are used to <b>tap vast amounts</b> of electronic <b>data</b> to <b>obtain meaningful information</b> is known as Data Analytics.</p>
Q9.	<p>In an automated environment, the relationship between the application controls and the General IT controls over IT systems are not interrelated. (SA, Nov 2022, 2 marks)</p> <p><b>Incorrect.</b> The relationship between the application controls and the General IT Controls is such that <b>General IT Controls are needed to support the functioning of application controls</b>, and both are needed to ensure complete and accurate information processing through IT systems. These two categories of control over IT systems are <b>interrelated</b>.</p>
Q10.	<p>If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered less complex and easy to audit compared to using an off-the-shelf accounting software. (SA, May 2023, 2 marks)</p> <p><b>Incorrect.</b> If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered <b>more complex</b> to audit. On the other hand, if a company is using off-the-shelf accounting software, then it is likely to be less automated, less complex and easy to audit.</p>

### Part III: Multiple Choice Questions

Q1.	<p>The operations of a company are automated substantially. Which of the following statements is most appropriate in this respect?</p> <p>(a) It results in complex business environment.</p> <p>(b) It results in simple business environment and easier audit.</p> <p>(c) Automation has no relationship with complexity of business environment.</p> <p>(d) It results in simple business environment. However, it increases complexity of audit.</p> <p>(ICAI Study Material - Test Your Knowledge)</p> <p><b>Correct answer:</b> (a) It results in complex business environment.</p> <p><b>Explanation:</b> The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex</p>
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Q2.	<p>Which of the following is not a risk to a company's internal control due to its IT environment?</p> <p>(a) Potential loss of data (b) Inability to access data when required (c) Unauthorized access to data (d) Processing of large volumes of data</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) Processing of large volumes of data</p> <p><b>Explanation:</b> Risks arising from use of IT Systems are Inaccurate processing of data, processing inaccurate data, or both, Unauthorized access to data, Direct data changes, Excessive access / Privileged access, Lack of adequate SOD, Unauthorized changes to systems or programs, Failure to make necessary changes to systems or programs, Loss of data</p>
Q3.	<p>Which of the following is not an example of "General IT controls"?</p> <p>(a) Controls pertaining to Disaster recovery plan (b) Controls pertaining to batch preparation (c) Controls pertaining to data security (d) Controls pertaining to validation of input data in an application</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) Controls pertaining to validation of input data in an application</p> <p><b>Explanation:</b> Controls pertaining to validation of input data in an application is an example of "Application Controls"</p>
Q4.	<p>In WH Limited every business activity was being carried out manually. The top management of WH Limited decided to change the business environment of WH Limited by using computer systems and computer systems related technology to carry out all the major business activities of WH Limited. This business environment of WH Limited, where all the major business activities are done using computer systems and computers related technology is an example of:</p> <p>(a) Operational Environment (b) Computational Environment (c) Control Environment. (d) Automated Environment</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) Automated Environment</p> <p><b>Explanation:</b> An automated environment refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems</p>
Q5.	<p>IT related risks, if not mitigated, may put an impact on</p> <p>(a) Substantive Audit (b) Controls (c) Reporting (d) All of above</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) All of above</p>
Q6.	<p>Which of the following is a General IT control?</p> <p>(a) IT Environment (b) Application Control (c) Access Security (d) IT Dependent Control</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) Access Security</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Types of Controls in an Automated Environment are General IT Control, Application Controls and IT-Dependent</li> </ul>

	<p>Controls</p> <ul style="list-style-type: none"> <li>General IT-controls that maintain the integrity of information and security of data commonly include controls over the following: Data center and network operations, Program change, Access security and Application system acquisition, development, and maintenance</li> </ul>
Q7.	<p>_____are also known as pervasive or indirect controls:-</p> <p>(a) General IT Controls (b) Application Controls (c) IT dependent Controls (d) None of the above <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) General IT Controls <b>Explanation:</b> General IT Controls are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as “pervasive” controls or “indirect” controls.</p>
Q8.	<p>User Training is an activity related to which of the following General IT Controls?</p> <p>(a) Data center and network operations (b) Program change (c) Access security (d) Application system acquisition, development, and maintenance (Business Applications) <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Program change</p>
Q9.	<p>The Objective of establishing Security Policies and Procedures is to</p> <p>(a) To ensure that production systems are processed to meet financial reporting objectives. (b) To ensure that modified systems continue to meet financial reporting objectives (c) To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives. (d) To ensure that systems are developed, configured and implemented to meet financial reporting objectives. <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (c) To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives. <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives</li> <li>Objective of Program Change to ensure that modified systems continue to meet financial reporting objectives</li> <li>Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.</li> </ul>
Q10.	<p>_____ are manual or automated procedures that typically operate at a business process level and apply to the processing of individual applications.</p> <p>(a) Application controls (b) General IT controls (c) Process controls (d) All of these <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) Application controls <b>Explanation:</b> Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems</p>



Q11.	<p>Which of the following is an automated control?</p> <p>(a) Program change (b) System generated report (c) Application control (d) Configurations</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) Application control</p> <p><b>Explanation:</b> Types of Controls in an Automated Environment are General IT Control, Application Controls and IT-Dependent Controls.</p> <p><b>Note:</b> Option D is the correct answer as per ICAI MCQs booklet</p>
Q12.	<p>_____ are the manual controls that make use of some form of data or information or report produced from the IT systems and applications.</p> <p>(a) Application (b) IT dependent Controls (c) Automated Controls (d) General IT Controls</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (b) IT dependent Controls</p> <p><b>Explanation:</b> For a student's understanding, the meaning of different terms are explained below:</p> <ul style="list-style-type: none"> <li>IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.</li> <li>General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments.</li> <li>Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.</li> </ul>
Q13.	<p>_____ are needed to support the functioning of _____</p> <p>(a) General IT Controls; Application Controls (b) Application Controls; General IT Controls (c) IT Dependent Controls; General IT Controls (d) Application Controls; IT Dependent Controls</p> <p><b>(ICAI MCQs) (MTP2, May 2023, 1 mark)</b></p>
	<p><b>Correct answer:</b> (a) General IT Controls; Application Controls</p> <p><b>Explanation:</b> General IT Controls and Application Controls are interrelated. The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.</p>
Q14.	<p>Which of the following Audit testing methods is most effective as an audit test and gives the best audit evidence?</p> <p>(a) Inquiry (b) Observation (c) Inspection (d) Reperformance</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) Reperformance</p> <p><b>Explanation:</b> Reperformance is most effective as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time. Inquiry is the most efficient audit test but it also gives the least audit evidence.</p>

Q15.	Which of the following Audit Testing methods give the least audit evidence? (a) Inquiry (b) Inspection (c) Observation (d) Reperformance <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (a) Inquiry <b>Explanation:</b> Inquiry is the most efficient audit test but it also gives the least audit evidence
Q16.	Applying _____ gives the most effective and efficient audit evidence while using Audit testing methods. (a) Inquiry in combination with Inspection. (b) Inspection in combination with Observation (c) Observation in combination with reperformance (d) Reperformance in combination with Inquiry <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (a) Inquiry in combination with Inspection <b>Explanation:</b> Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.
Q17.	The standard that requires auditors to analyse journal entries in an audit is? (a) SA 260 (b) SA 230 (c) SA 315 (d) SA 240 <b>(ICAI MCQs) (MTP1, May 2019, 1 Mark)</b>
	<b>Correct answer:</b> (d) SA 240
Q18.	_____ is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information:- (a) Computer Assisted Audit Techniques (b) Automated Controls (c) Data Analytics (d) Combination Controls <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (c) Data Analytics
Q19.	The tools and techniques that auditors use in applying the principles of data analytics are known as: (a) Data analytics tools (b) Computer Assisted Auditing Techniques or CAATs in short (c) Analytics tools and techniques (d) System generated tools <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (b) Computer Assisted Auditing Techniques or CAATs in short
Q20.	_____ exists when an internal control is either missing or not operating effectively to prevent or detect a misstatement in a timely manner by management (a) Significant Deficiency (b) Operating Deficiency (c) Management Control Deficiency

	<p>(d) Control Deficiency (ICAI MCQs)</p> <p><b>Correct answer:</b> (d) Control Deficiency</p>
Q21.	<p>_____ is a logical subsystem within a larger information system where electronic data is stored in a predefined form and retrieved for use.</p> <p>(a) Data Mining (b) Data warehouse (c) Database (d) Data Analytics (ICAI MCQs)</p> <p><b>Correct answer:</b> (c) Database</p> <p><b>Explanation:</b> For a student's understanding, meaning of different terms are explained below:</p> <ul style="list-style-type: none"> <li>• Data Mining is the process of analyzing data to find previously unknown trends, patterns, and associations to make decisions.</li> <li>• Data warehouse stores both the historic and transactional data.</li> <li>• Data analytics is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information</li> </ul>
Q22.	<p>_____ is a control deficiency or a combination of deficiencies in internal controls that is important enough to merit the attention of those charged with governance since there is a reasonable possibility that a material misstatement will not be prevented or detected in a timely manner by management.</p> <p>(a) Material Weakness (b) Material deficiency (c) Control Risk (d) Significant Deficiency (ICAI MCQs)</p> <p><b>Correct answer:</b> (a) Material Weakness</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Meaning of Significant Deficiency: a control deficiency or a combination of deficiencies in internal controls that is important enough to merit the attention of TCWG since there is a reasonable possibility that a misstatement will not be prevented or detected in a timely manner by management</li> <li>• <b>Difference b/w Significant Deficiency and material weakness:</b> In significant deficiency, there is a possibility that a <b>misstatement</b> will not be prevented or detected in a timely manner by management and in material weakness, there is a possibility that a <b>material misstatement</b> will not be prevented or detected in a timely manner by management</li> </ul>
Q23.	<p>A type of super user access to information systems that enforces less or no limits on using that system is known as:</p> <p>(a) Super access. (b) Super user access. (c) Unlimited access. (d) Privileged access (RTP, May 2022, NA)</p> <p><b>Correct answer:</b> (d) Privileged access</p>
Q24.	<p>Tools and techniques that auditors use in applying the principles of data analytics are known as-</p> <p>(a) Computer Aided Audit Technique (b) Computer Aided Audit Tools (c) Computer Accounting and Auditing Technique (d) Computer Assisted Audit Technique (RTP, May 2023, NA)</p>

	<b>Correct answer:</b> (d) Computer Assisted Audit Technique
Q25.	<p>Which of the following is a risk that arises from the use of IT systems?</p> <p>(a) Direct data changes (backend changes). (b) Limited/Monitored access. (c) Adequate segregation of duties. (d) Authorized access to data.</p> <p><b>(RTP, Nov 2023, NA)</b></p>
	<p><b>Correct answer:</b> (a) Direct data changes (backend changes).</p> <p><b>Explanation:</b> Risks arising from use of IT Systems are Inaccurate processing of data, processing inaccurate data, or both, Unauthorized access to data, Direct data changes, Excessive access / Privileged access, Lack of adequate SOD, Unauthorized changes to systems or programs, Failure to make necessary changes to systems or programs, Loss of data</p>

## Chapter 4 - Audit Evidence

### SA 500 “Audit Evidence”

#### Part I : Descriptive Questions

Q1.	<p>On perusal of financial statements of a company, auditor of company finds that notes to accounts contain aging of trade payables in accordance with requirements of Schedule III of Companies Act, 2013. The accountant of company is responsible for ensuring proper aging of trade payables included in notes to accounts. The auditor wants to verify whether aging of trade payables made in financial statements is proper or not. Identify what he is trying to do.</p> <p><b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p>The auditor is verifying aging of trade payables. He is “<b>reperforming</b>” the control which was mandated by the management. Reperformance involves the auditor’s <b>independent</b> execution of procedures or controls that were originally performed as part of the entity’s internal control.</p>
Q2.	<p>CA Sooryagaythri is conducting audit of an entity. During the course of audit, she has made oral inquiries from head accountant regarding preparing of bank reconciliations every month as has been laid down by the management. Discuss, whether inquiries as stated above would provide satisfaction to her that controls in respect of preparing bank reconciliations statements have operated effectively. <b>(ICAI Study Material - Test Your Understanding)</b></p> <ul style="list-style-type: none"> <li>• Inquiry <b>alone</b> ordinarily does <b>not</b> provide <b>sufficient</b> audit <b>evidence</b> of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls. Mere inquiry does not lead to obtaining of sufficient appropriate audit evidence.</li> <li>• In the given case, CA Sooryagaythri should verify whether proper bank reconciliations have been carried out monthly as stipulated by management. Only then, she can be satisfied about operating effectiveness of controls in this regard</li> </ul>
Q3.	<p>A company has stipulated a control that reconciliations of its records showing quantitative details of its property, plant and equipment are carried out at regular intervals with physical verification of such items. The auditor has found that such reconciliations are being carried out as stipulated. Discuss, whether above factor, increases reliability of other internally generated evidence within the company relating to existence of such items. <b>(ICAI Study Material - Test Your Understanding)</b></p> <p>The management is carrying out reconciliations of items contained in Property, Plant and Equipment records with physical verification of such items at regular intervals. It means that controls in this regard have operated effectively.</p> <p>The <b>reliability</b> of audit <b>evidence</b> that is <b>generated internally</b> is <b>increased</b> when the related <b>controls</b>, including those over its preparation and maintenance, imposed by the entity are <b>effective</b></p>
Q4.	<p>The auditor of JPJ Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor. Explain what relationship exists between Audit Evidence and Opinion of Auditor.</p> <p><b>(ICAI Study Material - Illustration)</b></p> <p><b>Relationship between Audit Evidence and Opinion of Auditor:</b></p> <ul style="list-style-type: none"> <li>• There exists a very important relationship between Audit Evidence and opinion of the Auditor.</li> <li>• While conducting an audit of a company, the auditor <b>obtains</b> audit <b>evidence</b> and with the help of that audit evidence obtained, the auditor <b>forms</b> an audit <b>opinion</b> on the financial statements of that company.</li> </ul>
Q5.	<p>An audit team member of the auditors of Genuine Limited was of the view that audit evidence obtained internally from within the company under audit are more appropriate from the reliability point of view as compared to audit evidence obtained externally as evidence obtained internally are obtained from the company whose audit is being conducted. Give your views as auditor of Genuine Limited. <b>(ICAI Study Material - Illustration)</b></p> <p>Audit evidence obtained <b>externally</b> is <b>more appropriate</b> from reliability point of view as compared to those which are obtained internally. The reason that audit evidence obtained externally is more appropriate from the point of view of reliability is that there is a very <b>low risk</b> that they can be altered or changed.</p>
Q6.	<p>There was a Partnership Firm of Chartered Accountants VM and Associates. Mr. M, one of the partners of VM and Associates, while explaining to his audit team members about importance of audit evidence informed them about</p>

	<p>sufficiency and appropriateness of audit evidence. Mr. A, one of the members of audit team of VM and Associates was of the view that sufficiency of audit evidence means simplicity of audit evidence and appropriateness of audit evidence means ease of obtaining audit evidence. Explain whether sufficiency and appropriateness of audit evidence mean simplicity and ease of obtaining audit evidence. <b>(ICAI Study Material - Illustration)</b></p> <p>Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather <b>sufficiency</b> of audit evidence is related to the <b>quantity</b> of audit evidence and <b>appropriateness</b> of audit evidence is related to <b>quality</b> of audit evidence.</p>
Q7.	<p>While auditing the books of accounts of AB Limited for the financial year 2023-24, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of Extremely Distinct Limited. <b>(ICAI Study Material - Illustration)</b></p> <p>The audit procedure used by auditor of AB Limited is known as <b>Inspection</b> because inspection is an audit procedure in which complete <b>documents</b> and <b>records</b> of a company are checked in <b>detail</b> for the purpose of obtaining audit evidence.</p>
Q8.	<p>Discuss what is understood by “appropriateness” of audit evidence. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p>Appropriateness is the measure of the <b>quality</b> of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.</p> <p>The reliability of evidence is influenced by its <b>source</b> and <b>nature</b>, and is dependent on the individual <b>circumstances</b> under which it is obtained.</p>
Q9.	<p>Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditor. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <ul style="list-style-type: none"> <li>• An audit trail is a <b>documented flow</b> of a transaction.</li> <li>• It is used to investigate how a <b>source</b> document was <b>translated</b> into an account <b>entry</b> and from there it was inserted into financial statement of an entity.</li> <li>• It is used as audit evidence to establish <b>authentication</b> and <b>integrity</b> of a transaction.</li> <li>• Audit trails help in maintaining <b>record</b> of system and user activity.</li> <li>• Like, in case of <b>banks</b>, there is an audit trail keeping <b>track</b> of <b>log-on activity</b> detailing record of log-on attempts and device used.</li> <li>• Audit trails help to <b>enhance</b> internal <b>controls</b> and data security.</li> <li>• Audit trails assist in <b>assigning</b> responsibility, reconstructing events, and analyzing issues</li> <li>• Audit trails incur costs, both in system expenses and time spent analyzing data. Automated tools can <b>efficiently</b> analyze the <b>large volume</b> of data from audit trails.</li> <li>• Audit trails boost auditor <b>confidence</b> by verifying if management’s controls work effectively and if authorized personnel performed transactions. They <b>enhance</b> data <b>security</b>, increasing the <b>reliability</b> of audit evidence obtained.</li> </ul>
Q10.	<p>What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor’s judgement as to the sufficiency of audit evidence. <b>(ICAI Study Material - Test Your Knowledge) (MTP2, May 2023, 3 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement. Auditor’s judgment as to sufficiency may be affected by a few factors. Explain. <b>(RTP, May 2018, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor’s judgement as to sufficiency of audit evidence. <b>(RTP, May 2019, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>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 and also by the quality of such audit evidence. Obtaining more audit</p>

evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence. (RTP, Nov 2020, NA)

OR

Explain the various factors affecting the auditor's judgments as to the sufficiency of the audit evidence. (RTP, May 2023, NA)

#### Sufficiency of Audit Evidence:

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

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

- **Materiality:** It may be defined as the **significance** of **classes** of transactions, account balances and presentation and disclosures to the **users** of the financial statements. **Less evidence** would be required in case assertions are **less material** to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
- **Risk of material misstatement**
  - It may be defined as the risk that the financial statements are materially misstated **prior to audit**.
  - This consists of two components described as follows at the assertion level
    - **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
    - **Control risk**—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.
  - **Less evidence** would be required in case assertions that have a **lower risk** of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.
- **Size of a population:** 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

Q11. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2018, NA)

OR

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain (RTP, Nov 2019, NA)

- Audit evidence is necessary to support the auditor's opinion and report.
- It is **cumulative** in **nature** and is **primarily obtained** from audit procedures performed during the course of the audit. It may, however, also **include information** obtained from **other sources** such as **previous audits**. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence.
- Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises **both** information that **supports** and **corroborates** management's **assertions**, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
- Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry.
- 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.
- As explained in **SA 200**, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", **reasonable** assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of

	audit evidence are <b>interrelated</b>
Q12.	<p>Evaluating responses to inquiries is an integral part of the inquiry process. Explain. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence. (RTP, May 2022, NA)</p> <p><b>Inquiry – Audit Procedure to obtain Audit Evidence:</b></p> <ul style="list-style-type: none"> <li>• Inquiry consists of <b>seeking information</b> of <b>knowledgeable persons</b>, both financial and non- financial, <b>within</b> the entity or <b>outside</b> the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from <b>formal</b> written inquiries to <b>informal</b> oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.</li> <li>• Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.</li> <li>• Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.</li> <li>• In respect of some matters, the auditor may consider it necessary to obtain <b>written representations</b> from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.</li> </ul>
Q13.	<p>Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the detailed meaning of audit evidence. (RTP, Nov 2019, NA) (MTP2, Nov 2023, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. Explain and discuss the meaning of Audit Evidence in detail. (RTP, Nov 2023, NA)</p> <p>Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. The auditor needs evidence to obtain information for arriving at his judgment.</p> <p>As per SA 500, the objective of the auditor is to design and perform audit procedures to obtain sufficient appropriate audit evidence to draw <b>reasonable</b> conclusions on which to base the auditor's opinion</p> <p>Audit evidence may be defined as the <b>information used</b> by the <b>auditor</b> in arriving at the <b>conclusions</b> on which the auditor's <b>opinion</b> is based. Audit evidence includes both information contained in the <b>accounting records</b> underlying the financial statements and <b>other information</b>.</p> <p>Explaining this further, audit evidence includes:-</p> <ul style="list-style-type: none"> <li>• <b>Information contained in the accounting records:</b> <ul style="list-style-type: none"> <li>○ Accounting records include <ul style="list-style-type: none"> <li>■ the records of initial accounting <b>entries</b> and supporting records, such as checks and records of electronic fund transfers;</li> <li>■ <b>invoices</b>;</li> <li>■ <b>contracts</b>;</li> </ul> </li> </ul> </li> </ul>



	<ul style="list-style-type: none"> <li>■ the <b>ledgers, journal</b> entries and other <b>adjustments</b> to the financial statements</li> <li>■ <b>records</b> such as <b>worksheets</b> and <b>spreadsheets</b> supporting cost allocations, computations, reconciliations and disclosures.</li> </ul> <ul style="list-style-type: none"> <li>● <b>Other information</b> that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements: Other information which the auditor may use as audit evidence includes, for example <ul style="list-style-type: none"> <li>○ <b>minutes</b> of the meetings,</li> <li>○ written <b>confirmations</b> from trade receivables and trade payables,</li> <li>○ <b>manuals</b> containing details of internal control etc.</li> </ul> </li> </ul> <p>A <b>combination</b> of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.</p>
Q14.	<p>"Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability". Explain. Also state clearly generalisations about the reliability of audit evidence. (RTP, May 2018, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source, its nature and the circumstances under which it is obtained. Explain and elucidate the guiding principles which are useful in assessing the reliability of audit evidence (MTP1, May 2022, 3 marks)</p> <p><b>Reliability of Audit Evidence:</b></p> <p>SA 500 on "Audit Evidence" provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its <b>source</b> and its <b>nature, circumstances</b> under which it is obtained, including the <b>controls</b> over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions.</p> <p>While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:</p> <ul style="list-style-type: none"> <li>● The reliability of audit evidence is increased when it is obtained from <b>independent sources</b> outside the entity.</li> <li>● The reliability of audit evidence that is generated <b>internally</b> is <b>increased</b> when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.</li> <li>● Audit evidence obtained <b>directly</b> by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).</li> <li>● Audit evidence in <b>documentary form</b>, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).</li> <li>● Audit evidence provided by <b>original documents</b> is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.</li> </ul>
Q15.	<p>The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples. (RTP, Nov 2020, NA)</p> <p><b>Nature and Timing of the Audit Procedures:</b></p> <ul style="list-style-type: none"> <li>● The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available <b>only</b> in <b>electronic form</b> or only at <b>certain</b> points or <b>periods</b> in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.</li> <li>● Certain electronic information may <b>not</b> be <b>retrievable</b> after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.</li> </ul>
Q16.	<p>When information to be used as audit evidence has been prepared using the work of a management's expert and having</p>

	<p>regard to the significance of the expert's work for the auditor's purposes, explain the considerations the auditor would consider for the purposes of his audit. <b>(RTP, May 2021, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>CA Amar is the statutory auditor of XYZ Ltd. for the FY 2023-24. During the course of audit, CA Amar found that a litigation is going against the company for which the company has hired an external legal team (management expert). CA Amar wanted to use the information as audit evidence which is prepared using the work of the management expert. What should CA Amar consider before using the work of such management expert? <b>(MTP2, Nov 2022, 3 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>T Ltd has used the services of an expert for the purpose of physical verification of its inventory which is appearing in the financial statements of the company at ₹ 75 Crores. Discuss the broad parameters auditor would take into consideration while deciding about using the work performed by the Management's Expert in physical verification of company's inventory <b>(RTP, Nov 2023, NA)</b></p>
	<p>Management's expert is an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.</p> <p>When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:</p> <ul style="list-style-type: none"> <li>• Evaluate the <b>competence, capabilities</b> and <b>objectivity</b> of that expert;</li> <li>• Obtain an <b>understanding</b> of the work of that expert; and</li> <li>• Evaluate the <b>appropriateness</b> of that expert's work as audit evidence for the relevant assertion</li> </ul>
Q17.	<p>In the course of audit of SMP Limited for the financial year ended 31st March, 2024 you have observed as an auditor that the company has provided a sum of ₹ 20 Lakhs in the books of account as Gratuity payable to employees based on certificate obtained from an actuary. Give your comments with reference to the Standard on Auditing. <b>(MTP2, Nov 2021, 3 Marks)</b></p> <p><b>Certificate from a Management's Expert:</b></p> <p>In the given case, SMP Limited has provided a sum of ₹ 20 lakh in the books of accounts as gratuity payable on the basis of certificate obtained from an actuary. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.</p> <p>The auditor should check the <b>quantification</b> of the gratuity liability. He should ascertain whether the same had been actuarially determined. The auditor should treat the actuary as managements' expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 500.</p> <p>As per <b>SA 500</b>, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:</p> <ul style="list-style-type: none"> <li>• Evaluate the <b>competence, capabilities</b> and <b>objectivity</b> of that expert;</li> <li>• Obtain an <b>understanding</b> of the work of that expert; and</li> <li>• Evaluate the <b>appropriateness</b> of that expert's work as audit evidence for the relevant assertion.</li> </ul>
Q18.	<p>CA K audited the books of accounts of E Ltd. for the financial year 2023-2024. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor and its reliability <b>(SA, Dec 2021, 3 marks)</b></p> <p><b>Audit Procedure:</b></p> <ul style="list-style-type: none"> <li>• Inspection involves <b>examining records</b> or <b>documents</b>, whether internal or external, in paper form, electronic form, or other media, or a <b>physical examination</b> of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their <b>nature</b> and <b>source</b> and, in the case of internal records and documents, on the effectiveness of the controls over their production.</li> <li>• Example of inspection used as a test of controls is inspection of records for evidence of authorisation. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as an inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value.</li> <li>• In addition, inspecting an executed contract may provide audit evidence relevant to the entity's <b>application</b> of <b>accounting policies</b>, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence</li> </ul>

	<p>with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.</p> <ul style="list-style-type: none"> <li>In view of above, it can be concluded that CA K used <b>Inspection</b> as an audit procedure</li> </ul>
Q19.	<p>An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. Explain. (RTP, Nov 2022, NA)</p> <ul style="list-style-type: none"> <li>Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.</li> <li><b>Objective examination</b> connotes <b>critical examination</b> and <b>scrutiny</b> of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs.</li> <li>An opinion founded on a rather reckless and <b>negligent</b> examination and evaluation may expose the auditor to <b>legal</b> action with consequential loss of professional standing and prestige. He needs evidence to obtain information for arriving at his <b>judgment</b>.</li> <li>SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw <b>reasonable</b> conclusions on which to base the auditor's opinion</li> </ul>
Q20.	<p>Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ &amp; Co. is having doubts over the reliability of information given to him as audit evidence. Also, auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation. (RTP, Nov 2022, NA)</p> <p><b>Inconsistency in or Doubts over Reliability of Audit Evidence:</b></p> <p>If:</p> <ol style="list-style-type: none"> <li>audit evidence obtained from one source is <b>inconsistent</b> with that obtained from another; or</li> <li>the auditor has <b>doubts</b> over the <b>reliability</b> of information to be used as audit evidence,</li> </ol> <p>the auditor shall determine what <b>modifications</b> or additions to audit procedures are necessary to resolve the matter, and shall consider the <b>effect</b> of the matter, if any, on other aspects of the audit</p>
Q21.	<p>The objective of auditing is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This can be obtained by performing which procedures? Name the types of audit procedures the auditor can perform to obtain audit evidence? (SA, Nov 2022, 4 marks)</p> <p><b>Audit Procedures to Obtain Audit Evidence:</b></p> <p>Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:</p> <ol style="list-style-type: none"> <li><b>Risk assessment</b> procedures; and</li> <li><b>Further</b> audit procedures, which comprise: <ol style="list-style-type: none"> <li><b>Test of controls</b>, when required by the SAs or when the auditor has chosen to do so; and</li> <li><b>Substantive procedures</b>, including <b>tests of details</b> and substantive <b>analytical</b> procedures.</li> </ol> </li> </ol> <p>Audit procedures to obtain audit evidence can include</p> <ol style="list-style-type: none"> <li><b>Inspection</b></li> <li><b>Observation</b></li> <li><b>External Confirmation</b></li> <li><b>Recalculation</b></li> <li><b>Reperformance</b></li> <li><b>Analytical Procedures</b></li> <li><b>Inquiry</b></li> </ol>

## Part II: Correct/Incorrect Questions

Q1.	<p>Purchase invoice is an example of internal evidence. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Incorrect.</b> Internal evidence is the evidence that originates <b>within</b> the client's organisation. Since the purchase invoice originates <b>outside</b> the client's organisation, therefore, it is an example of <b>external</b> evidence.</p>
Q2.	<p>Sufficiency is the measure of the quality of audit evidence. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Incorrect.</b> Sufficiency is the measure of the <b>quantity</b> of audit evidence. On the other hand, <b>appropriateness</b> is the measure of the <b>quality</b> of audit evidence.</p>
Q3.	<p>When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Incorrect.</b> When auditor inquires the management as part of audit procedures such inquiries may <b>range from formal written inquiries to informal oral inquiries</b></p>
Q4.	<p>Subjective examination connotes critical examination and scrutiny of the accounting statements. (RTP, Nov 2019, NA)</p> <p><b>Incorrect.</b> Objective examination connotes critical <b>examination</b> and <b>scrutiny</b> of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a <b>true</b> and <b>fair</b> view about the financial results and state of affairs</p>
Q5.	<p>Inquiry alone provides sufficient audit evidence of the absence of a material misstatement at the assertion level and of the operating effectiveness of controls. (RTP, Nov 2019, NA)</p> <p><b>Incorrect.</b> Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, <b>inquiry alone</b> ordinarily does <b>not</b> provide <b>sufficient</b> audit <b>evidence</b> of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.</p>
Q6.	<p>Sufficiency is the measure of the quantity of audit evidence. (SA, Jan 2021, 2 Marks)</p> <p><b>Correct.</b> Sufficiency is the measure of the <b>quantity</b> 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)</p>
Q7.	<p>Inquiry alone ordinarily does not provide sufficient audit evidence. (MTP2, Nov 2021, 2 Marks) (MTP1, May 2022, 2 marks)</p> <p><b>Correct.</b> Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, <b>inquiry alone</b> ordinarily does <b>not provide sufficient</b> audit <b>evidence</b> of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.</p>
Q8.	<p>While auditing the books of accounts of ABC Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection" (SA, Dec 2021, 2 marks) (RTP, May 2023, NA)</p> <p><b>Incorrect.</b> The auditor procedure used in the given case is "<b>Observation</b>". Observation consists of <b>looking</b> at a <b>process</b> or procedure being performed by others whereas <b>Inspection</b> involves <b>examining records</b> or <b>documents</b>, whether internal or external, in paper form, electronic form, or other media, or a <b>physical examination</b> of an asset.</p>
Q9.	<p>Audit evidence obtained through observation of the application of a control is less reliable than audit evidence obtained by inquiry about the application of a control. (MTP2, Nov 2022, 2 Marks)</p> <p><b>Incorrect.</b> Audit evidence obtained <b>directly</b> by the auditor (for example, observation of the application of a control) is <b>more reliable</b> than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).</p>

Q10.	Appropriateness is the measure of the quantity of audit evidence. <b>(SA, May 2023, 2 marks)</b>
	<b>Incorrect.</b> <b>Sufficiency</b> is the measure of the <b>quantity</b> of audit evidence. On the other hand, <b>appropriateness</b> is the measure of the <b>quality</b> of audit evidence
Q11.	While auditing the books of accounts of XYZ Ltd., the auditor of the company was involved in examining records and documents in paper form, electronic form etc. and was also conducting physical examination of assets. In the present case, audit procedure used by the auditor is known as "Observation" <b>(MTP1, Nov 2023, 2 marks) (MTP2, Nov 2023, 2 marks)</b>
	<b>Incorrect.</b> The audit procedure used by the auditor of XYZ Ltd. is known as " <b>Inspection</b> ". Whereas <b>Observation</b> consists of <b>looking</b> at a <b>process</b> or procedure being performed by others.

### Part III: Multiple Choice Questions

Q1.	Audit evidence is necessary to support the auditor's opinion and report. It is _____ in nature and is primarily obtained from audit procedures performed during the course of the audit. (a) cumulative (b) regressive (c) selective (d) objective <b>(Sample MCQs) (RTP, Nov 2019, NA) (MTP1, Nov 2019, 1 Mark) (MTP2, May 2022, 1 mark)</b>
	<b>Correct answer:</b> (a) Cumulative
Q2.	Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. (a) obtaining audit evidence. (b) evaluating audit evidence. (c) obtaining or evaluating audit evidence. (d) obtaining and evaluating audit evidence. <b>(Sample MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)</b>
	<b>Correct answer:</b> (d) obtaining and evaluating audit evidence
Q3.	Audit procedures to obtain audit evidence can include (a) inspection, observation, confirmation, recalculation, re-performance and analytical procedures (b) inspection, observation, confirmation, recalculation and re-performance (c) inspection, observation, confirmation and analytical procedures (d) inspection, observation, recalculation, re-performance and analytical procedures <b>(Sample MCQs)</b>
	<b>Correct answer:</b> (a) inspection, observation, confirmation, recalculation, re-performance and analytical procedures
Q4.	Auditor's judgment as to sufficiency may be affected by the factors such as: (a) Materiality (b) Risk of material misstatement (c) Size and characteristics of the population. (d) All of the above <b>(Sample MCQs) (ICAI MCQs)</b>
	<b>Correct answer:</b> (d) All of the above
Q5.	Which of the following is not an Audit procedure to obtain audit evidence: (a) Inspection (b) Observation

	(c) External Confirmation (d) Internal Control <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (d) Internal Control
Q6.	When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (i) Evaluate the competence, capabilities and objectivity of that expert (ii) Obtain an understanding of the work of that expert (iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion (a) (i) and (ii) (b) (ii) and (iii) (c) (i) and (iii) (d) (i),(ii) and (iii) <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (d) (i),(ii) and (iii)
Q7.	Audit evidence includes (a) information contained in the accounting records underlying the financial statements (b) both information contained in the accounting records underlying the financial statements and other information. (c) other information. (d) information contained in the accounting records underlying the financial statements or other information. <b>(Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark) (MTP2, May 2021, 2 Marks) (MTP2, Nov 2021, 2 Marks) (MTP2, May 2023, 1 mark)</b>
	<b>Correct answer:</b> (b) both information contained in the accounting records underlying the financial statements and other information.
Q8.	which of the following is incorrect : (a) Inquiry consists of seeking information of unknown persons, both financial and non- financial, within the entity or outside the entity. (b) Inquiry is used extensively throughout the audit in addition to other audit procedures. (c) Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process. (d) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. <b>(MTP1, May 2019, 2 Marks)</b>
	<b>Correct answer:</b> (a) Inquiry consists of seeking information of unknown persons, both financial and non- financial, within the entity or outside the entity. <b>Explanation:</b> Inquiry consists of seeking information of knowledgeable persons (NOT unknown persons), both financial and non-financial, within the entity or outside the entity.
Q9.	Mr. H and his team members carefully watched the whole process of counting of finished wooden doors by employees of Bottom Limited. This is an example of which audit procedure: (a) External Confirmation. (b) Observation. (c) Inquiry. (d) Inspection. <b>(RTP, Nov 2021, NA)</b>
	<b>Correct answer:</b> (b) Observation <b>Explanation:</b> Observation consists of looking at a process or procedure being performed by others.

Q10.	<p>Mr. H and his team members in detail checked and evaluated the books of accounts and relevant documents of WT Limited. This is an example of which audit procedure:</p> <p>(a) Inspection. (b) Re-performance. (c) Recalculation. (d) Observation.</p> <p><b>(MTP1, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (a) Inspection</p> <p><b>Explanation:</b> Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.</p>
Q11.	<p>CA X, auditor of Green Shoots Private Ltd. is going through financial statements of the company. On perusing notes to accounts, he finds ageing of trade payables reflecting in accordance with requirements of Schedule III of Companies Act, 2013. He wants to be sure that ageing of trade payables forming part of notes of accounts is proper and carries out ageing independently to confirm its veracity. Identify audit procedure(s) being performed by CA X.</p> <p>(a) Analytical procedures (b) Recalculation (c) Re-performance (d) Observation</p> <p><b>(MTP2, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (c) Re-performance</p> <p><b>Explanation:</b> Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control. Examples are Re-performing the reconciliation of bank statements, re-performing the aging of accounts receivable.</p>
Q12.	<p>_____ may be defined as the 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.</p> <p>(a) Audit procedure (b) Audit evidence (c) Audit plan (d) Audit programme</p> <p><b>(MTP1, Nov 2023, 1 mark)</b></p>
	<p><b>Correct answer:</b> (b) Audit evidence</p>
Q13.	<p>While auditing the books of accounts of Mehra Limited for the financial year 2023-24, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of company.</p> <p>(a) Recalculation (b) Analytical Procedures (c) Inquiry (d) Inspection</p> <p><b>(MTP1, Nov 2023, 1 mark)</b></p>
	<p><b>Correct answer:</b> (d) Inspection</p> <p><b>Explanation:</b> Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset</p>

# SA 610 “Using the work of internal Auditors”

## Part I : Descriptive Questions

Q1.	<p>A company has stipulated a control through its automated software that interest @ 12% p.a. is charged in case of those customers who fail to make payment within a month of a sales transaction. The internal auditor of the company finds that during a certain period, software has failed to charge interest due to certain technical glitches. Does reporting of above situation fall in domain of internal auditor's work? (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> <li>One of the functions of internal auditor includes responsibility for <b>reviewing controls</b>, evaluating their operation, and recommending <b>improvements</b> thereto.</li> <li>In the given case, the internal auditor has found that controls relating to levying of interest have not operated. The system has not levied stipulated interest in respect of a certain period. It can result in loss of income for the company and improper financial reporting.</li> <li>Such a matter, definitely, <b>falls in the domain of reporting by the internal auditor</b>.</li> </ul>
Q2.	<p>CA Sukesh is external auditor of an entity. He comes to know that there is also an internal auditor in the entity. However, he finds that internal auditor is not reporting directly to higher echelons of the management. CA Sukesh has also assessed risk of material misstatement to be high. Discuss, whether it would be proper for CA Sukesh to rely upon work of internal auditor extensively in above situation. (ICAI Study Material - Test Your Understanding)</p>
	<p>In the given case, the organizational status of internal audit function is not commensurate with his duties. He is not reporting directly to higher echelons of management. It shows that such a function is not given its due importance in entity. Since <b>risk</b> of material misstatements has also been assessed as <b>high</b> by CA Sukesh, both the above factors suggest that he should <b>not rely upon work of internal auditor extensively</b>.</p>
Q3.	<p>Discuss some of circumstances when work of the internal auditor cannot be used by external auditor. (ICAI Study Material - Test Your Knowledge)</p>
	<p>The external auditor shall not use the work of the internal audit function if the external auditor determines that:</p> <ul style="list-style-type: none"> <li>The function's organizational status and relevant policies and procedures do <b>not</b> adequately support the <b>objectivity</b> of internal auditors;</li> <li>The function <b>lacks</b> sufficient <b>competence</b>; or</li> <li>The function does <b>not apply</b> a <b>systematic</b> and <b>disciplined</b> approach, including quality control.</li> </ul>
Q4.	<p>Moon Ltd. of which you are the statutory auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.</p>
	<p>As per <b>SA 610 “Using the Work of Internal Auditor”</b>, the external auditor can take direct assistance of internal auditor subject to following conditions:</p> <ol style="list-style-type: none"> <li>The external auditor is <b>not prohibited by law or regulation</b> from obtaining direct assistance from internal auditors.</li> <li>There are <b>no significant threats to the objectivity</b> of the internal auditor</li> <li>The internal auditor have <b>sufficient competence</b> to perform the proposed work</li> </ol> <p><b>Precautions to be taken while using direct assistance:</b></p> <p>The external auditor shall not use internal auditors to provide direct assistance to perform procedures that</p> <ol style="list-style-type: none"> <li>Involve making <b>significant judgments</b> in the audit;</li> <li>Relate to <b>higher assessed risks</b> of material misstatement;</li> <li>Relate to <b>work</b> with which the <b>internal auditors</b> have been <b>involved</b>; or</li> <li>Relate to <b>decisions</b> the <b>external auditor</b> makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.</li> </ol> <p>Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:</p> <ol style="list-style-type: none"> <li>Obtain <b>written agreement</b> from an <b>authorized representative</b> of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the <b>entity will not intervene</b> in the work the internal auditor performs for the external auditor; and</li> </ol>



	<p>b) Obtain <b>written agreement</b> from the <b>internal auditors</b> that they will keep <b>confidential</b> specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity</p> <p>The external auditor shall <b>direct, supervise and review</b> the work performed by internal auditors on the engagement in accordance with <b>SA 220</b>.</p>
Q5.	<p>CA Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Kishore, the statutory auditor of the Company, for his view and reporting. Can CA Kishore rely on such report?</p> <p>As per <b>SA 610 "Using the Work of Internal Auditors"</b>, while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-</p> <ol style="list-style-type: none"> <li>The extent to which the internal audit function's organizational status and relevant policies and procedures <b>support the objectivity</b> of the internal auditors;</li> <li>The <b>level of competence</b> of the internal audit function; and</li> <li>Whether the internal audit function applies a <b>systematic and disciplined approach</b>, including quality control.</li> </ol> <p>Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:</p> <ol style="list-style-type: none"> <li>The function's organizational status and relevant policies and procedures <b>do not adequately support the objectivity</b> of internal auditors;</li> <li>The function <b>lacks sufficient competence</b>; or</li> <li>The function <b>does not apply a systematic and disciplined approach</b>, including quality control.</li> </ol> <p>In the instant case, CA. Kishore should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also <b>test check</b> a few items and he can also observe the procedures performed by the internal auditors.</p> <p><b>Conclusion:</b> If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The <b>final responsibility</b> to express opinion on the financial statement <b>remains with the statutory auditor</b>.</p>
Q6.	<p>Explain the meaning, objectives and scope of internal audit functions as per SA 610. <b>(RTP, May 2019, NA)</b></p> <p><b>Meaning of Internal audit function:</b> A function of an entity that performs <b>assurance and consulting activities</b> designed to evaluate and improve the effectiveness of the entity's <b>governance, risk management</b> and internal <b>control</b> processes.</p> <p><b>Objectives and scope of internal audit functions:</b></p> <p>The objectives and scope of internal audit functions typically include <b>assurance and consulting activities</b> designed to evaluate and improve the effectiveness of the entity's <b>governance</b> processes, <b>risk management</b> and internal <b>control</b>.</p> <ol style="list-style-type: none"> <li><b>Activities Relating to Governance:</b> Internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, accountability and communicating risk to appropriate areas of the organization.</li> <li><b>Activities Relating to Risk Management:</b> Internal audit function may assist the entity by identifying and evaluating significant exposures to <b>risk</b> and contributing to the <b>improvement</b> of risk management and internal control (including effectiveness of the financial reporting process)</li> <li><b>Activities Relating to Internal Control</b> <ul style="list-style-type: none"> <li><b>Evaluation of internal control:</b> Internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending <b>improvements</b> thereto.</li> <li><b>Examination of financial and operating information:</b> Internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.</li> <li><b>Review of operating activities.</b> The internal audit function may be assigned to review the <b>economy, efficiency and effectiveness</b> of operating activities, including <b>non-financial</b> activities of an entity.</li> <li><b>Review of compliance with laws and regulations.</b> The internal audit function may be assigned to review</li> </ul> </li> </ol>

	compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements
Q7.	<p>Explain how Internal Financial Control and Internal controls over financial reporting differ?(SA, Jan 2021, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain clearly the difference between Internal Financial Control and Internal Controls over financial reporting. (RTP, Nov 2021, NA)</p> <p><b>Difference between internal financial control and internal control over financial reporting</b></p> <ul style="list-style-type: none"> <li>The term Internal Financial Controls (IFC) refers to the <b>policies</b> and <b>procedures</b> put in place by companies for ensuring <b>reliability</b> of financial <b>reporting</b>, <b>effectiveness</b> and <b>efficiency</b> of <b>operations</b>, <b>compliance</b> with applicable <b>laws</b> and <b>regulations</b>, <b>safeguarding</b> of <b>assets</b> and <b>prevention</b> and <b>detection</b> of <b>frauds</b>.</li> <li>On the other hand, Internal controls over financial reporting is required where <b>auditors are required to express an opinion on the effectiveness of an</b> entity's internal controls over financial reporting, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.</li> <li>Therefore, "internal financial control" is a wider term whereas "internal controls over financial reporting" is a narrower term restricted to entity's internal controls over financial reporting only</li> </ul>
Q8.	<p>Discuss the objectives and scope of internal audit functions with respect to activities relating to internal control. (SA, Jan 2021, 3 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Saburi Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control. (RTP, May 2022, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Internal audit not only analyses the effectiveness with which the internal control of a company is operating but also improves the effectiveness of internal control. Elucidate the statement. (SA, May 2022, 4 Marks)</p> <p>Objectives and scope of internal audit functions relating to Internal Control are:</p> <ul style="list-style-type: none"> <li><b>Evaluation of internal control:</b> The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending <b>improvements</b> thereto.</li> <li><b>Examination of financial and operating information:</b> The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.</li> <li><b>Review of operating activities:</b> The internal audit function may be assigned to review the <b>economy, efficiency</b> and <b>effectiveness</b> of operating activities, including <b>non-financial</b> activities of an entity.</li> <li><b>Review of compliance with laws and regulations:</b> The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>The scope of work of an internal auditor may extend even beyond the financial accounting. (MTP1, Nov 2019, 2 Marks)</p> <p><b>Correct.</b> As per <b>SA 610</b> "Using the work of internal Auditors", the scope of internal auditor may include <b>Monitoring</b> of internal control, <b>Examination of financial and operating information</b>, <b>Review of operating activities</b>, <b>Review of compliance with laws and regulations</b>, <b>Risk management</b> and <b>Governance</b></p>
Q2.	<p>The objectives and scope of internal audit functions are restricted to activities relating to evaluation of internal control only. (SA, Jan 2021, 2 marks)</p> <p><b>Incorrect.</b> As per <b>SA 610</b>, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The objectives and scope of internal audit functions typically include <b>assurance</b> and <b>consulting</b> activities designed to evaluate and improve the effectiveness of the entity's <b>governance</b> processes, <b>risk management</b> and internal</p>

**control.** From the above, it can be concluded that the objective and scope of internal audit function are not restricted to activities relating to evaluation of control only

### Part III: Multiple Choice Questions

Q1.	<p>Which of the following is not one of functions of internal auditor of an organization?</p> <p>(a) Performing assurance activities (b) Performing consulting activities to improve governance of organization (c) Performing risk management activities (d) Expressing independent opinion on financial statements of organization <b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) Expressing independent opinion on financial statements of organization <b>Explanation:</b> The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control. The external auditor's objective is to express an independent opinion on financial statements of organization</p>
Q2.	<p>Which of the following is not an objective of a company's policies for ensuring "internal financial controls"?</p> <p>(a) Efficient conduct of business (b) Safeguarding of assets (c) Prevention and detection of frauds and errors (d) Assessing audit risk <b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) Assessing audit risk <b>Explanation:</b> Internal financial controls are the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of the accounting records, and timely preparation of reliable financial information</p>
Q3.	<p>Which of the following is true:</p> <p>(a) The internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit. (b) The internal audit plan should, generally be consistent with the goals and objectives of the internal audit function as listed out in the internal audit charter as well as the goals and objectives of the organisation. (c) In case the entire internal audit or the particular internal audit engagement has been outsourced, the internal auditor should also ensure that the plan is consistent with the terms of the engagement. (d) All the above <b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) All the above</p>
Q4.	<p>CA M is internal auditor of Crayon Products Limited. Which of the following is not TRUE about scope of internal audit?</p> <p>(a) Internal audit is an independent assurance activity. (b) Internal audit helps in improving internal control of the company. (c) Internal audit cannot review non-financial activities of company. (d) Internal audit can review compliance of company with various laws and regulations. <b>(MTP2, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (c) Internal audit cannot review non-financial activities of company. <b>Explanation:</b> Statement 3 is incorrect as the internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non financial activities of an entity.</p>

# SA 530 "Audit Sampling"

## Part I : Descriptive Questions

Q1.	<p>An auditor, while conducting audit of an entity, has selected samples based upon his personal experience and knowledge. Later on, it turns out that selected samples were not representative and it has led to faulty selection of samples. The auditor contends that samples were selected based upon his personal experience and knowledge. Can auditor escape from his responsibility in this regard? (ICAI Study Material - Test Your Understanding)</p> <ul style="list-style-type: none"> <li>In the provided situation, the auditor has selected samples based upon his personal experience and knowledge. It is a case of a <b>non-statistical</b> sampling approach adopted by the auditor.</li> <li><b>Whatever</b> may be the <b>approach</b>, non-statistical or statistical sampling, the <b>sample must</b> be <b>representative</b>. This means that it must be <b>closely similar</b> to the whole population although <b>not necessarily</b> exactly the <b>same</b>. T</li> <li>The auditor <b>cannot</b> escape his responsibility in this regard.</li> </ul>
Q2.	<p>What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling". (ICAI Study Material - Test Your Knowledge)</p> <p><b>Meaning of Audit Sampling:</b> "Audit Sampling" means the application of audit procedures to <b>less than 100% of items</b> within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a <b>reasonable basis</b> on which to <b>draw conclusions</b> about the <b>entire population</b>.</p> <p>The objective of the auditor when using audit sampling is to provide a <b>reasonable basis</b> for the auditor to <b>draw conclusions</b> about the population from which the sample is selected.</p> <p><b>Methods of Sampling:</b></p> <ol style="list-style-type: none"> <li><b>Random Sampling:</b> Random selection ensures that <b>all</b> items in the population have an <b>equal</b> chance of selection. It may involve use of random number tables.</li> <li><b>Interval Sampling or Systematic Sampling:</b> Systematic selection is a selection method in which the number of sampling units in the population is <b>divided</b> by the <b>sample size</b> to <b>give a sampling interval</b>, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.</li> <li><b>Monetary Unit Sampling:</b> It is a type of <b>value-weighted selection</b> in which sample size, selection and evaluation results in a conclusion in monetary amounts</li> <li><b>Haphazard sampling:</b> Haphazard selection, in which the auditor selects the sample <b>without following a structured technique</b>. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability. Haphazard selection is not appropriate when using statistical sampling.</li> <li><b>Block Sampling:</b> This method involves <b>selection</b> of a <b>block(s)</b> of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population</li> </ol>
Q3.	<p>With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>State the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (MTP1, Nov 2021, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain the meaning of Audit Sampling as per the relevant standard on auditing. State the requirements relating to audit sampling, sample design, sample size and selection of items for testing. (RTP, Nov 2022, NA)</p> <p>As per <b>SA 530</b> on "Audit Sampling", the meaning of the term Audit Sampling is the application of audit procedures to <b>less than 100% of items</b> within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a <b>reasonable basis</b> on which to <b>draw conclusions</b> about the <b>entire population</b>.</p> <p>The requirements relating to sample design, sample size and selection of items for testing:</p> <ul style="list-style-type: none"> <li><b>Sample design:</b> When designing an audit sample, the auditor shall consider the <b>purpose</b> of the audit procedure and the <b>characteristics</b> of the population from which the sample will be drawn.</li> <li><b>Sample Size:</b> The auditor shall determine a sample size <b>sufficient</b> to <b>reduce sampling risk</b> to an acceptably <b>low</b></li> </ul>

	<p>level.</p> <ul style="list-style-type: none"> <li>• <b>Selection of Items for Testing:</b> The auditor shall select items for the sample in such a way that <b>each</b> sampling unit in the population has a <b>chance of selection</b></li> </ul>
Q4.	<p>While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind? (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks) (RTP, May 2023, NA)</p> <p>OR</p> <p>"Sampling risk can lead to erroneous conclusions". Justify (SA, May 2019, 4 Marks) (MTP2, May 2021, 3 Marks)</p> <p>OR</p> <p>Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk (RTP, May 2022, NA)</p> <p><b>Risk Factors while applying Sampling Techniques:</b></p> <p>As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's <b>conclusion</b> based on a <b>sample</b> may be <b>different</b> from the <b>conclusion</b> if the <b>entire</b> population were <b>subjected</b> to the <b>same audit procedure</b>. Sampling risk can lead to two types of erroneous conclusions-</p> <ol style="list-style-type: none"> <li>In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects <b>audit effectiveness</b> and is more likely to lead to an <b>inappropriate audit opinion</b>.</li> <li>In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects <b>audit efficiency</b> as it would usually lead to <b>additional work</b> to establish that initial conclusions were incorrect</li> </ol> <p><b>NOTE:</b> For a student's understanding, answer is explained in simple language:</p> <ul style="list-style-type: none"> <li>• Situation I: The auditor determines that the controls of the entity are effective and that no misstatements in the FS exist. However, actual controls are not effective, and misstatements exist. The auditor can give an inappropriate opinion in this case, which affects audit effectiveness. (Danger situation)</li> <li>• Situation II: The auditor determines that the controls of the entity are not effective and that misstatements in the FS exist. However, actual controls are effective, and misstatements do not exist. This situation would usually lead to additional work to establish that the initial conclusions were incorrect. More time and effort are required in this situation. (Loss situation)</li> </ul>
Q5.	<p>Write a short note on Advantages of Statistical sampling in Auditing. (ICAI Study Material - Test Your Knowledge)</p> <p>OR</p> <p>Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Explain and also state advantages of Statistical sampling. (MTP1, Nov 2020, 4 Marks)</p> <p>OR</p> <p>What are the advantages of Statistical sampling technique in auditing (RTP, May 2022, NA)</p> <p>Audit testing done through this approach is <b>more scientific</b> than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Statistical sampling has reasonably <b>wide application</b> where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.</p> <p>The advantages of statistical sampling may be summarized as follows -</p> <ul style="list-style-type: none"> <li>• The amount of testing (sample size) does <b>not increase</b> in <b>proportion</b> to the <b>increase</b> in the <b>size</b> of the area (universe) tested.</li> <li>• The sample selection is <b>more objective</b> and thereby more <b>defensible</b>.</li> <li>• The method provides a means of estimating the <b>minimum sample size</b> associated with a <b>specified risk</b> and precision.</li> <li>• It provides a means for deriving a "<b>calculated risk</b>" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.</li> <li>• It may provide a <b>better description</b> of a <b>large</b> mass of <b>data</b> than a complete examination of all the data, since</li> </ul>

	<p>non-sampling errors such as processing and clerical mistakes are not as large.</p> <ul style="list-style-type: none"> <li>It is <b>widely accepted</b> way of sampling as it is <b>more scientific, without</b> personal <b>bias</b> and the result of sample can be evaluated and projected in more reliable way.</li> </ul>
Q6.	<p>Write a short note on Stratified Sampling. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Stratified Sampling</b></p> <ul style="list-style-type: none"> <li>This method involves <b>dividing</b> the whole population to be tested in a <b>few separate groups</b> called <b>strata</b> and taking a sample from each of them.</li> <li><b>Each</b> stratum is treated as if it was a <b>separate population</b> and items are selected from each of these stratum.</li> <li>The number of groups into which the whole population has to be divided is determined on the basis of auditor <b>judgment</b>.</li> </ul> <p><b>Example:</b> The population in the range between ₹500 to ₹ 11,50,000 say for trade receivables balances may be divided into groups as follows:-</p> <ol style="list-style-type: none"> <li>balances in excess of ₹ 10,00,000;</li> <li>balances in the range of ₹ 7,75,001 to ₹ 10,00,000;</li> <li>balances in the range of ₹ 5,50,001 to ₹ 7,75,000</li> <li>balances in the range of ₹ 2,25,001 to ₹ 5,50,000; and</li> <li>balances ₹ 2,25,000 and below.</li> </ol> <p>From these above groups the auditor may pick up different percentages of items from each of the group. -</p> <ul style="list-style-type: none"> <li>From the top group i.e. balances in excess of ₹ 10,00,000, the auditor may examine all the items;</li> <li>from the second group 25% of the items;</li> <li>from the third group 10% of the items; and</li> <li>from the lowest group 2% of the items may be selected</li> </ul>
Q7.	<p>What precautions should be taken by the auditor while applying test check techniques? (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>CA B is appointed as an auditor of M/s. Divine Pharmacy, a wholesale medicine supplier. While auditing for the financial year 2023-24, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard. (SA, July 2021, 4 Marks)</p> <p><b>Precautions to be taken while applying test check techniques are</b></p> <ul style="list-style-type: none"> <li>Thorough study of <b>accounting system</b> should be done before adopting sampling.</li> <li>Proper study of <b>internal control</b> systems.</li> <li><b>Areas</b> which are not <b>suitable</b> for <b>sampling</b> should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.</li> <li>Proper <b>planning</b> for Sampling methods to be used and explaining the staff,</li> <li>Transactions and balances have to be properly <b>classified</b> (stratified)</li> <li>Sample <b>size</b> should be appropriately <b>determined</b>.</li> <li>Sample should be chosen in <b>unbiased</b> way,</li> <li><b>Errors</b> located in the sample should be analysed properly.</li> </ul>
Q8.	<p>Explain the factors to be considered while determining the extent of checking on a sampling plan. (ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks) (RTP, May 2019, NA) (RTP, Nov 2020, NA)</p> <p>The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:</p> <ul style="list-style-type: none"> <li><b>Size</b> of the organisation under audit.</li> <li><b>State</b> of the internal control.</li> <li><b>Adequacy</b> and <b>reliability</b> of books and records.</li> <li><b>Tolerable error</b> range.</li> <li><b>Degree</b> of the desired <b>confidence</b>.</li> </ul>

Q9.	<p>Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non Statistical sampling approaches. <b>(RTP, May 2018, NA)</b></p> <p><b>Statistical sampling:</b></p> <ul style="list-style-type: none"> <li>An approach to sampling that has the following characteristics: <ul style="list-style-type: none"> <li><b>Random selection</b> of the sample items; and</li> <li>The use of <b>probability theory</b> to evaluate sample results, including measurement of sampling risk.</li> </ul> </li> <li>This method is <b>more scientific</b> as it involves use of <b>mathematical</b> laws of probability. This method has <b>reasonably wide</b> application where a population to be tested consists of a large number of <b>similar</b> items</li> </ul> <p><b>Non- Statistical sampling:</b></p> <ul style="list-style-type: none"> <li>A sampling approach that does not have characteristics of random selection and use of probability theory is considered non-statistical sampling.</li> <li>Under this approach, the sample size and its composition are determined on the basis of the <b>personal experience</b> and <b>knowledge</b> of the auditor.</li> <li>This approach has been in common application for many years because of its simplicity in operation.</li> </ul> <p>The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's <b>judgment</b>; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches. Sample must be representative. Whatever may be the <b>approach</b>, non-statistical or statistical sampling, the sample must be <b>representative</b>. This means that it must be <b>closely similar</b> to the whole population although <b>not necessarily</b> exactly the <b>same</b>. The sample must be large enough to provide statistically meaningful results.</p>
Q10.	<p>XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value - weighted sampling techniques. Advise the auditor in accordance with SA 530 <b>(RTP, May 2018, NA) (MTP2, May 2018, 5 Marks) (MTP1, Nov 2019, 4 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. Guide the auditor on the use of stratification and value-weighted sampling techniques. <b>(RTP, Nov 2021, NA)</b></p> <p><b>Stratification and Value-Weighted Selection:</b></p> <p>As per SA 530 "Audit Sampling", the objective of the auditor when using audit sampling is to provide a <b>reasonable basis</b> for the auditor to <b>draw conclusions</b> about the population from which the sample is selected. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate.</p> <p><b>Stratification:</b></p> <ul style="list-style-type: none"> <li>It is the process of <b>dividing</b> a population into sub-populations, each of which is a group of sampling units which have <b>similar characteristics</b> (often monetary value).</li> <li>The objective of stratification is to <b>reduce</b> the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.</li> <li>When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement.</li> <li>Similarly, a population may be stratified according to a particular <b>characteristic</b> that indicates a <b>higher risk</b> of misstatement</li> <li>The results of samples from the units drawn under each subpopulation are projected to that respective stratum. In order to draw an opinion on the overall population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement.</li> </ul> <p><b>Value-Weighted Selection:</b></p> <ul style="list-style-type: none"> <li>When performing tests of details it may be efficient to identify the sampling unit as the <b>individual monetary units</b> that make up the population.</li> <li>One benefit of this approach to defining the sampling unit is that audit effort is directed to the <b>larger value items</b></li> </ul>

	<p>because they have a greater chance of selection, and can result in smaller sample sizes.</p> <ul style="list-style-type: none"> <li>This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.</li> </ul>
Q11.	<p>The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls. <b>(MTP1, May 2018, 5 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen. Explain Stating the examples of factors (any four) that the auditor may consider when determining the sample size for tests of controls. <b>(MTP2, Nov 2018, 5 Marks) (MTP1, May 2019, 4 Marks) (MTP1, May 2020, 3 Marks)</b></p> <p><b>Factors to be considered while determining the sample size for tests of controls:</b></p> <p>The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.</p> <p><b>Examples of Factors Influencing Sample Size for Tests of Controls:</b></p> <ul style="list-style-type: none"> <li>An <b>increase</b> in the extent to which the auditor's <b>risk assessment</b> takes into account relevant controls will <b>increase</b> the sample size.</li> <li>An <b>increase</b> in the <b>tolerable</b> rate of deviation, will <b>decrease</b> the sample size.</li> <li>An <b>increase</b> in the <b>expected</b> rate of deviation of the population to be tested, will <b>increase</b> the sample size.</li> <li>An <b>increase</b> in the auditor's desired level of <b>assurance</b> that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will <b>increase</b> the sample size.</li> </ul>
Q12.	<p>The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain <b>(RTP, May 2019, NA) (RTP, Nov 2023, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. Explain <b>(RTP, May 2020, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>It is imperative for the auditor to project misstatements for the population while performing audit procedures through sampling. Comment. <b>(SA, Nov 2020, 3 Marks) (MTP2, Nov 2023, 2 marks)</b></p> <ul style="list-style-type: none"> <li>As per <b>SA 530</b> "Audit Sampling", the auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.</li> <li>When a misstatement has been established as an <b>anomaly</b>, it may be <b>excluded</b> when <b>projecting misstatements</b> to the population. However, the effect of any such misstatement, if <b>uncorrected</b>, still needs to be considered in <b>addition</b> to the projection of the non-anomalous misstatements.</li> <li>For <b>tests of details</b>, the auditor shall <b>project</b> misstatements found in the sample to the population whereas for <b>tests of controls</b>, <b>no explicit projection</b> of deviations is <b>necessary</b> since the sample deviation rate is also the projected deviation rate for the population as a whole.</li> </ul>
Q13.	<p>There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain <b>(RTP, Nov 2019, NA) (MTP2, May 2022, 3 marks)</b></p> <ul style="list-style-type: none"> <li>No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception.</li> <li>In the traditional approach more emphasis is placed on routine checking, which often is not necessary in view of the <b>time</b> and the <b>cost</b> involved. In routine checking, auditor considers extensive checking and vouching of all entries</li> <li>With the shift in favour of <b>formal internal controls</b> in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly <b>diminished</b> and auditors often find extensive routine checking as <b>nothing</b></li> </ul>



	<p><b>more than a ritual</b> because it <b>seldom reveals anything material</b>.</p> <ul style="list-style-type: none"> <li>Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the <b>questions of principles and controls</b> with a curtailment of non-consequential routine checking.</li> </ul>
Q14.	<p>The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed Explain (RTP, Nov 2019, NA)</p> <ul style="list-style-type: none"> <li>The auditor is required to <b>express</b> an <b>opinion</b> on the financial statements. For this purpose, the auditor is required to decide the extent of the checking to be performed. The extent of the checking to be undertaken is primarily a matter of <b>judgment</b> of the auditor, there is <b>nothing statutorily stated</b> anywhere which specifies <b>what</b> work is to be done, <b>how</b> it is to be done and to what <b>extent</b>.</li> <li>It is also <b>not obligatory</b> that the auditor must <b>adopt</b> the <b>sampling technique</b>.</li> <li>To ensure a good and reasonable standard of work, he <b>should adopt standards</b> and techniques that can lead him to an <b>informed professional opinion</b>. On a consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are <b>widely followed</b> and which have a recognised basis.</li> <li>Since statistical theory of sampling is based on a <b>scientific</b> law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability.</li> </ul>
Q15.	<p>Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example. (RTP, May 2020, NA)</p> <p><b>Block Sampling:</b></p> <ul style="list-style-type: none"> <li>This method involves <b>selection</b> of a <b>block(s)</b> of contiguous items from within the population.</li> <li>Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.</li> <li>In some circumstances it may be an appropriate audit procedure to examine a block of items, it would <b>rarely</b> be an <b>appropriate</b> sample selection <b>technique</b> when the auditor intends to <b>draw valid inferences</b> about the <b>entire</b> population based on the sample.</li> </ul> <p>Example: Take the first 300 sales invoices from the sales day book in the month of August; alternatively take any five blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.</p>
Q16.	<p>Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk leads to erroneous conclusions. Explain in detail distinguishing it from nonsampling risk with examples. (RTP, Nov 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'NonSampling risk'. (SA, Jan 2021, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>While designing an audit sample, the auditor shall determine a sample size sufficient to reduce the sampling risk to an acceptably low level. In this context, explain sampling risk and non-sampling risk. (SA, May 2023, 4 marks)</p> <p>As per <b>SA 530</b> "Audit Sampling", sampling risk is the risk that the auditor's <b>conclusion</b> based on a <b>sample</b> may be <b>different</b> from the <b>conclusion</b> if the <b>entire</b> population were <b>subjected</b> to the <b>same audit procedure</b>. Sampling risk can lead to two types of erroneous conclusions-</p> <ol style="list-style-type: none"> <li>In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects <b>audit effectiveness</b> and is more likely to lead to an <b>inappropriate audit opinion</b>.</li> <li>In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects <b>audit efficiency</b> as it would usually lead to <b>additional work</b> to establish that initial conclusions were incorrect</li> </ol> <p><b>Non-Sampling Risk.</b> The risk that the auditor reaches an erroneous conclusion for any reason <b>not related to sampling risk</b>.</p>

	<p>Non sampling risk can <b>never be mathematically measured</b>. Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.</p> <p><b>Sources of Non Sampling risk are :</b></p> <ul style="list-style-type: none"> <li>• <b>Human Mistakes</b></li> <li>• Applying <b>audit procedures not appropriate</b> to the objectives of audit</li> <li>• Relying on <b>erroneous information</b> e.g. erroneous confirmation</li> <li>• <b>Misinterpreting</b> the sample results</li> </ul>
Q17.	<p>In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. Explain in detail. (RTP, May 2021, NA)</p> <ul style="list-style-type: none"> <li>• In most of the circumstances, the evidence available is not conclusive and the auditor always takes a <b>calculated risk</b> in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries.</li> <li>• Auditors realised that they can derive good satisfaction by undertaking a much lesser checking by adoption of this technique in the auditing process. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population.</li> <li>• By adopting the sampling technique, the auditor only checks a <b>part</b> of the whole mass of transactions. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records. Sampling is used as a part of the Test of controls. Auditors will check a few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e checking of transactions and balances)</li> <li>• If the <b>internal control</b> is <b>satisfactory</b> in its design and implementation, a much <b>smaller sample</b> can give the auditor the necessary reliability of the result he obtains. On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result.</li> <li>• Another truth about the sampling technique should be noted. It can <b>never bring complete reliability</b>; it <b>cannot give precisely accurate results</b>. It is a process of <b>estimation</b>. It may have some errors. What error is tolerable for a particular matter under examination is a matter of the individual's <b>judgment</b> in that particular case.</li> </ul>
Q18.	<p>Explain the following terms with reference to Audit Sampling :</p> <ol style="list-style-type: none"> <li>Stratification</li> <li>Tolerable misstatement</li> <li>Tolerable rate of deviation</li> </ol> <p>(RTP, May 2021, NA)</p> <ul style="list-style-type: none"> <li>• <b>Stratification:</b> The process of <b>dividing</b> a population into sub-populations, each of which is a group of sampling units which have <b>similar</b> characteristics (often monetary value).</li> <li>• <b>Tolerable misstatement:</b> A <b>monetary amount</b> set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is <b>not exceeded</b> by the <b>actual misstatement</b> in the population.</li> <li>• <b>Tolerable rate of deviation:</b> A <b>rate of deviation</b> from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is <b>not exceeded</b> by the <b>actual rate of deviation</b> in the population.</li> </ul>
Q19.	<p>CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of the Sampling to be used by him in auditing. (MTP2, Nov 2021, 3 marks)</p> <p><b>Sample Selection:</b></p> <p>CA. X should obtain the knowledge before using the sampling methods. The principal methods are as follows:</p> <ul style="list-style-type: none"> <li>• <b>Random</b> selection.</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Systematic</b> selection.</li> <li>• <b>Monetary Unit</b> sampling.</li> <li>• <b>Haphazard</b> selection.</li> <li>• <b>Block</b> selection.</li> </ul> <p>Advantages of Statistical Sampling in Auditing:</p> <ul style="list-style-type: none"> <li>• The amount of testing (sample size) does <b>not increase</b> in <b>proportion</b> to the <b>increase</b> in the <b>size</b> of the area (universe) tested.</li> <li>• The sample selection is <b>more objective</b> and thereby more <b>defensible</b>.</li> <li>• The method provides a means of estimating the <b>minimum sample size</b> associated with a <b>specified risk</b> and precision.</li> <li>• It provides a means for deriving a "<b>calculated risk</b>" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.</li> <li>• It may provide a <b>better description</b> of a <b>large</b> mass of <b>data</b> than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.</li> <li>• It is <b>widely accepted</b> way of sampling as it is <b>more scientific</b>, <b>without</b> personal <b>bias</b> and the result of sample can be evaluated and projected in more reliable way.</li> </ul>
Q20.	<p>With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details –</p> <ol style="list-style-type: none"> <li>i) The desired level of assurance</li> <li>ii) Stratification of the population</li> </ol> <p>(SA, Dec 2021, 3 marks)</p> <p><b>Examples of factors influencing Sample Size for Test of Details:</b></p> <ul style="list-style-type: none"> <li>• <b>Desired Level of Assurance:</b> An <b>increase</b> in the auditor's desired level of <b>assurance</b> that tolerable misstatement is not exceeded by actual misstatement in the population will <b>increase</b> the <b>sample size</b>. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.</li> <li>• <b>Stratification of population:</b> When stratification of the population is appropriate then sample size will <b>decrease</b> as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.</li> </ul>
Q21.	<p>ABC Ltd is a Large Company with huge purchase and sales transactions. Which sampling approach is recommended in such a company? Explain giving features of such sampling approach along with example (MTP1, May 2022, 3 Marks)</p> <p>In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the samples selected are not prejudged.</p> <p>Features/Characteristics of Statistical Sampling:</p> <ul style="list-style-type: none"> <li>• Audit testing done through this approach is <b>more scientific</b> than testing based entirely on the auditor's own judgment because it involves use of <b>mathematical</b> laws of probability in determining the appropriate sample size in varying circumstances.</li> <li>• Statistical sampling has reasonably <b>wide application</b> where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.</li> <li>• There is <b>no personal bias</b> of the auditor in case of statistical sampling. Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner.</li> </ul> <p>For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 50,000 in number, then in such case, statistical sampling will be highly recommended in the audit programme.</p>
Q22.	<p>The approach to audit and extent of checking are undergoing a progressive change in favour of more attention towards the questions of principle and controls with a curtailment of non-consequential routine checking. Discuss the given statement.</p> <p>(SA, May 2022, 3 Marks)</p>

	<ul style="list-style-type: none"> <li>No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all the efforts are directed to check all transactions without any exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the <b>time</b> and the <b>cost</b> involved.</li> <li>With the shift in favour of <b>formal internal controls</b> in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly <b>diminished</b>. Thus, the auditors often find extensive routine checking as <b>nothing more than a ritual</b> because it <b>seldom reveals anything material</b>. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the <b>questions of principles and controls</b> with a curtailment of non-consequential routine checking.</li> <li>By routine checking, we traditionally think of <b>extensive checking</b> and <b>vouching</b> of all the entries, <b>disregarding</b> the concept of <b>materiality</b>. The extent of the checking to be undertaken is primarily a matter of <b>judgment</b> of the auditor. There is <b>nothing statutorily stated</b> anywhere which specifies <b>what</b> work is to be done, <b>how</b> it is to be done and to what <b>extent</b> it has to be done.</li> <li>It is also <b>not obligatory</b> that the auditor must adopt the <b>sampling</b> technique. What he is to do as an auditor is to <b>express</b> his <b>opinion</b> on the financial statements and become bound by that.</li> <li>To ensure good and reasonable standard of work, he <b>should adopt standards</b> and techniques that can lead him to an <b>informed professional opinion</b>. This enables the auditor to make conclusions and express fair opinion without having to check all of the items within the financial statements.</li> </ul>
Q23.	<p>This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range. Explain about that method. (RTP, Nov 2022, NA)</p> <p><b>Simple Random Sampling:</b></p> <ul style="list-style-type: none"> <li>Under this method <b>each unit</b> of the whole population e.g. purchase or sales invoice has an equal chance of being selected.</li> <li>Samples are selected through a <b>random number table</b>.</li> <li>Random number tables are simple and <b>easy</b> to use and also provide assurance that the auditors' <b>bias does not affect the selection</b>.</li> <li>Each item in a population is selected by use of a random number table either with the help of a computer or picking up a number in a random way.</li> <li>This method is considered appropriate provided the population to be sampled consists of <b>reasonably similar units</b> and fall within a reasonable range i.e it is suitable for a <b>homogeneous</b> population having a similar range</li> </ul>
Q24.	<p>What are the matters that the auditor shall consider while designing an audit sample? (SA, Nov 2022, 3 marks)</p> <p><b>Matters to be considered while designing an Audit Sample:</b></p> <p>As per SA 530, "Audit Sampling", when designing an audit sample, the auditor shall</p> <ul style="list-style-type: none"> <li>consider the <b>purpose</b> of the audit procedures and the <b>characteristics</b> of the population from which the sample will be drawn.</li> <li>determine a sample size sufficient to <b>reduce</b> sampling <b>risk</b> to an acceptably <b>low</b> level.</li> <li>select items for the sample in such a way that <b>each</b> sampling <b>unit</b> in the population has a <b>chance of selection</b>.</li> <li>determine that the sample selected must be <b>representative</b> of the population.</li> <li>consider including the <b>specific purpose</b> to be achieved and the combination of audit procedures that is likely to best achieve that purpose.</li> <li>consider <b>nature</b> of the audit <b>evidence</b> sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.</li> <li>perform audit <b>procedures</b> to obtain evidence that the population from which the audit sample is drawn is <b>complete</b>.</li> </ul>
Q25.	<p>Random selection ensures that all items in the population or within each stratum have a known chance of selection. Random sampling includes two very popular methods. Explain. (RTP, May 2023, NA)</p> <p>Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Random sampling includes two very popular methods which are discussed below–</p> <ul style="list-style-type: none"> <li><b>Simple Random Sampling:</b> <ul style="list-style-type: none"> <li>Under this method <b>each unit</b> of the whole population e.g. purchase or sales invoice has an equal chance of</li> </ul> </li> </ul>

	<p>being selected.</p> <ul style="list-style-type: none"> <li>○ Samples are selected through a <b>random number table</b>.</li> <li>○ Random number tables are simple and <b>easy</b> to use and also provide assurance that the auditors' <b>bias does not affect the selection</b>.</li> <li>○ Each item in a population is selected by use of a random number table either with the help of a computer or picking up a number in a random way.</li> <li>○ This method is considered appropriate provided the population to be sampled consists of <b>reasonably similar units</b> and fall within a reasonable range i.e it is suitable for a <b>homogeneous</b> population having a similar range</li> </ul> <ul style="list-style-type: none"> <li>● <b>Stratified Sampling:</b> This method involves <b>dividing</b> the whole population to be tested in a <b>few separate groups</b> called <b>strata</b> and taking a sample from each of them. <b>Each stratum</b> is treated as if it was a <b>separate population</b> and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor <b>judgment</b></li> </ul>
Q26.	<p>Chintamani Ltd appoints Chintan &amp; Mani as statutory auditors for the financial year 2022-2023. Chintan &amp; Mani seem to have different opinion on audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population. Chintan is concerned whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530 (RTP, Nov 2023, NA)</p> <p>As per SA 530, "Audit Sampling", the auditor shall evaluate:</p> <ol style="list-style-type: none"> <li>a) The <b>results</b> of the sample; and</li> <li>b) Whether the <b>use</b> of audit <b>sampling</b> has provided a <b>reasonable basis</b> for <b>conclusions</b> about the population that has been tested.</li> </ol> <p>If the auditor concludes that audit sampling has <b>not</b> provided a reasonable basis for conclusions about the population that has been tested, the auditor may:</p> <ul style="list-style-type: none"> <li>● <b>Request management</b> to <b>investigate</b> misstatements that have been identified and the potential for further misstatements and to make any <b>necessary adjustments</b>; or</li> <li>● Tailor the <b>nature, timing</b> and <b>extent</b> of those <b>further audit procedures</b> to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.</li> </ul>
Q27.	<p>What is tolerable misstatement and total rate of deviation? (MTP1, Nov 2023, 3 marks)</p> <ul style="list-style-type: none"> <li>● Tolerable misstatement is a <b>monetary amount</b> set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is <b>not exceeded</b> by the <b>actual misstatement</b> in the population. When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.</li> <li>● Total rate of deviation / Tolerable rate of deviation - A <b>rate of deviation</b> from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is <b>not exceeded</b> by the <b>actual rate of deviation</b> in the population</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Incorrect.</b> Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.</p>
Q2.	<p>Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics. (ICAI Study Material - Test Your Knowledge)</p>

	<b>Incorrect.</b> <b>Statistical sampling</b> is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics
Q3.	The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. <b>(ICAI Study Material - Test Your Knowledge)</b>
	<b>Incorrect.</b> The objective of stratification is to <b>reduce</b> the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
Q4.	Stratified Sampling is used for homogeneous population. <b>(ICAI Study Material - Test Your Knowledge)</b>
	<b>Incorrect.</b> Stratified sampling is used when the population is diversified i.e <b>heterogeneous</b> . The population is divided into sub population having <b>similar</b> characteristics. Sample are then chosen from these sub populations which are called Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.
Q5.	Non statistical sampling is considered to be more scientific than the statistical sampling. <b>(ICAI Study Material - Test Your Knowledge)</b>
	<b>Incorrect.</b> <b>Statistical</b> sampling uses the <b>scientific</b> method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an <b>equal chance</b> of getting selected. In the <b>non statistical</b> sampling, auditors' <b>judgment</b> and past experience is used to choose samples without any scientific method
Q6.	In case of Statistical sampling, auditor's bias in choosing sample is involved <b>(ICAI Study Material - Test Your Knowledge)</b>
	<b>Incorrect.</b> <b>Statistical</b> sampling uses the <b>scientific</b> method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an <b>equal chance</b> of getting selected. In the <b>non-statistical</b> sampling, auditor's <b>judgment</b> and past experience is used to choose samples without and scientific method. Hence, <b>personal bias is involved in Non statistical sampling</b> and not Statistical.
Q7.	When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation. <b>(ICAI Study Material - Test Your Knowledge) (SA, May 2018, 2 Marks)</b> <b>OR</b> Sample need not be representative. <b>(ICAI Study Material - Test Your Knowledge)</b>
	<b>Incorrect.</b> Whatever may be the <b>approach</b> , non-statistical or statistical sampling, the <b>sample must be representative</b> . This means that it must be <b>closely similar</b> to the whole population although <b>not necessarily</b> exactly the <b>same</b> . The sample must be large enough to provide statistically meaningful results.
Q8.	The method which involves dividing the population into groups of items is known as block sampling. <b>(ICAI Study Material - Test Your Knowledge) (MTP1, Nov 2019, 2 Marks)</b>
	<b>Incorrect.</b> The method which involves dividing the population into groups of items is known as <b>cluster</b> sampling whereas block sampling involves the <b>selection</b> of a defined <b>block</b> of <b>consecutive</b> items.
Q9.	In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population <b>(ICAI Study Material - Test Your Knowledge) (SA, July 2021, 2 Marks)</b>
	<b>Incorrect.</b> In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the <b>possible</b> effect of <b>misstatement</b> or deviation. Hence the samples are used to derive conclusions only on the <b>respective stratum</b> from where they are drawn and <b>not the whole population</b> .
Q10.	Low acceptable sampling risk requires larger sample size. <b>(ICAI Study Material - Test Your Knowledge) (MTP1, May 2023, 2 marks)</b>
	<b>Correct.</b> Sampling risk arises from the possibility that the auditor's <b>conclusion</b> based upon the <b>sample</b> may be <b>different</b> from the <b>conclusion</b> that would have been reached if the <b>same</b> audit <b>procedures</b> were applied on the <b>entire population</b> . If acceptable sampling risk is <b>low</b> , <b>large</b> sample <b>size</b> is needed.

Q11.	<p>According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to 100% of items within a population of audit relevance. <b>(MTP1, May 2018, 2 Marks) (MTP1, May 2019, 2 Marks)</b></p> <p><b>Incorrect.</b> According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to <b>less than 100% of items</b> within a population of audit relevance such that all sampling units have a <b>chance of selection</b> in order to provide the auditor with a <b>reasonable basis</b> on which to <b>draw conclusions</b> about the <b>entire population</b>.</p>
Q12.	<p>Stratified Sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. <b>(MTP2, Nov 2018, 2 Marks)</b></p> <p><b>Correct.</b> Stratified Sampling involves <b>dividing</b> the whole population to be tested in a <b>few separate groups</b> called <b>strata</b> and taking a sample from each of them. <b>Each stratum</b> is treated as if it was a <b>separate population</b> and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor <b>judgment</b>.</p>
Q13.	<p>Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches. <b>(MTP2, May 2019, 2 Marks) (RTP, Nov 2023, NA)</b></p> <p><b>Correct.</b> The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's <b>judgment</b>; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.</p> <p><b>Whatever</b> may be the <b>approach</b>, non-statistical or statistical sampling, the <b>sample must be representative</b>. This means that it must be <b>closely similar</b> to the whole population although <b>not necessarily</b> exactly the <b>same</b>. The sample must be large enough to provide statistically meaningful results.</p>
Q14.	<p>The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. <b>(SA, Nov 2019, 2 Marks)</b></p> <p><b>Correct.</b> The non-statistical sampling is criticized on the grounds that it is <b>neither objective nor scientific</b>. The expected <b>degree of objectivity</b> cannot be assured in non-statistical sampling because the <b>risk of personal bias</b> in selection of sample items cannot be eliminated. The closeness of the qualities projected by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques.</p>
Q15.	<p>Statistical sampling has narrower application where a population to be tested consists of a large number of similar items. <b>(RTP, May 2020, NA)</b></p> <p><b>Incorrect.</b> Statistical sampling has reasonably <b>wide application</b> where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.</p>
Q16.	<p>Statistical sampling being more scientific and without personal bias bias will always be appropriate to use under all circumstances <b>(SA, Dec 2021, 2 marks) (MTP2, May 2023, 2 marks) (MTP2, Nov 2023, 2 marks)</b></p> <p><b>Incorrect.</b> Statistical sampling is a <b>widely</b> accepted way of sampling as it is <b>more scientific</b>, without personal bias and the result of sample can be evaluated and projected in more reliable way.</p> <p>Under some audit circumstances, statistical sampling methods <b>may not</b> be <b>appropriate</b>. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc</p>
Q17.	<p>The level of sampling risk that the auditor is willing to accept will not affect the sample size. <b>(MTP2, May 2022, 2 marks) (RTP, Nov 2022, NA)</b></p> <p><b>Incorrect.</b> As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The <b>lower</b> the <b>risk</b> the auditor is willing to accept, the <b>greater</b> the <b>sample size</b> will need to be.</p>
Q18.	<p>In case of stratified sampling, the conclusions are drawn on the stratum. <b>(MTP1, Nov 2022, 2 Marks)</b></p> <p><b>Correct.</b> In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the <b>possible</b> effect of <b>misstatement</b> or deviation. Hence the samples are used to</p>

	derive conclusion <b>only</b> on the <b>respective stratum</b> from where they are drawn and <b>not</b> the <b>whole population</b> .
Q19.	<p>Systematic sampling means dividing heterogeneous population into homogeneous sub population, where samples are drawn from each sub population. <b>(MTP2, Nov 2022, 2 Marks)</b></p> <p><b>Incorrect.</b> Stratification means <b>dividing a heterogeneous population into a homogeneous</b> sub population, where samples are drawn from each sub population. Systematic sampling is a selection method in which the number of sampling units in the population is <b>divided by the sample size</b> to give a <b>sampling interval</b>, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.</p>
Q20.	<p>The higher the auditor's assessment of the risk of material misstatement, the smaller the sample size needs to be. <b>(MTP2, Nov 2022, 2 marks)</b></p> <p><b>Incorrect.</b> The <b>higher</b> the auditor's <b>assessment</b> of the risk of material misstatement, the <b>larger</b> the <b>sample size</b> needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk. Therefore, in order to <b>reduce</b> audit <b>risk</b> to an acceptably low level, the auditor needs a <b>low detection risk</b> and will rely <b>more</b> on <b>substantive procedures</b>. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.</p>

### Part III: Multiple Choice Questions

Q1.	<p>Which of the following is not an advantage of statistical sampling?</p> <p>(a) Sample size does not increase in proportion to size of area tested.</p> <p>(b) Sample selection is more objective.</p> <p>(c) It provides a means of deriving a calculated risk and corresponding precision.</p> <p>(d) In case of verifying compliance with specific legal requirements, it is suitable.</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>Correct answer:</b> (d) In case of verifying compliance with specific legal requirements, it is suitable.</p>
Q2.	<p>As the number of transactions of WY Limited for the financial year 2023-24 were very large, the auditor of WY Limited decided to use the technique of Audit Sampling. Before selecting the sample from Repair and Maintenance Expenses, the auditor of WY Limited wished that the entire data of Repair and Maintenance Expenses of WY Limited for financial year 2023-24 should have three characteristics. These three characteristics are:</p> <p>(a) Simple, Completeness, Relevant.</p> <p>(b) Appropriateness, Simple, Relevant.</p> <p>(c) Reliable, Simple, Relevant.</p> <p>(d) Appropriateness, Completeness, Reliable.</p> <p><b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (d) Appropriateness, Completeness, Reliable</p> <p><b>Explanation:</b> Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. Characteristics of Population are Appropriateness, completeness and Reliable.</p>
Q3.	<p>The main advantage of using statistical sampling techniques is that such techniques:</p> <p>(a) Mathematically measure risk</p> <p>(b) Eliminate the need for judgmental sampling</p> <p>(c) Defines the values of tolerable error</p> <p>(d) All of the them</p> <p><b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) Mathematically measure risk</p>
Q4.	<p>Which of the following is more scientific:</p> <p>(a) Statistical</p>



	<p>(b) Non- statistical (c) both (a) and (b) (d) none of the above <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (a) Statistical <b>Explanation:</b> Statistical sampling uses the scientific method of choosing samples from a given population. In the non-statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.</p>
Q5.	<p>Statistical sampling has the following characteristics (a) Random selection (b) Use of Probability theory (c) both (a) and (b) (d) Judgmental approach <b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (c) both (a) and (b)</p>
Q6.	<p>Which of the following factors is (are) considered in determining the sample size for tests of control? (a) Projected error (b) Tolerable error (c) Expected error (d) Both (b) and (c) <b>(Sample MCQs) (ICAI MCQs)</b></p> <p><b>Correct answer:</b> (d) Both (b) and (c) <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Tolerable error means the maximum error in a population that the auditor is willing to accept.</li> <li>• Expected errors are errors that the auditor expects in the population based on prior audit results, changes in processes, and evidence/conclusions from other sources.</li> </ul>
Q7.	<p>Tolerable error, is the maximum monetary error that the auditor is prepared to accept in the population and still conclude that audit objective has been achieved, is directly related to (a) Sample size (b) Audit risk (c) Materiality (d) Expected error <b>(Sample MCQs) (ICAI MCQs)</b></p> <p><b>Correct answer:</b> (c) Materiality <b>Explanation:</b> Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditor's judgment about materiality. The larger the tolerable error, the smaller the sample size will need to be. That means if the auditor can tolerate a high level of risk that means less checking to be done i.e. a high level of materiality will be determined by the auditor.</p>
Q8.	<p>Which of the following is source of Non Sampling risk : (a) Human Mistakes (b) Applying audit procedures not appropriate to the objectives of audit (c) Misinterpreting the sample results (d) All of the above <b>(Sample MCQs) (ICAI MCQs)</b></p> <p><b>Correct answer:</b> (d) All of the above <b>Explanation:</b> Sources of Non Sampling risk are Human Mistakes, Applying audit procedures not appropriate to the objectives of audit, Relying on erroneous information e.g. erroneous confirmation, Misinterpreting the sample results</p>

Q9.	<p>While auditing TEN Ltd., CA. Porky divided the whole population of trade receivables balances to be tested in a few separate groups called 'strata' and started taking a sample from each of them. He treated each stratum as if it was a separate population. He divided the trade receivables balances of TEN Ltd. for the Financial Year 2022-23 into groups on the basis of personal judgment as follows:</p> <table border="1" data-bbox="188 237 1062 510"> <thead> <tr> <th>S. No.</th><th>Particulars</th></tr> </thead> <tbody> <tr> <td>1</td><td>Balances in excess of ₹ 10,00,000;</td></tr> <tr> <td>2</td><td>Balances in the range of ₹ 7,75,001 to ₹ 10,00,000;</td></tr> <tr> <td>3</td><td>Balances in the range of ₹ 5,50,001 to ₹ 7,75,000;</td></tr> <tr> <td>4</td><td>Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;</td></tr> <tr> <td>5</td><td>Balances ₹ 2,25,000 and below</td></tr> </tbody> </table> <p>From the abovementioned groups, CA. Porky picked up different percentage of items for examination from each of the groups, for example, from the top group i.e. balances in excess of ₹10,00,000, he selected all the items to be examined; from the second group, he opted for 25 % of the items to be examined; from the lowest group, he selected 2% of the items for examination; and so on from rest of the groups. Which one of the following methods of sample selection is he following?</p> <p>(a) Systematic sampling.          (b) Stratified sampling.          (c) Section sampling.          (d) Selection sampling.</p> <p><b>(Sample MCQs)</b></p>	S. No.	Particulars	1	Balances in excess of ₹ 10,00,000;	2	Balances in the range of ₹ 7,75,001 to ₹ 10,00,000;	3	Balances in the range of ₹ 5,50,001 to ₹ 7,75,000;	4	Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;	5	Balances ₹ 2,25,000 and below
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4	Balances in the range of ₹ 2,25,001 to ₹ 5,50,000;												
5	Balances ₹ 2,25,000 and below												
	<p><b>Correct answer:</b> (b) Stratified sampling.  <b>Explanation:</b> Stratified sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them.</p>												
Q10.	<p>In random Sample, each item of population has</p> <p>(a) equal chance of selection          (b) has varying chance of selection depending upon placing of items.          (c) may have a chance of selection based on auditors professional judgement          (d) All of these</p> <p><b>(ICAI MCQs)</b></p>												
Q11.	<p>The relationship between tolerable error and sample size is</p> <p>(a) Inverse          (b) Direct          (c) Close          (d) There is no relationship.</p> <p><b>(ICAI MCQs) (MTP2, May 2023, 1 mark)</b></p>												
	<p><b>Correct answer:</b> (a) Inverse  <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Tolerable error is the maximum error in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved the audit objective.</li> <li>If there is an increase in the tolerable error, then sample size will decrease, as lower the tolerable error, larger the sample size needs to be. That means if the auditor can tolerate a high level of risk that means less checking to be done because deviation/misstatements can be accepted and less samples are drawn thus, sample size decreases.</li> </ul>												
Q12.	<p>In the case of tests of details</p> <p>(a) the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.          (b) the projected misstatement is the auditor's best estimate of misstatement in the population.          (c) the anomalous misstatement is the auditor's best estimate of misstatement in the population.</p>												

	<p>(d) the projected misstatement plus anomalous misstatement, if any, cannot be the auditor's best estimate of misstatement in the population.</p> <p><b>(MTP1, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (a) the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.</p>
Q13.	<p>Which of the following is correct :</p> <p>(a) When the projected misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.</p> <p>(b) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.</p> <p>(c) When the anomalous misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.</p> <p>(d) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about the population that has been tested.</p> <p><b>(MTP1, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (b) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.</p>
Q14.	<p>It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts :</p> <p>(a) Haphazard sampling</p> <p>(b) Monetary Unit Sampling</p> <p>(c) Stratified Sampling</p> <p>(d) Interval sampling</p> <p><b>(MTP2, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (b) Monetary Unit Sampling</p>
Q15.	<p>_____ in which the auditor selects the sample without following a structured technique.</p> <p>(a) Haphazard selection,</p> <p>(b) Monetary Unit Sampling</p> <p>(c) Block Sampling</p> <p>(d) Structured Sampling</p> <p><b>(RTP, May 2021, NA)</b></p>
	<p><b>Correct answer:</b> (a) Haphazard selection</p>
	<p><b>Explanation:</b> In Haphazard selection, the auditor does not follow a structured technique but avoids bias or predictability</p>

## SA 501 "Audit Evidence- Specific Considerations for Selected Items"

### Part I : Descriptive Questions

Q1.	<p>The audit procedures performed so far by auditor of a company indicate that there is a possibility that company has not disclosed all material litigation cases involving the company. Does such a situation warrant direct communication by auditor with external lawyer of the company? <b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p>As per requirements of <b>SA 501</b>, If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, seek <b>direct communication with the entity's external legal counsel</b>. The above situation warrants direct communication with the company's standing external lawyer.</p>

Q2.	<p>JK Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of JK Exports Ltd. considers that inventory held with job workers is material to the financial statements. Suggest the audit procedures in the given case. <b>(ICAI Study Material - Illustration)</b></p>
	<p>When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:</p> <ol style="list-style-type: none"> <li>Request <b>confirmation</b> from the third party as to the <b>quantities</b> and <b>condition</b> of inventory held on behalf of the entity.</li> <li>Perform <b>inspection</b> or other audit procedures appropriate in the circumstances.</li> </ol>
Q3.	<p>Parag India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims resulting to risk of material misstatements. Suggest the auditor with reference to SAs. <b>(ICAI Study Material - Illustration) (SA, May 2019, 4 Marks) (MTP1, May 2020, 4 Marks) (MTP2, May 2021, 3 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV &amp; Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose. <b>(RTP, May 2022, NA)</b></p> <p>The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:</p> <ol style="list-style-type: none"> <li><b>Inquiry</b> of management and, where applicable, others within the entity, including in-house legal counsel;</li> <li>Reviewing <b>minutes</b> of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and</li> <li>Reviewing <b>legal expense accounts</b>.</li> </ol> <p>If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek <b>direct communication with the entity's external legal counsel</b>.</p>
Q4.	<p>Briefly mention the matters that are relevant in planning attendance at physical inventory counting. <b>(ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks) (RTP, May 2020, NA)</b></p> <p>Matters relevant in planning attendance at physical inventory counting: Matters relevant in planning attendance at physical inventory counting include, for example:</p> <ul style="list-style-type: none"> <li><b>Nature</b> of inventory.</li> <li><b>Stages</b> of completion of work in progress.</li> <li>The <b>risks</b> of material misstatement related to inventory.</li> <li>The nature of the <b>internal control</b> related to inventory.</li> <li>Whether <b>adequate procedures</b> are expected to be established and proper instructions issued for physical inventory counting.</li> <li>The <b>timing</b> of physical inventory counting.</li> <li>Whether the entity maintains a <b>perpetual inventory system</b>.</li> <li>The <b>locations</b> at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate</li> <li>Whether the <b>assistance</b> of an auditor's <b>expert</b> is needed.</li> </ul>
Q5.	<p>ABC Ltd is engaged in manufacturing of different type of yarns. On going through its financial statements for the past years, it is observed that inventory is material to the financial statements. You as an auditor of the company wanted to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as appearing in the financial statements. Discuss, how would you proceed as an auditor. <b>(MTP1, May 2018, 5 Marks) (MTP1, Nov 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks) (MTP1, May 2019, 4 Marks) (MTP1, May 2020, 4 Marks)</b></p> <p>When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the <b>existence</b> and <b>condition</b> of inventory by:</p>

	<ul style="list-style-type: none"> <li>● <b>Attendance</b> at <b>physical inventory counting</b>, unless impracticable, to: <ul style="list-style-type: none"> <li>○ Evaluate <b>management's instructions</b> and <b>procedures</b> for recording and controlling the results of the entity's physical inventory counting;</li> <li>○ <b>Observe</b> the performance of management's count procedures;</li> <li>○ <b>Inspect</b> the inventory; and</li> <li>○ Perform <b>test counts</b>; and</li> </ul> </li> <li>● <b>Performing audit procedures</b> over the <b>entity's final inventory records</b> to determine whether they accurately reflect actual inventory count results.</li> </ul>
Q6.	<p>TRM Ltd. is a company engaged in manufacture of beauty products. It has hair care segment, skin care segment and kids' beauty products. The auditor wants to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework. Suggest the audit procedures in the given case. <b>(MTP1, May 2021, 4 Marks)</b></p> <p>The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:</p> <ul style="list-style-type: none"> <li>● <b>Obtaining</b> an <b>understanding</b> of the <b>methods</b> used by management in determining segment information. Further, <ul style="list-style-type: none"> <li>○ Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and</li> <li>○ Where appropriate, testing the application of such methods; and</li> </ul> </li> <li>● Performing <b>analytical procedures</b> or <b>other</b> audit procedures appropriate in the circumstances</li> </ul>
Q7.	<p>GPS &amp; Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2024 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS &amp; Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GPS &amp; Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing. <b>(RTP, May 2022, NA)</b></p> <p>The auditors, GPS &amp; Co wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information.</p> <p>As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:</p> <ul style="list-style-type: none"> <li>● <b>Sales</b>, transfers and charges between segments, and elimination of inter segment amounts.</li> <li>● <b>Comparisons</b> with <b>budgets</b> and other expected results, for example, operating profits as a percentage of sales.</li> <li>● The <b>allocation</b> of assets and costs among segments.</li> <li>● <b>Consistency</b> with <b>prior periods</b>, and the <b>adequacy</b> of the disclosures with respect to inconsistencies.</li> </ul>
Q8.	<p>SPR Ltd has been into the media business since 1990. During the F.Y 2023-2024 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances? <b>(SA, May 2022, 3 Marks)</b></p> <p><b>Circumstances when becoming necessary to meet with external legal counsel:</b></p> <p>In certain circumstances, the auditor also may judge it <b>necessary to meet</b> with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:</p> <ul style="list-style-type: none"> <li>● The auditor determines that the matter is a <b>significant risk</b>.</li> <li>● The matter is <b>complex</b>.</li> <li>● There is <b>disagreement</b> between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.</li> </ul>
Q9.	<p>What auditor should do if it is impracticable to attend the physical inventory count? <b>(SELF)</b></p> <ul style="list-style-type: none"> <li>● If attendance at physical inventory counting is impracticable, the auditor shall <b>perform alternative audit procedures</b></li> </ul>

	<p>to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.</p> <ul style="list-style-type: none"> <li>• If it is <b>not</b> possible to do so, the auditor shall <b>modify</b> the opinion in the auditor's report in accordance with <b>SA 705</b>.</li> <li>• In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor.</li> </ul>
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## Part II: Correct/Incorrect Questions

Q1.	<p>If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, the auditor need not seek direct communication with the entity's external legal counsel. <b>(RTP, Nov 2021, NA)</b></p> <p><b>Incorrect.</b> If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek <b>direct communication with the entity's external legal counsel</b>.</p>
Q2.	<p>When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management <b>(SA, Dec 2021, 2 Marks) (RTP, May 2023, NA) (MTP2, May 2023, 2 marks)</b></p> <p><b>Incorrect.</b> When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:</p> <ul style="list-style-type: none"> <li>• Request <b>confirmation</b> from the third party as to the <b>quantities</b> and <b>condition</b> of inventory held on behalf of the entity.</li> <li>• Perform <b>inspection</b> or other audit procedures appropriate in the circumstances</li> </ul>
Q3.	<p>When inventory under the custody and control of a third party is material to the financial statements, the auditor cannot obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management. <b>(MTP1, Nov 2023, 2 marks)</b></p> <p><b>Correct.</b> When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:</p> <ul style="list-style-type: none"> <li>• Request <b>confirmation</b> from the third party as to the <b>quantities</b> and <b>condition</b> of inventory held on behalf of the entity.</li> <li>• Perform <b>inspection</b> or other audit procedures appropriate in the circumstances</li> </ul>

## Part III: Multiple Choice Questions

Q1.	<p>Coyote Ltd. is dealing in trading of electronic goods. Huge inventory (60% approximately) of the company is lying on consignment (i.e. under the custody of a third party). CA. Star, the auditor of the company, wants to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory lying on consignment. Thus, he requested &amp; obtained confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, however, it raised doubts about the integrity and objectivity of the third party. Which of the following other audit procedures may be performed by CA. Star to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory under the custody of a third party?</p> <p>(a) Attend a third party's physical counting of inventory.</p> <p>(b) Arrange for another auditor to attend a third party's physical counting of inventory.</p> <p>(c) Inspect warehouse receipts regarding inventory held by third parties.</p> <p>(d) All of the above.</p> <p><b>(Sample MCQs) (RTP, May 2019, NA)</b></p> <p><b>Correct answer:</b> (d) All of the above</p> <p><b>Explanation:</b> Where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include :</p>
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	<ul style="list-style-type: none"> <li>• Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.</li> <li>• Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.</li> <li>• Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.</li> <li>• Requesting confirmation from other parties when inventory has been pledged as collateral</li> </ul>
Q2.	<p>The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:</p> <p>(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.</p> <p>(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.</p> <p>(c) Reviewing legal expense accounts.</p> <p>(d) All of the above</p> <p><b>(ICAI MCQs) (MTP2, May 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (d) All of the above

## SA 505 "External Confirmations"

### Part I : Descriptive Questions

Q1.	<p>CA Jignesh Desai is in midst of audit of a company. The company is fairly large one and has a well -functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, he has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is approach of CA Jignesh Desai proper? <b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p>When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:</p> <ul style="list-style-type: none"> <li>a) <b>Determining</b> the <b>information</b> to be confirmed or requested;</li> <li>b) <b>Selecting</b> the <b>appropriate</b> confirming <b>party</b>;</li> <li>c) <b>Designing</b> the confirmation <b>requests</b>, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and</li> <li>d) <b>Sending</b> the requests, including <b>follow-up</b> requests when applicable, to the confirming party.</li> </ul> <p>In the given case, it appears that the external auditor has delegated the entire work of sending out external confirmation requests to internal audit department over which he has no control. Further, responses to external confirmation requests are received on mail id of internal audit department. All these acts are <b>not in line</b> with requirements under SA 505</p>
Q2.	<p>On reviewing schedule of trade receivables of a company, CA Mary finds that in respect of one outstanding balance, the CFO of the company is not willing to allow her to send external confirmation request due to the reason that sending out such request could spoil precariously placed business relations with the customer. On further inquiry, she finds out that there is a dispute going on with the company relating to some quality issues of goods sent to the customer and matter is sub judice. Efforts are also being made by the company for out of court settlement. Reviewing correspondence with the customer, she finds that issue is near resolution and no fraud risk factors exist. Is unwillingness of CFO justifiable? <b>(ICAI Study Material - Test Your Understanding)</b></p>
	<ul style="list-style-type: none"> <li>• In terms of requirements of SA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall <b>inquire</b> as to management's <b>reasons</b> for the refusal, and seek <b>audit evidence</b> as to their <b>validity</b> and reasonableness.</li> <li>• A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. Further, fraud risk factors do not exist.</li> <li>• Keeping in view, unwillingness of CFO is <b>justifiable</b></li> </ul>
Q3.	<p>During the financial year 2023-24, the auditor of Healthy and Wealthy Limited asked a Trade Receivable to respond directly to the auditor whether or not the amount they were required to pay to Healthy and Wealthy Limited was ₹ 1,23,000. That trade receivable confirmed to the auditor of Healthy and Wealthy Limited, that they were required to pay an amount of ₹ 1,23,000 to</p>

	<p>Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor (ICAI Study Material - Illustration)</p> <p>This is an example of <b>Positive Confirmation Request</b> because in Positive Confirmation Request the party confirms the auditor of a company <b>whether</b> such party <b>agrees</b> or whether such party <b>disagrees</b> with the information for which the confirmation is required by the auditor of that company.</p>
Q4.	<p>While conducting the audit of AB Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables, but the management refused the auditor to send confirmation request. How would the auditor proceed? (ICAI Study Material - Illustration) (SA, Nov 2020, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2023 for which external confirmations are not available. CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd. refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing. (SA, May 2023, 4 marks)</p> <p>If the management refuses to allow the auditor to send a confirmation request, the auditor shall</p> <ul style="list-style-type: none"> <li>• <b>Inquire</b> as to management's <b>reasons</b> for the refusal and seek <b>audit evidence</b> as to their <b>validity</b> and reasonableness.</li> <li>• Evaluate the <b>implications</b> of management's refusal on the auditor's assessment of the relevant <b>risks</b> of material misstatement, <b>including</b> the <b>risk of fraud</b>, and on the nature, timing and extent of other <b>audit procedures</b>; and</li> <li>• Perform <b>alternative audit procedures</b> designed to obtain relevant and reliable evidence.</li> </ul> <p>If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures,</p> <ul style="list-style-type: none"> <li>• the auditor shall <b>communicate</b> with those charged with governance in accordance with <b>SA 260</b>.</li> <li>• The auditor shall also determine the <b>implication</b> for the audit and the auditor's opinion in accordance with <b>SA 705</b>.</li> </ul>
Q5.	<p>When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p> <p>As per SA 505 "External Confirmations", when using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:</p> <ol style="list-style-type: none"> <li>a) <b>Determining</b> the <b>information</b> to be confirmed or requested;</li> <li>b) <b>Selecting</b> the <b>appropriate</b> confirming party;</li> <li>c) <b>Designing</b> the confirmation <b>requests</b>, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and</li> <li>d) <b>Sending</b> the requests, including <b>follow-up</b> requests when applicable, to the confirming party.</li> </ol>
Q6.	<p>Define the following :</p> <ol style="list-style-type: none"> <li>i) Positive confirmation request</li> <li>ii) Negative confirmation request</li> <li>iii) Non-response</li> <li>iv) Exception</li> </ol> <p>(RTP, May 2020, NA)</p> <ul style="list-style-type: none"> <li>• <b>Positive confirmation request:</b> A request that the confirming party respond directly to the auditor indicating <b>whether</b> the <b>confirming party agrees</b> or <b>disagrees</b> with the information in the request, or <b>providing</b> the requested <b>information</b>.</li> <li>• <b>Negative confirmation request:</b> A request that the confirming party <b>respond</b> directly to the auditor <b>only if</b> the <b>confirming party disagrees</b> with the information provided in the request.</li> <li>• <b>Non-response:</b> A <b>failure</b> of the confirming party to <b>respond</b>, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.</li> </ul>



	<ul style="list-style-type: none"> <li>● <b>Exception:</b> A response that indicates a <b>difference</b> between information <b>requested</b> to be confirmed, or contained in the entity's records, and information <b>provided</b> by the confirming party.</li> </ul>
Q7.	<p>CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable Confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. <b>(SA, July 2021, 4 Marks)</b></p> <p>Negative confirmation is a request that the confirming party <b>respond</b> directly to the auditor <b>only if the confirming party disagrees</b> with the information provided in the request. Negative information provides <b>less persuasive</b> audit evidence than positive confirmations.</p> <p>Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless <b>all</b> of the following are present:</p> <ul style="list-style-type: none"> <li>● The auditor has assessed the <b>risk</b> of material misstatement as <b>low</b> and has obtained sufficient appropriate audit evidence regarding the <b>operating effectiveness of controls</b> relevant to the assertion;</li> <li>● The population of items subject to negative confirmation procedures comprises a large number of <b>small, homogeneous</b>, account balances, transactions or conditions;</li> <li>● A very <b>low exception rate</b> is expected; and</li> <li>● The auditor is <b>not aware</b> of <b>circumstances</b> or conditions that would <b>cause</b> recipients of negative confirmation requests to <b>disregard</b> such requests.</li> </ul>
Q8.	<p>External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement? <b>(MTP2, May 2022, 3 marks) (RTP, Nov 2022, NA)</b></p> <p>Examples of situations where external confirmations may be used include the following:</p> <ul style="list-style-type: none"> <li>● <b>Inventories</b> held by <b>third parties</b> at bonded warehouses for processing or on consignment.</li> <li>● <b>Property title deeds</b> held by lawyers or financiers for safe custody or as security.</li> <li>● <b>Investments</b> held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.</li> <li>● Amounts <b>due to lenders</b>, including relevant terms of repayment and restrictive covenants.</li> </ul>
Q9.	<p>What are the factors that are to be considered while designing a confirmation request? <b>(SELF)</b></p> <p>As per <b>SA 505</b> "External confirmation", the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.</p> <p>Factors to consider when designing confirmation requests include:</p> <ul style="list-style-type: none"> <li>● The <b>assertions</b> being addressed.</li> <li>● Specific identified <b>risks</b> of material misstatement, including fraud risks.</li> <li>● The <b>layout</b> and <b>presentation</b> of the confirmation request.</li> <li>● <b>Prior experience</b> on the audit or similar engagements.</li> <li>● The <b>method</b> of communication [for example, in paper form, or by electronic mode (like e-mail) or other medium].</li> <li>● Management's <b>authorisation</b> or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.</li> <li>● The <b>ability</b> of the <b>intended confirming party to confirm</b> or provide the requested information (for example, individual invoice amount versus total balance).</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request is called a positive confirmation request. <b>(MTP2, May 2018, 2 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information</p>
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	provided in the request. <b>(SA, May 2019, 2 Marks)</b>
	<b>Incorrect.</b> In Positive confirmation request confirming party respond directly to the auditor indicating <b>whether</b> the <b>confirming party agrees or disagrees</b> with the information in the request, or <b>providing</b> the requested <b>information</b> whereas Negative confirmation request is a request that the confirming party <b>respond</b> directly to the auditor <b>only if</b> the <b>confirming party disagrees</b> with the information provided in the request.
Q2.	Audit evidence obtained from external confirmation is always reliable. <b>(SA, Nov 2018, 2 Marks) (MTP1, Nov 2021, 2 Marks)</b>
	<b>Incorrect.</b> The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its <b>source</b> and its <b>nature</b> , and the <b>circumstances</b> under which it is obtained, including the <b>controls</b> over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.
Q3.	External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only. <b>(SA, Nov 2020, 2 Marks)</b>
	<b>Incorrect.</b> External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmation need <b>not</b> be <b>restricted to account balances only</b> .
Q4.	R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability. <b>(MTP2, May 2022, 2 marks)</b>
	<b>Correct. SA 505</b> , "External Confirmations", responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because <b>proof of origin</b> and <b>authority</b> of the respondent may be <b>difficult to establish</b> , and alterations may be difficult to detect. Hence R Ltd. Should avoid using email responses as evidence for external confirmation.

### Part III: Multiple Choice Questions

Q1.	<p>A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard?</p> <p>(a) It shows that said trade receivable exists.</p> <p>(b) It shows that said trade receivable is properly valued.</p> <p>(c) It shows that company has a right to said trade receivable.</p> <p>(d) It shows that amount of said trade receivable has been recorded in proper account.</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (b) It shows that said trade receivable is properly valued.
Q2.	<p>Statement 1: A response that indicates a difference between information requested to be confirmed and information provided by confirming party is Negative Confirmation.</p> <p>Statement 2: A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is exception.</p> <p>(a) Statement 1 is correct</p> <p>(b) Statement 2 is correct</p> <p>(c) Both 1 &amp; 2 are incorrect</p> <p>(d) Both 1 &amp; 2 are correct</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) Both 1 &amp; 2 are incorrect</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party is an Exception</li> <li>• A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is Non response.</li> </ul>

Q3.	Which of the following is not correct? (a) SA 230- Audit Documentation (b) SA 500- Audit Evidence (c) SA 505- Written Representation (d) SA 560- Subsequent Events <b>(ICAI MCQs)</b>
	<b>Correct answer:</b> (c) SA 505- Written Representation <b>Explanation:</b> SA 580 "Written Representations" and SA 505 "External Confirmation"
Q4.	A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request is- (a) Positive confirmation request (b) Non-response (c) Exception (d) Negative confirmation request <b>(ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, May 2020, 2 Marks)</b>
	<b>Correct answer:</b> (d) Negative confirmation request
Q5.	A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is called- (a) Negative confirmation request (b) Non-response (c) Exception (d) Positive confirmation request <b>(RTP, Nov 2019, NA)</b>
	<b>Correct answer:</b> (b) Non-response

## SA 510 "Initial Audit Engagements-Opening Balances"

### Part I : Descriptive Questions

Q1.	M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? <b>(ICAI Study Material - Test Your Knowledge) (SA, Nov 2018, 5 Marks)</b>
	Initial audit engagement is an engagement in which either : <ul style="list-style-type: none"> <li>• The financial statements for the prior period were <b>not audited</b>; or</li> <li>• The financial statements for the prior period were <b>audited</b> by a <b>predecessor auditor</b>.</li> </ul> <p><b>Audit Procedures regarding Opening Balances</b></p> <p>The auditor shall <b>read</b> the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.</p> <p>The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:</p> <ul style="list-style-type: none"> <li>• Determining whether the <b>prior period's closing balances</b> have been <b>correctly brought forward</b> to the current period or, when appropriate, any <b>adjustments</b> have been <b>disclosed</b> as prior period items in the current year's Statement of Profit and Loss;</li> <li>• Determining whether the <b>opening balances</b> reflect the <b>application</b> of <b>appropriate accounting policies</b>; and</li> <li>• Performing one or more of the following: <ul style="list-style-type: none"> <li>◦ Where the prior year financial statements were audited, <b>perusing</b> the copies of the audited financial</li> </ul> </li> </ul>

	<p>statements including the other relevant documents relating to the prior period financial statements;</p> <ul style="list-style-type: none"> <li>○ Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or</li> <li>○ Performing specific audit procedures to obtain evidence regarding the opening balances</li> </ul> <p><b>Conclusion:</b> Thus, we can conclude that CA Pankaj is <b>not correct</b> in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.</p>
Q2.	<p>An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard? (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> <li>● If the auditor is <b>unable</b> to obtain <b>sufficient appropriate audit evidence</b> regarding the opening balances, the auditor shall express a <b>qualified</b> opinion or a <b>disclaimer</b> of opinion, as appropriate, in accordance with SA 705.</li> <li>● If the auditor <b>concludes</b> that the opening balances contain a <b>misstatement</b> that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or <b>not</b> adequately presented or disclosed, the auditor shall express a <b>qualified</b> opinion or an <b>adverse</b> opinion, as appropriate, in accordance with SA 705.</li> </ul>
Q3.	<p>Discuss the objective of Auditor with respect to Opening balances in conducting an initial audit engagement. (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2023-24. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510? (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>What is the objective of the auditor with respect to the opening balances when conducting an initial audit engagement as per the relevant SA? (RTP, May 2023, NA)</p> <p><b>Objective of auditor with respect to opening balances</b></p> <p>As per <b>SA 510</b> "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-</p> <ul style="list-style-type: none"> <li>● Opening balances contain <b>misstatements</b> that <b>materially affect</b> the <b>current period's financial statements</b>; and</li> <li>● <b>Appropriate accounting policies</b> reflected in the opening balances have been <b>consistently</b> applied in the current period's financial statements, or <b>changes</b> thereto are properly <b>accounted</b> for and adequately <b>presented</b> and <b>disclosed</b> in accordance with the applicable financial reporting framework.</li> </ul>
Q4.	<p>Auditors of M/s Tender India (P) Ltd. were changed for the accounting year 2023-24. The closing inventory of the company as on 31.3.2023 amounting to ₹ 100 lacs continued as it is and became closing inventory as on 31.3.2024. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of ₹ 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. (MTP1, Nov 2019, 4 Marks)</p> <p><b>Verification of Inventory:</b></p> <ul style="list-style-type: none"> <li>● As per <b>SA 510</b> "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether- <ul style="list-style-type: none"> <li>○ Opening balances contain <b>misstatements</b> that <b>materially affect</b> the <b>current period's financial statements</b>; and</li> <li>○ <b>Appropriate accounting policies</b> reflected in the opening balances have been <b>consistently</b> applied in the current period's financial statements, or <b>changes</b> thereto are properly <b>accounted</b> for and adequately <b>presented</b> and <b>disclosed</b> in accordance with the applicable financial reporting framework.</li> </ul> </li> <li>● When the financial statements for the preceding period were audited by predecessor auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by <b>perusing</b> the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. <b>Ordinarily</b>, the current auditor can place <b>reliance</b> on the closing balances contained in the financial statements for the preceding period, <b>except</b> when</li> </ul>

	<p>during the performance of audit procedures for the current period the <b>possibility of misstatements in opening balances</b> is indicated.</p> <ul style="list-style-type: none"> <li>General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the Balance Sheet date.</li> <li>The contention of the management that the inventory has not undergone any change <b>cannot be accepted</b>, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the inventory lying as it is might have deteriorated and the same need to be examined. The auditor is advised <b>not to exclude</b> the audit of closing inventory from his audit programme.</li> </ul>
Q5.	<p>The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? (SA, May 2022, 3 Marks) (MTP2, May 2023, 3 marks)</p> <p>The newly appointed auditor of BTN Ltd shall <b>read</b> the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.</p> <p>The auditor of BTN Ltd shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:</p> <ul style="list-style-type: none"> <li>Determining whether the <b>prior period's closing balances</b> have been <b>correctly brought forward</b> to the current period or, when appropriate, any <b>adjustments</b> have been <b>disclosed</b> as prior period items in the current year's Statement of Profit and Loss;</li> <li>Determining whether the <b>opening balances</b> reflect the <b>application of appropriate accounting policies</b>; and</li> <li>Performing one or more of the following: <ul style="list-style-type: none"> <li>Where the prior year financial statements were audited, <b>perusing</b> the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;</li> <li>Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or</li> <li>Performing specific audit procedures to obtain evidence regarding the opening balances</li> </ul> </li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>An auditor is not concerned with consistency of accounting policies relating to opening balances. (SA, Nov 2018, 2 Marks)</p> <p><b>Incorrect.</b> In conducting an initial audit engagement, one of the objective of the auditor with respect to opening balances is to <b>obtain sufficient appropriate audit evidence</b> about whether appropriate <b>accounting policies</b> reflected in the opening balances have been <b>consistently</b> applied in the current period's financial statements, or <b>changes</b> thereto are properly <b>accounted</b> for and adequately <b>presented</b> and <b>disclosed</b> in accordance with the applicable financial reporting framework.</p>
Q2.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. (MTP1, May 2020, 2 marks) (MTP2, May 2021, 2 marks)</p> <p><b>Incorrect.</b> As per SA 510, if the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a <b>qualified</b> opinion or a <b>disclaimer</b> of opinion, as appropriate, in accordance with SA 705</p>

## Part III: Multiple Choice Questions

Q1.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express :</p> <p>(a) a disclaimer opinion</p> <p>(b) a qualified opinion</p> <p>(c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.</p> <p>(d) unmodified opinion</p> <p>(ICAI MCQs) (MTP2, May 2019, 1 Mark) (RTP, Nov 2019) (MTP1, May 2020, 2 Marks)</p> <p><b>Correct answer:</b> (c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.</p>
Q2.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances,</p>

- (a) the auditor shall express a qualified opinion in accordance with SA 705.  
 (b) the auditor shall express a disclaimer of opinion in accordance with SA 705.  
 (c) the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.  
 (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.  
**(MTP1, Nov 2019, 2 Marks)**

**Correct answer:** (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705

**Explanation:**

- If the auditor is unable to obtain SAAE regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705
- If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's FS, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate.

## SA 550 "Related Parties"

### Part I : Descriptive Questions

Q1.	<p>Many related party transactions are in the normal course of business. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Give few examples of such areas.  <b>(ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</b></p>
	<p>Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.</p> <p>Example</p> <ul style="list-style-type: none"> <li>• Related parties may operate through an <b>extensive</b> and <b>complex</b> range of relationships and structures, with a corresponding increase in the complexity of related party transactions.</li> <li>• <b>Information systems</b> may be <b>ineffective</b> at identifying or summarising transactions and outstanding balances between an entity and its related parties.</li> <li>• Related party transactions may <b>not be conducted</b> under <b>normal market terms</b> and conditions; for example, some related party transactions may be conducted with no exchange of consideration</li> </ul>
Q2.	<p>How can an auditor verify the existence of related party relationships and transactions?  <b>(ICAI Study Material)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples. <b>(RTP, Nov 2021, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples. <b>(MTP2, Nov 2023, 4 marks)</b></p> <p>During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:</p> <ol style="list-style-type: none"> <li>1. Entity <b>income tax returns</b>.</li> <li>2. <b>Information</b> supplied by the entity to regulatory authorities.</li> <li>3. <b>Documents</b> associated with the entity's filings with a securities regulator e.g, prospectuses)</li> <li>4. <b>Statements</b> of conflicts of interest from management and those charged with governance.</li> </ol>

	<ol style="list-style-type: none"> <li>5. <b>Contracts</b> and <b>agreements</b> with key management or those charged with governance.</li> <li>6. Significant <b>contracts</b> and <b>agreements</b> not in the entity's ordinary course of business.</li> <li>7. Significant <b>contracts re-negotiated</b> by the entity during the period.</li> <li>8. Specific <b>invoices</b> and correspondence from the entity's professional advisors.</li> <li>9. <b>Internal auditors' reports</b>.</li> <li>10. <b>Shareholder registers</b> to identify the entity's principal shareholders.</li> <li>11. <b>Life insurance policies</b> acquired by the entity.</li> <li>12. <b>Records</b> of the entity's investments and those of its pension plans.</li> </ol>
Q3.	<p>P Ltd. is a company from a business group "ABCD" and is engaged in trading of garments. The promoters of the company are promoters and directors of some other group companies also. You have been appointed as an auditor of P Ltd. P Ltd has entered into various inter company transactions (within group companies) during the year which are outside its normal course of business. What will be your duties as an auditor in relation to those transactions? (SA, May 2022, 4 Marks)</p> <p>SA 550 "Related Parties" deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements.</p> <p>For identified significant related party transactions outside the P Ltd.'s normal course of business, the auditor shall:</p> <ul style="list-style-type: none"> <li>• <b>Inspect</b> the underlying <b>contracts</b> or <b>agreements</b>, if any, and evaluate whether: <ul style="list-style-type: none"> <li>○ The business <b>rationale</b> (or lack thereof) of the transactions suggests that they may have been entered into to engage in <b>fraudulent</b> financial reporting or to conceal <b>misappropriation</b> of assets;</li> <li>○ The <b>terms</b> of the transactions are <b>consistent</b> with <b>management's explanations</b>; and</li> <li>○ The <b>transactions</b> have been appropriately <b>accounted</b> for and <b>disclosed</b> in accordance with the applicable financial reporting framework; and</li> </ul> </li> <li>• Obtain audit <b>evidence</b> that the transactions have been appropriately <b>authorised</b> and approved.</li> </ul>

## Part II: Correct/Incorrect Questions

Q1.	<p>All entities that are under common control by a state (i.e., national, regional or local government) are considered related party. (SA, Nov 2019, 2 marks)</p> <p><b>Incorrect.</b> Entities that are under <b>common control</b> by a state (i.e., a national, regional or local government) are <b>not</b> considered related unless they engage in <b>significant transactions</b> or share resources to a significant extent with one another</p>
Q2.	<p>In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater. (SA, July 2021, 2 marks)</p> <p><b>Correct:</b> In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:</p> <ul style="list-style-type: none"> <li>• <b>Management</b> may be <b>unaware</b> of the existence of all related party relationships.</li> <li>• Related party relationships may present a greater opportunity for <b>collusion</b>, concealment or <b>manipulation</b> by management.</li> </ul>

## Part III: Multiple Choice Questions

Q1.	<p>An auditor finds during course of an audit that the entity has entered into many related party transactions. Which of the following statements is true?</p> <ol style="list-style-type: none"> <li>(a) The risk that management may override controls in respect of related party transactions is lower.</li> <li>(b) The risk that management may override controls in respect of related party transactions is higher.</li> <li>(c) There is no effect on the risk that management may override controls in respect of related party transactions.</li> <li>(d) Risk of overriding of controls by management has no relationship at all with related party transactions.</li> </ol> <p>(ICAI Study Material - Test Your Knowledge)</p> <p><b>Correct answer:</b> (b) The risk that management may override controls in respect of related party transactions is higher.</p>
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# SA 520 “Analytical Procedures”

## Part I : Descriptive Questions

Q1.	<p>An auditor of a company intends to apply analytical procedures for verifying revenue. Discuss any two analytical procedures which may be performed by auditor relating to revenues. <b>(ICAI Study Material - Test Your Understanding)</b></p> <p>Analytical procedures in relation to revenue can include:-</p> <ul style="list-style-type: none"><li>Comparing revenue of current year with <b>previous</b> year and investigating significant fluctuations</li><li>Comparing revenue of current year with <b>budgeted</b> targets and investigating significant fluctuations.</li></ul>																				
Q2.	<p>CA Aarav wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2023-24. The rent amounts to ₹ 50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of ₹ 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.?</p> <p><b>(ICAI Study Material - Illustration) (MTP2, May 2021, 3 Marks)</b></p> <p>If CA Aarav checks in detail the monthly rent payments, he may find that such payments are <b>consistent</b> with the rent agreement i.e. XYZ Ltd. paid ₹ 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Aarav may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location.</p> <p><b>If CA Aarav applies analytical procedure</b> i.e. <b>compares</b> the <b>rent</b> payment by XYZ Ltd. with the <b>similar payments</b> made by <b>companies in similar industry</b> and similar area, he will notice an <b>inconsistency</b> in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.</p> <p>However, <b>if CA Aarav does not make</b> such <b>comparison</b> and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the <b>misstatement</b> may remain <b>undetected</b>.</p>																				
Q3.	<p>Analytical procedure involves analysis of relationship among financial and nonfinancial data. Explain with the help of an example as to how, the statutory auditor of ABC Ltd. will analyse such relationship with respect to the total wages paid by ABC Ltd. during the FY 2023-24. <b>(ICAI Study Material - Illustration)</b></p> <p>As per <b>SA 520</b>, Analytical Procedures means <b>evaluations</b> of <b>financial information</b> through <b>analysis</b> of <b>plausible</b> relationships among both <b>financial</b> and <b>non-financial data</b>. The following example explains the analysis of relationship between financial and non-financial data while applying analytical procedures.</p> <p>The statutory auditor of ABC Ltd. has to verify the total wages paid by the company having factories in various states. He can verify the same by <b>analyzing</b> the <b>relationship</b> between <b>wages per worker</b> and <b>total number of workers</b> across all the factories.</p> <p>i.e. Total wages = Wages per worker x Total number of workers.</p> <p>Here <b>wages per worker is financial data</b> i.e. in ₹ and <b>total number of workers</b> is a number which is a <b>non financial data</b>. Thus, the statutory auditor of ABC Ltd. is evaluating financial information i.e. total wages paid (in ₹) by analyzing the relationship between wages per worker (in ₹) which is financial data and number of workers which is a non financial data</p>																				
Q4.	<p>Enumerate various analytical procedures that can be used from below data:</p> <table><tr><th>Particulars</th><th colspan="2">Client</th><th colspan="2">Industry</th></tr><tr><td>Year</td><td>2021-22</td><td>2022-23</td><td>2021-22</td><td>2022-23</td></tr><tr><td>Inventory Turnover</td><td>2.8</td><td>2.9</td><td>3.1</td><td>2.8</td></tr><tr><td>Gross Margin</td><td>22.5%</td><td>22.7%</td><td>23.6%</td><td>22.2%</td></tr></table> <p><b>(ICAI Study Material - Illustration)</b></p> <ul style="list-style-type: none"><li>Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques.</li><li>Analytical procedures may be applied to <b>consolidated financial statements, components</b> and <b>individual</b> elements</li></ul>	Particulars	Client		Industry		Year	2021-22	2022-23	2021-22	2022-23	Inventory Turnover	2.8	2.9	3.1	2.8	Gross Margin	22.5%	22.7%	23.6%	22.2%
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	<p>of information.</p> <ul style="list-style-type: none"> <li>Analytical Procedures may be segregated into the following major types: <ul style="list-style-type: none"> <li>comparison of client and <b>industry</b> data,</li> <li>comparison of client data with similar <b>prior</b> period data,</li> <li>comparison of client data with <b>client-determined expected</b> results,</li> <li>comparison of client data with <b>auditor-determined expected</b> results and</li> <li>comparison of client data with <b>expected</b> results, using <b>non financial</b> data.</li> </ul> </li> </ul>
Q5.	<p>Define Analytical Procedures. (ICAI Study Material - Test Your Knowledge)</p> <p><b>Meaning of Analytical Procedures:</b></p> <p>As per <b>SA 520</b> "Analytical Procedures" "the term "analytical procedures" means <b>evaluations</b> of <b>financial information</b> through <b>analysis</b> of <b>plausible</b> relationships among both <b>financial</b> and <b>non-financial data</b>. Analytical procedures also encompass such <b>investigation</b> as is necessary of <b>identified fluctuations</b> or relationships that are <b>inconsistent</b> with other <b>relevant information</b> or that differ from expected values by a significant amount.</p> <p>Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.</p>
Q6.	<p>While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence?</p> <p>(ICAI Study Material - Test Your Knowledge) (MTP1, May 2022, 4 marks) (RTP, May 2023, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Explain stating the techniques available as substantive analytical procedures (RTP, May 2018, NA) (MTP1, Nov 2019, 3 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain techniques available as substantive analytical procedures. (SA, May 2018, 5 Marks) (RTP, May 2019, NA) (SA, Jan 2021, 3 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Explain clearly stating the techniques available as substantive analytical procedures. (MTP1, Nov 2018, 5 Marks) (RTP, May 2021, NA)</p> <p><b>Techniques available as substantive analytical procedures:</b></p> <ol style="list-style-type: none"> <li><b>Trend analysis:</b> Trend analysis is a commonly used technique. It is the <b>comparison</b> of <b>current data</b> with the <b>prior period</b> balance or with a <b>trend in two or more prior period balances</b>. The auditor evaluates whether the <b>current balance</b> of an account moves in <b>line</b> with the <b>trend established with previous balances</b> for that account, after adjusting for relevant factors responsible for changes</li> <li><b>Ratio analysis:</b> Ratio analysis is useful for analysing asset and liability <b>accounts</b> as well as revenue and expense accounts. An <b>individual balance sheet account is difficult to predict</b> on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared <b>over time</b> or to the ratios of separate entities <b>within the group</b>, or with the ratios of <b>other companies in the same industry</b>.</li> <li><b>Reasonableness tests:</b> Unlike trend analysis, this analytical procedure does <b>not</b> rely on events of prior periods, but uses <b>non-financial data</b> for the audit period under consideration (e.g., <b>occupancy rates</b> to estimate rental income or <b>interest rates</b> to estimate interest income or expense). These tests are generally <b>more applicable to income statement accounts</b> and certain accrual or <b>prepayment</b> accounts.</li> <li><b>Structural modelling:</b> A modelling tool <b>constructs a statistical model</b> from <b>financial</b> and/or <b>non-financial data</b> of prior accounting periods to <b>predict current</b> account balances (e.g., linear regression).</li> </ol> <p>The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.</p>
Q7.	<p>Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit. (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2021, 3 Marks)</p>

	<p style="text-align: center;"><b>OR</b></p> <p>In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk. Explain <b>(RTP, Nov 2020, NA)</b></p> <p><b>Analytical Procedures in Planning the Audit</b></p> <ul style="list-style-type: none"> <li>In the planning stage, analytical procedures assist the auditor in <b>understanding</b> the client's <b>business</b> and in <b>identifying areas</b> of potential <b>risk</b> by indicating aspects of and developments in the entity's business of which he was previously unaware.</li> <li>This information will assist the auditor in determining the <b>nature, timing</b> and <b>extent</b> of his other audit <b>procedures</b>.</li> <li>Analytical procedures in planning the audit use both <b>financial data</b> and <b>non-financial</b> information, such as number of employees, square feet of selling space, volume of goods produced and similar information. <ul style="list-style-type: none"> <li>For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions</li> </ul> </li> </ul>
Q8.	<p>The statutory auditor of MNO Ltd., CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. What should CA Kishore do in this case with reference to SA 520 on "Analytical Procedures"? <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p>While performing analytical procedures on financial statements of ABC Ltd., auditor identifies fluctuations or relationships that are inconsistent with other relevant information and also that differs from expected values by a significant amount, the auditor seeks your advise as to how should he proceed <b>(MTP2, May 2018, 5 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how would the auditor investigate such differences. <b>(RTP, May 2019, NA) (RTP, May 2022, NA) (RTP, May 2023, NA) (MTP2, Nov 2023, 3 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences? <b>(SA, July 2021, 3 Marks)</b></p> <p>As per <b>SA 520- "Analytical Procedures"</b> If while applying analytical procedures in accordance with SA 520, the statutory auditor identifies fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:</p> <ol style="list-style-type: none"> <li><b>Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:</b> Audit evidence relevant to <b>management's responses</b> may be obtained by evaluating those responses taking into account the auditor's <b>understanding</b> of the entity and its environment, and with <b>other audit evidence</b> obtained during the course of the audit.</li> <li><b>Performing other audit procedures as necessary in the circumstances:</b> The need to perform <b>other audit procedures</b> may arise when, for example, <b>management</b> is <b>unable</b> to provide an <b>explanation</b>, or the <b>explanation</b>, together with the audit evidence obtained relevant to management's response, is <b>not</b> considered <b>adequate</b>.</li> </ol> <p>In the present case, the auditor identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of the company. The auditor should inquire the management of the company and obtain sufficient and appropriate audit evidence relevant to management response. Further, the auditor should also perform other audit procedures if required in the circumstances of the case to obtain further sufficient and appropriate audit evidence.</p>
Q9.	<p>What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA 520 on "Analytical procedures". <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p>The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. <b>(MTP1, May 2018, 5 marks) (MTP2, Nov 2018, 5 marks) (SA, May 2023, 3 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures. <b>(SA, Nov 2019, 3 Marks)</b></p>

	<p style="text-align: center;"><b>OR</b></p> <p>Discuss with examples the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. <b>(RTP, Nov 2022, NA)</b></p> <p>The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:</p> <ul style="list-style-type: none"> <li>• <b>Source of the information available.</b> For example, information may be more reliable when it is obtained from <b>independent sources</b> outside the entity.</li> <li>• <b>Comparability of the information available.</b> For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.</li> <li>• <b>Nature and relevance of the information available.</b> For example, whether budgets have been established as results to be expected rather than as goals to be achieved.</li> <li>• <b>Controls over the preparation of the information</b> that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.</li> </ul>
Q10.	<p>Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures with examples. <b>(RTP, May 2018, NA)</b></p> <p><b>Purpose of analytical procedures</b></p> <ul style="list-style-type: none"> <li>• Analytical procedures involve <b>comparing</b> and relating data to determine if data in the financial statements seems reasonable.</li> <li>• These are helpful in the <b>detection</b> of <b>unusual</b> state of affairs and mistakes in accounts</li> <li>• It will assist the auditor in <b>identifying risks</b> of material misstatement, especially risks of material misstatement due to fraud.</li> <li>• Few Examples             <ul style="list-style-type: none"> <li>○ Comparing <b>Profit and Loss Statement balances</b> of an entity with another similar entity in the same trade can reveal <b>reasons</b> for variations in profitability rates.</li> <li>○ Comparing current Profit and Loss Statement balances with the <b>previous</b> period can identify reasons for profit increases or decreases over the years.</li> <li>○ Establishing <b>expense ratios</b> from the Profit and Loss Statement and comparing them with previous years helps ascertain the extent of changes in expenditure relative to sales and trading profit's relation to sales.</li> <li>○ The cost of <b>importing</b> goods subject to a uniform ad-valorem duty can be verified through the amount of duty paid.</li> <li>○ The quantity of sugar sold by a mill can be independently verified through the amount of GST paid.</li> <li>○ Income or expenses directly tied to profits or sales can be independently verified, like commission on net profits or sales percentage. The process of calculating ratios, trends, and comparisons is also known as analytical review.</li> </ul> </li> </ul>
Q11.	<p>Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain <b>(RTP, Nov 2018, NA) (MTP2, May 2019, 4 Marks) (MTP2, May 2022, 4 marks)</b></p> <ul style="list-style-type: none"> <li>• Substantive analytical procedures are generally <b>more applicable to large volumes of transactions</b> that tend to be <b>predictable</b> over time.</li> <li>• The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the <b>auditor's assessment</b> of how <b>effective</b> it will be in <b>detecting a misstatement</b> that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.</li> <li>• In some cases, even an <b>unsophisticated predictive model</b> may be effective as an analytical procedure.             <ul style="list-style-type: none"> <li>○ For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.</li> </ul> </li> <li>• The use of widely recognised trade <b>ratios</b> (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.</li> </ul>

Q12.	<p>Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures (RTP, Nov 2019, NA)</p>
	<p>Routine checks <b>cannot</b> be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like <b>trend</b> and <b>ratio</b> analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired a lot of significance as substantive audit procedures. SA 520 on Analytical Procedures discusses the application of analytical procedures during an audit.</p> <p><b>Meaning of Analytical Procedures:</b> As per SA 520 "Analytical Procedures" the term "analytical procedures" means <b>evaluations</b> of <b>financial information</b> through <b>analysis</b> of <b>plausible</b> relationships among both <b>financial</b> and <b>non-financial data</b>. Analytical procedures also encompass such <b>investigation</b> as is necessary of <b>identified fluctuations</b> or relationships that are <b>inconsistent</b> with other <b>relevant information</b> or that differ from expected values by a significant amount.</p>
Q13.	<p>Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information (RTP, Nov 2019, NA)</p>
	<p>Examples of Analytical Procedures having <b>consideration of comparisons</b> of the entity's financial information with are:</p> <ul style="list-style-type: none"> <li>• Comparable information for <b>prior periods</b>.</li> <li>• <b>Anticipated results</b> of the <b>entity</b>, such as budgets or forecasts, or <b>expectations</b> of the <b>auditor</b>, such as an estimation of depreciation.</li> <li>• <b>Similar industry information</b>, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry</li> </ul>
Q14.	<p>Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. (RTP, May 2020, NA)</p>
	<ul style="list-style-type: none"> <li>• <b>Trend analysis</b> is the most commonly used technique which involves <b>comparison</b> of <b>current data</b> with the <b>prior period</b> balance or with a <b>trend in two or more prior period balances</b>.</li> <li>• The auditor evaluates whether the <b>current balance</b> of an account moves in <b>line</b> with the <b>trend established with previous balances</b> for that account, or based on an understanding of factors that may cause the account to change.</li> <li>• For example, the auditor may compare the rent paid by the company during the year under audit with the rent paid by the company for several earlier years. There may be some percentage increase in the rent expense over the years. However, an unusual increase in such expense amounts may indicate that fraudulent payments are being made</li> </ul>
Q15.	<p>When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. (RTP, May 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Explain the aspects to be considered by an auditor when designing and performing substantive analytical procedures, either alone or in combination with test of details, as substantive procedures in accordance with SA 330. (RTP, Nov 2022, NA)</p>
	<p>When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:</p> <ul style="list-style-type: none"> <li>• Determine the <b>suitability</b> of particular substantive analytical procedures for given <b>assertions</b>, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;</li> <li>• Evaluate the <b>reliability</b> of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of <b>source</b>, <b>comparability</b>, and <b>nature</b> and <b>relevance</b> of information available, and <b>controls</b> over preparation;</li> <li>• <b>Develop</b> an <b>expectation</b> of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to <b>identify</b> a <b>misstatement</b> that, individually or when aggregated with other misstatements, may <b>cause</b> the <b>financial statements</b> to be <b>materially misstated</b>; and</li> <li>• Determine the <b>amount</b> of any <b>difference</b> of recorded amounts from expected values that is <b>acceptable</b> without further investigation.</li> </ul>

Q16.	<p>The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment. Explain (RTP, Nov 2020, NA)</p> <p><b>Use of substantive analytical procedures:</b></p> <ul style="list-style-type: none"> <li>The substantive procedures at the assertion level may be <b>tests of details</b>, substantive <b>analytical</b> procedures, or a <b>combination</b> of both.</li> <li>The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's <b>judgment</b> about the expected effectiveness and efficiency of the available audit procedures to <b>reduce</b> audit <b>risk</b> at the assertion level to an acceptably low level.</li> <li>The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.</li> </ul>
Q17.	<p>With respect to SA 520 "Analytical procedures", explain the following factors to be considered by the auditor for substantive audit procedures. (i) Account type (ii) Predictability (iii) Nature of Assertion (SA, Nov 2020, 3 Marks)</p> <p>The auditor should consider the following factors for Substantive Audit Procedures:</p> <ul style="list-style-type: none"> <li><b>Account Type:</b> Substantive analytical procedures are more useful for certain types of accounts than for others. <b>Income</b> statement accounts tend to be <b>more predictable</b> because they reflect <b>accumulated</b> transactions over a period, whereas <b>balance sheet</b> accounts represent the <b>net effect</b> of transactions at a point in time or are subject to greater management <b>judgment</b>.</li> <li><b>Predictability:</b> Substantive analytical procedures are <b>more appropriate</b> when an account balance or relationships between items of data are <b>predictable</b> (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may <b>reasonably</b> be <b>expected to exist</b> and <b>continue</b> over time.</li> <li><b>Nature of Assertion:</b> Substantive analytical procedures may be <b>more effective</b> in providing evidence for some assertions (e.g., <b>completeness</b> or <b>valuation</b>) <b>than</b> for others (e.g., <b>rights</b> and <b>obligations</b>). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.</li> </ul>
Q18.	<p>For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both. (RTP, Nov 2021, NA)</p> <p>Analytical procedures include the <b>consideration of comparisons</b> of the entity's financial information with</p> <ul style="list-style-type: none"> <li>Comparable information for <b>prior periods</b>.</li> <li><b>Anticipated results</b> of the <b>entity</b>, such as budgets or forecasts, or <b>expectations</b> of the <b>auditor</b>, such as an estimation of depreciation.</li> <li><b>Similar industry information</b>, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.</li> </ul> <p>Analytical procedures also include <b>consideration of relationships</b></p> <ul style="list-style-type: none"> <li>Among <b>elements</b> of financial information that would be <b>expected to conform</b> to a predictable <b>pattern</b> based on the entity's experience, such as gross margin percentages.</li> <li>Between <b>financial information</b> and relevant <b>non-financial information</b>, such as payroll costs to number of employees.</li> </ul>
Q19.	<p>Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples. (SA, Dec 2021, 3 Marks)</p> <ul style="list-style-type: none"> <li>Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.</li> <li>For instance, the cost of <b>importing</b> goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by a sugar mill can be verified independently from the amount of excise duty/ GST paid.</li> <li>Similarly, the amount of any <b>income</b> or <b>expenses</b> which has a <b>direct</b> relationship with the amount of <b>profits</b> or that</li> </ul>

	<p>of <b>sales</b> can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.</p> <ul style="list-style-type: none"> <li>Thus, it is important to note that Analytical procedures may help identify the existence of <b>unusual</b> transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying <b>risks of material misstatement</b>, especially risks of material misstatement due to fraud.</li> </ul>
Q20.	<p>Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated. <b>(RTP, May 2022, NA)</b></p> <p>Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:</p> <ul style="list-style-type: none"> <li><b>The accuracy with which the expected results of substantive analytical procedures can be predicted.</b> For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.</li> <li><b>The degree to which information can be disaggregated.</b> For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.</li> <li><b>The availability of the information, both financial and non-financial.</b> For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.</li> </ul>
Q21.	<p>Tree Limited presented its financial statements for the F.Y. 2022-2023 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons? <b>(SA, May 2022, 4 Marks) (RTP, Nov 2023, NA)</b></p> <p><b>Purpose of Applying Analytical Procedure:</b> Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. The auditor of Tree Ltd. would achieve the following by carrying out the comparison stated in the question:</p> <ul style="list-style-type: none"> <li>If <b>balances</b> included in the <b>Statement of Profit and Loss</b> of an entity are <b>compared</b> with those contained in the Statement of Profit and Loss with that of the <b>previous</b> period, it would be possible to find out the <b>reasons</b> for increase or decrease in the amount of profits of those years.</li> <li>By setting up certain <b>expenses' ratios</b> on the basis of balances included in the Statement of Profit and Loss, for the year under audit, <b>comparing</b> them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.</li> <li>If differences are found to be material, the auditor would ascertain the <b>reasons</b> thereof and assess whether the accounts have been manipulated to inflate or suppress profits.</li> <li>It would be possible to identify the existence of <b>unusual</b> transactions, amounts, ratios and trends that might indicate matters that have audit implications.</li> </ul>
Q22.	<p>As per the Standard on Auditing (SA) 520 "Analytical Procedures", what are the examples of analytical procedures having consideration of relationships? <b>(SA, Nov 2022, 3 marks)</b></p> <p><b>Examples of Analytical Procedure having consideration of relationship:</b> As per the Standard on Auditing (SA) 520 "Analytical Procedures", examples of Analytical Procedures having consideration of relationships are:</p> <ul style="list-style-type: none"> <li>Among <b>elements</b> of financial information that would be <b>expected</b> to <b>conform</b> to a predictable <b>pattern</b> based on the entity's experience, such as gross margin percentages.</li> <li>Between <b>financial information</b> and relevant <b>non-financial information</b>, such as payroll costs to number of employees.</li> </ul>
Q23.	When designing and performing substantive analytical procedures, either alone or in combination with tests of details as

substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Discuss. (RTP, Nov 2023, NA)

- Substantive analytical procedures are generally **more applicable to large volumes of transactions** that tend to be predictable over time.
  - The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.
  - However, the suitability of a particular analytical procedure will depend upon the **auditor's assessment** of how **effective** it will be in **detecting a misstatement** that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
  - In some cases, even an **unsophisticated predictive model** may be effective as an analytical procedure.
- **Different types of analytical procedures provide different levels of assurance.**
  - For example, prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.
  - In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.
- The determination of the suitability of particular substantive analytical procedure is influenced by the **nature** of the **assertion** and the auditor's assessment of the **risk of material misstatement**.
  - For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.
- Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion.
  - For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

## Part II: Correct/Incorrect Questions

Q1.	<p>As per the Standard on Auditing (SA) 520 "Analytical Procedures" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data only.</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p><b>Incorrect.</b> As per the Standard on Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means <b>evaluations</b> of financial information through <b>analysis</b> of <b>plausible</b> relationships among <b>both financial and non-financial</b> data.</p>
Q2.	<p>Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.</p> <p>(ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>During the audit process, the auditor can easily identify all mistakes or manipulations that may exist in the accounts through routine checking processes. (SA, May 2018, 2 marks)</p>
	<p><b>Incorrect.</b> Routine checks <b>cannot</b> be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like <b>trend</b> and <b>ratio</b> analysis in addition to reasonable tests.</p>
Q3.	<p>Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures. (ICAI Study Material - Test Your Knowledge)</p>
	<p><b>Incorrect.</b> Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:</p> <ul style="list-style-type: none"> <li>• To obtain <b>relevant</b> and <b>reliable</b> audit <b>evidence</b> when using substantive analytical procedures; and</li> <li>• To <b>design</b> and <b>perform</b> analytical procedures <b>near the end</b> of the <b>audit</b> that <b>assist</b> the auditor when forming an overall <b>conclusion</b> as to whether the financial statements are <b>consistent</b> with the auditor's <b>understanding</b> of the entity</li> </ul>

Q4.	Analytical Procedures are required in the planning phase only. (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> Analytical Procedures are required in the <b>planning</b> phase and it is often done during the <b>testing</b> phase. In addition these are also required during the <b>completion</b> phase.
Q5.	Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time. (ICAI Study Material - Test Your Knowledge) (MTP1, Nov 2018, 2 marks)
	<b>Incorrect.</b> Substantive analytical procedures are generally <b>more</b> applicable to <b>large volumes of transactions</b> that tend to be predictable over time.
Q6.	Ratio analysis is useful in analyzing revenue and expense account only (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> Ratio analysis is useful for analysing <b>asset</b> and <b>liability</b> accounts as well as <b>revenue</b> and <b>expense</b> accounts
Q7.	Reasonableness test rely only on the events of the prior period like other analytical procedures. (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> Unlike trend analysis, Reasonableness test does <b>not</b> rely on events of <b>prior</b> periods, but upon <b>non-financial data</b> for the audit period under consideration
Q8.	The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements. (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> Analytical procedures may be applied to <b>consolidated</b> financial statements, <b>components</b> and <b>individual elements</b> of information.
Q9.	A modelling tool constructs a statistical model from financial data only of prior accounting periods to predict current account balances. (MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)
	<b>Incorrect.</b> A modelling tool <b>constructs a statistical model</b> from <b>financial</b> and/or <b>non-financial</b> data of prior accounting periods to <b>predict current</b> account balances (e.g., linear regression).
Q10.	When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. (MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)
	<b>OR</b>
	When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement. (RTP, Nov 2020, NA)
	<b>Correct.</b> When we are designing audit procedures to address an inherent risk or "what can go wrong", we <b>consider</b> the <b>nature</b> of the <b>risk of material misstatement</b> in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When <b>inherent risk</b> is <b>higher</b> , we may <b>design tests of details</b> to address the higher inherent risk. When significant risks have been identified, audit evidence obtained <b>solely</b> from substantive <b>analytical</b> procedures is <b>unlikely</b> to be <b>sufficient</b>
Q11.	Ratio analysis is a commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. (MTP2, Nov 2018, 2 marks)
	<b>Incorrect.</b> <b>Trend analysis</b> is the most commonly used technique in the comparison of <b>current</b> data with the <b>prior</b> period balance or with a <b>trend in two or more prior period balances</b> . The auditor evaluates whether the <b>current balance</b> of an account moves in <b>line</b> with the <b>trend established with previous balances</b> for that account, after adjusting for relevant factors responsible for changes. Ratio analysis is useful for analysing asset and liability <b>accounts</b> as well as revenue and expense accounts.
Q12.	When we are designing audit procedures to address an inherent risk or "what can go wrong", we do not consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. (MTP2, Nov 2018, 2 marks)



	<b>Incorrect.</b> When we are designing audit procedures to address an inherent risk or “what can go wrong”, we <b>consider</b> the <b>nature</b> of the <b>risk of material misstatement</b> in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When <b>inherent</b> risk is <b>higher</b> , we may <b>design tests of details</b> to address the higher inherent risk. When significant risks have been identified, audit evidence obtained <b>solely</b> from substantive <b>analytical</b> procedures is <b>unlikely</b> to be <b>sufficient</b>
Q13.	The auditor's substantive procedure at the assertion level means substantive analytical procedures only. (SA, Nov 2019, 2 Marks)
	<b>Incorrect.</b> The auditor's substantive procedures at the assertion level may be <b>tests of details</b> , substantive <b>analytical</b> procedures, or a <b>combination</b> of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's <b>judgment</b> about the expected effectiveness and efficiency of the available audit procedures to <b>reduce</b> audit <b>risk</b> at the assertion level to an acceptably low level.
Q14.	In the planning stage, analytical procedures would not in any way assist the auditor. (RTP, May 2020, NA)
	<b>Incorrect.</b> In the planning stage, analytical procedures assist the auditor in <b>understanding</b> the client's <b>business</b> and in identifying areas of <b>potential risk</b> by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the <b>nature</b> , <b>timing</b> and <b>extent</b> of his other audit <b>procedures</b> . Analytical procedures in planning the audit use <b>both financial</b> data and <b>non-financial</b> information, such as number of employees, square feet of selling space, volume of goods produced and similar information
Q15.	If an entity has a known number of employees at fixed rates of pay throughout the period, there would be more need to perform tests of details on the payroll. (RTP, Nov 2020, NA)
	<b>Incorrect.</b> If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to <b>estimate</b> the <b>total payroll costs</b> for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and <b>reducing</b> the need to perform <b>tests of details</b> on the payroll.
Q16.	SA 520 deals with the auditor's use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements. (SA, May 2022, 2 Marks)
	<b>Incorrect.</b> <b>SA 520</b> deals with the auditor's use of analytical procedures as substantive procedures (“substantive analytical procedures”), and as procedures <b>near</b> the <b>end</b> of the audit that <b>assist</b> the auditor when forming an overall <b>conclusion</b> on the financial statements.
Q17.	The term “Analytical Procedures” means evaluation of financial information through analysis of plausible relationships among financial data and non-financial data. (SA, Nov 2022, 2 marks)
	<b>Correct.</b> As per <b>SA 520</b> “Analytical Procedures”, the term “analytical procedures” means <b>evaluations</b> of <b>financial</b> information through <b>analysis</b> of <b>plausible</b> relationships among both <b>financial</b> and <b>non-financial</b> data. Analytical procedures also encompass such <b>investigation</b> as is necessary of <b>identified fluctuations</b> or <b>relationships</b> that are <b>inconsistent</b> with other relevant information or that differ from expected values by a significant amount
Q18.	Analytical procedures are used in all stages of audit by experienced auditors. (SA, May 2023, 2 marks)
	<b>Correct.</b> Experienced auditors use analytical procedures in <b>all</b> stages of the audit. Analytical Procedures are required in the <b>planning</b> phase and it is often done during the <b>testing</b> phase. In addition these are also required during the <b>completion</b> phase.

### Part III: Multiple Choice Questions

Q1.	What are analytical procedures? (a) Substantive tests designed to assess control risk (b) Substantive tests designed to evaluate the validity of management's representation letter (c) Substantive tests designed to study relationships between financial and non-financial data
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	<p>(d) All of the above (Sample MCQs) (ICAI MCQs)</p> <p><b>Correct answer:</b> (c) Substantive tests designed to study relationships between financial and non-financial data <b>Explanation:</b> As per SA 520, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data</p>
Q2.	<p>Analytical procedures issued in the planning stage of an audit, generally:</p> <p>(a) helps to determine the nature, timing and extent of other audit procedures (b) directs attention to potential risk areas (c) indicates important aspects of business (d) All of the above (Sample MCQs) (ICAI MCQs)</p> <p><b>Correct answer:</b> (d) All of the above <b>Explanation:</b> Analytical procedures may help the auditor during the planning stage to determine NTE of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions. Also, analytical procedures assist the auditor in understanding the client’s business and in identifying areas of potential risk by indicating aspects of and developments in the entity’s business of which he was previously unaware.</p>
Q3.	<p>Statement 1: Analytical procedures are more useful while conducting the audit and at the completion phase and are of no use at the planning stage. Statement 2: In the planning stage, audit procedures assist the auditor in understanding the client’s business and identifying the areas of potential risks.</p> <p>(a) Statement 1 &amp; 2 are correct (b) Statement 1 &amp; 2 are incorrect (c) Only Statement 1 is correct (d) Only Statement 2 is correct (ICAI MCQs)</p> <p><b>Correct answer:</b> (d) Only Statement 2 is correct <b>Explanation:</b> Statement 1 is incorrect. Analytical procedures can be used in all the stages of the audit (planning, testing and completion)</p> <ul style="list-style-type: none"> <li>Analytical procedures can be a part of the planning process. For example : During the planning process, current year financial statements can be compared with last year financial statements and changes can be determined. In case of any major variations in a specific area (say fixed assets) the auditor can put more focus on that area while conducting the audit.</li> <li>Analytical procedures can be often done during the testing phase (Execution stage) Analytical procedures can be applied in many areas. For example : an increase in sales can be compared with an increase in packaging expenditure, production and power and fuel expenditure.</li> <li>Analytical procedures are also required during the completion phase (Reporting stage). For example : During the reporting stage, company’s data can be compared with industry data.</li> </ul>
Q4.	<p>Marvin Ltd. is a renowned food chain supplier in a posh area providing restaurant facility along with food delivering. CA. Felix was appointed as an auditor of the company for the Financial Year 2023-24. While examining the books of accounts of the company, CA. Felix came to know about one of the major expenses of the company i.e. rent expense of ₹ 1,20,000 per month, for which he applied substantive analytical procedure for verification purpose. Explain, how would CA. Felix performs a substantive analytical procedure in the given scenario?</p> <p>(a) CA. Felix would inspect every single rent invoice per month of ₹ 1,20,000 and verify other elements appropriately. (b) CA. Felix would compare the rental expense of the company with that of another nearby company having corresponding dimensions, for high degree of accuracy. (c) CA. Felix would select the first month rent invoice of ₹ 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be ₹ 14,40,000 (i.e. ₹ 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation. (d) (a) and (b), both. (Sample MCQs) (RTP, May 2019, NA)</p>

	<p><b>Correct answer:</b> (c) CA. Felix would select the first month rent invoice of ₹ 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be ₹ 14,40,000 (i.e. ₹ 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation.</p>
Q5.	<p>The basic assumption underlying the use of analytical procedures is:</p> <p>(a) It helps the auditor to study relationship among elements of financial information</p> <p>(b) Relationship among data exist and continue in the absence of known condition to the contrary</p> <p>(c) Analytical procedures will not be able to detect unusual relationships</p> <p>(d) None of the above</p> <p><b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (b) Relationship among data exist and continue in the absence of known condition to the contrary</p> <p><b>Explanation:</b> The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.</p>
Q6.	<p>Which of the following is not an analytical procedure?</p> <p>(a) Tracing of purchases recurred in the purchase book to purchase invoices.</p> <p>(b) Comparing aggregate wages paid to number of employees</p> <p>(c) Comparing the actual costs with standard costs</p> <p>(d) All of them are analytical procedure</p> <p><b>(Sample MCQs) (ICAI MCQs) (MTP1, Nov 2019, 1 Mark)</b></p> <p><b>Correct answer:</b> (a) Tracing of purchases recurred in the purchase book to purchase invoices.</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Tracing purchases recorded in the purchase book to purchase invoices is not an analytical procedure; this is a substantive procedure used in audit testing to verify the completeness and accuracy of recorded transactions.</li> <li>Analytical procedures, on the other hand, involve the evaluation of financial information through analysis of plausible relationships and trends in data. Options (b) and (c) are examples of analytical procedures:</li> </ul>
Q7.	<p>Auditor Compares Gross Profit Ratio with that of Previous year and it is discovered that there has been a fall in the ratio. This is an example of :</p> <p>(a) Analytical Procedure</p> <p>(b) Test of Controls</p> <p>(c) Walk Through Test</p> <p>(d) Audit Sampling</p> <p><b>(ICAI MCQs) (RTP, Nov 2020, NA) (MTP2, May 2022, 1 mark) (MTP2, May 2023, 1 mark)</b></p> <p><b>Correct answer:</b> (a) Analytical Procedure</p>
Q8.	<p>When significant risk had been identified by the auditor, then:</p> <p>(a) Audit evidence obtained solely from substantive analytical procedures is sufficient.</p> <p>(b) Audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.</p> <p>(c) Auditor will perform test of details also.</p> <p>(d) Both b and c</p> <p><b>(ICAI MCQs)</b></p> <p><b>Correct answer:</b> (d) Both b and c</p> <p><b>Explanation:</b> When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a SAP can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from SAP is unlikely to be sufficient.</p>
Q9.	<p>_____ is the comparison of current data with the prior period balance.</p> <p>(a) Ratio Analysis</p> <p>(b) Trend analysis</p>

	(c) Reasonableness test (d) Structural Modelling <b>(ICAI MCQs)</b>
	<p><b>Correct answer:</b> (b) Trend analysis</p> <p><b>Explanation:</b> In trend analysis, the auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, after adjusting for relevant factors responsible for changes. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances.</p>
Q10.	<p>Which of the following statement is correct :</p> <p>(a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time</p> <p>(b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time</p> <p>(c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time</p> <p>(d) All statements are correct</p> <p><b>(Sample MCQs)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>Which of the following statement is correct :</p> <p>(a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time</p> <p>(b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time</p> <p>(c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time</p> <p>(d) None of the above</p> <p><b>(RTP, Nov 2019, NA)</b></p>
	<p><b>Correct answer:</b> (a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time</p>
Q11.	<p>Substantive Analytical Procedures are generally more applicable to:</p> <p>(a) Large volumes of transactions.</p> <p>(b) Transactions predictable over time</p> <p>(c) Both a and b</p> <p>(d) None of a and b</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (c) Both a and b</p> <p><b>Explanation:</b> Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.</p>
Q12.	<p>What is the primary objective of analytical procedures used in the overall review stage of an audit?</p> <p>(a) To help to corroborate the conclusions drawn from individual components of financial statements</p> <p>(b) To reduce specific detection risk</p> <p>(c) To direct attention to potential risk areas</p> <p>(d) To satisfy doubts when questions arise about a client's ability to continue.</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (a) To help to corroborate the conclusions drawn from individual components of financial statements</p> <p><b>Explanation:</b> The conclusions drawn from the results of analytical procedures designed and performed in accordance with, are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.</p>
Q13.	<p>Which of the following is correct :</p>

	<p>(a) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of financial data.</p> <p>(b) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of non-financial data.</p> <p>(c) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p> <p>(d) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through ratio analysis.</p> <p><b>(MTP1, May 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (c) As per the Standard on Auditing (SA) 520 "Analytical Procedure" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p>
Q14.	<p>which of the following is correct :</p> <p>(a) Different types of analytical procedures provide different levels of assurance.</p> <p>(b) Different types of analytical procedures provide similar levels of assurance.</p> <p>(c) Similar type of analytical procedures provide different levels of assurance.</p> <p>(d) All are correct</p> <p><b>(MTP1, Nov 2019, 2 Marks)</b></p>
	<p><b>Correct answer:</b> (a) Different types of analytical procedures provide different levels of assurance.</p>
Q15.	<p>Which of the following is not an example of Analytical Procedures having consideration of comparisons of the entity's financial information:</p> <p>(a) Comparable information for prior periods.</p> <p>(b) Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.</p> <p>(c) Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.</p> <p>(d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.</p> <p><b>(RTP, May 2020, NA)</b></p>
	<p><b>Correct answer:</b> (d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages is an example of Analytical Procedures having consideration of relationships</li> <li>• Comparable information for prior periods, Anticipated results of the entity and Similar industry information are examples of analytical Procedures having consideration of comparisons of the entity's financial information</li> </ul>
Q16.	<p>Statement I As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data.</p> <p>Statement II Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.</p> <p>(a) Only Statement I is correct</p> <p>(b) Only Statement II is correct</p> <p>(c) Both statements are correct</p> <p>(d) Both Statements are incorrect</p> <p><b>(RTP, May 2020, NA) (MTP2, May 2022, 1 mark) (MTP1, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (b) Only Statement II is correct</p> <p><b>Explanation:</b> Statement 1 is incorrect. As per "SA 520 Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.</p>

Q17.	<p>_____ implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.</p> <p>(a) Trend analysis (b) Ratio analysis (c) Structural modelling (d) Account fluctuations analysis</p> <p><b>(MTP1, May 2022, 1 mark)</b></p>
	<p><b>Correct answer:</b> (a) Trend analysis</p> <p><b>Explanation:</b> Trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years. For example, the auditor may compare the salary paid by the company during the year under audit with the salary paid by the company for several earlier years. An unusual increase in such expense amount may indicate that fraudulent payments are being made to fake employees</p>
Q18.	<p>The auditor of Vishwas Ltd wants to know from you which of the following methods are analytical procedures</p> <p>I. Comparison of client and industry data II. Comparison of client data with similar prior period data III. Comparison of client data with client-determined expected results IV. Comparison of client data with auditor-determined expected results</p> <p>(a) I, II and III only (b) I &amp;, II only (c) III &amp;, IV only (d) I, II, III and IV</p> <p><b>(MTP1, Nov 2022, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (d) I, II, III and IV</p> <p><b>Explanation:</b> Analytical Procedures may be segregated into the following major types - comparison of client and industry data, comparison of client data with similar prior period data, comparison of client data with client-determined expected results, comparison of client data with auditor-determined expected results and comparison of client data with expected results, using non financial data.</p>



## Chapter 5 - Audit of Items of Financial Statements

### Part I : Descriptive Questions

#### Assertions

Q1. A company is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. The company raises bill of its labour charges only on mills for converting yarn into fabrics. The auditor of company tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation? How he can ensure that? (ICAI Study Material - Test Your Understanding)

The auditor is trying to verify assertion relating to "**Rights and Obligations**". He is verifying that the company **owns** or **controls** the inventory recorded in the financial statements. Any inventory held by the company on behalf of another entity has not been recognized as part of inventory of the company. This can be achieved by **verifying stock records** pertaining to goods received from mills and sent back to mills after carrying out necessary operations. Besides, **agreements** with such mills may also be verified.

Q2. Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit. (RTP, May 2020, NA)

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

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

- **completeness;**
- **cut-off;**
- **existence/ occurrence;**
- **valuation/ measurement;**
- **rights and obligations; and**
- **presentation and disclosure**

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

**Example:** If the balance sheet of the company shows building with carrying amount of ₹ 85 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet **exists** as at the period-end (**existence** assertion);
- The company **owns** and **controls** such building (**Rights and obligations** assertion);
- The building has been **valued accurately** in accordance with the measurement principles (**Valuation** assertion);
- All buildings **owned** and **controlled** by the company are included within the carrying amount of ₹85 lakh (**Completeness** assertion).

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

Q3. What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory. (RTP, May 2020, NA)

#### Meaning of Valuation Assertion:

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

**Example of Inventory explaining the valuation assertion is given hereunder:**

As per AS 2 "Valuation of Inventories" inventory is to be recognized at **cost or net realizable value**, whichever is **lower**. Any



costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any **abnormal wastage** have been **excluded from the cost of inventory**. An **acceptable valuation basis** (eg. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

Q4

A junior accountant of a limited company has not separated transactions of one period from those in the ensuing period. As an Auditor, state the correct procedure to be followed and the areas in which it can be applied (RTP, Nov 2023, NA)

#### Cut-off Arrangement:

- Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for this purpose is technically known as "cut-off arrangement".
- It essentially forms part of the **internal control system** of the organisation.
- Accounts, other than sales, purchase and inventory are not usually affected by the continuity of the business and therefore, this arrangement is generally applied **only to sales, purchase and inventory**.
- The auditor satisfies by examination and test-checks that the cut-off procedures are adequately followed and ensure that:
  - Goods purchased, property in which has already been passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.
  - Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.
- The auditor may examine a **sample** of documents, evidencing the movement of inventory into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether inventories represented by those documents were included or excluded as appropriate during inventory taking for perfect and **correct presentation** in the financial statements.

### Audit of Share capital

Q5.

ABC Ltd. has issued shares for cash at a premium. Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account. Advise the means in which the amount in the account can be applied. (ICAI Study Material - Test Your Knowledge)

OR

The securities premium account may only be applied by the company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Comment. (SA, May 2019, 3 Marks) (MTP2, Nov 2022, 4 Marks)

#### Shares Issued at Premium:

Where a company issues shares at a premium, whether for cash or otherwise, aggregate amount of the premium received on those shares shall be transferred to securities premium account.

As per Section 52 of the Companies Act, 2013, the securities premium account may be applied by the company for the following purposes:

- issue of unissued shares of the company to the members of the company as fully paid **bonus shares**;
- in writing off the **preliminary expenses** of the Company;
- in writing off the **expenses** of, or the **commission** paid or **discount** allowed on, any issue of shares or debentures of the company;
- in providing for the **premium payable** on the **redemption** of any redeemable **preference shares** or of any debentures of the company; or
- for the **purchase** of its **own shares** or other securities under section 68.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above

Q6.

Any share issued by a company at a discounted price shall be void. Explain also the audit procedure in this regard. (MTP1, May 2019, 3 Marks)

OR

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



(SA, Nov 2019, 4 Marks)

OR

While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss clearly the provisions relating to discount on issue of shares and its verification by the auditor. (RTP, May 2022, NA) (MTP1, May 2022, 3 marks)

OR

Management of D Ltd. has issued shares at a discount to its creditors. Explain the provisions of the Companies Act, 2013 when shares are issued at a discount to creditors? As an auditor what will be your concern of checking in such a case? (SA, May 2023, 4 marks)

**Shares issued at a discount:**

- According to **Section 53** of the Companies Act, 2013, company shall **not issue shares at a discount, except** in the case of an issue of **sweat equity** shares given under Section 54 of the Companies Act, 2013.
- Any share issued by a company at a discounted price shall be **void**.
- However, a company **may issue shares at a discount** to its **creditors** when its **debt is converted** into shares in pursuance of any **statutory resolution plan** or **debt restructuring scheme** in accordance with any guidelines or directions or regulations specified by the **RBI** under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
- Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a **penalty** which may extend to an amount equal to the **amount raised** through the **issue of shares at a discount or ₹ 5 lakhs whichever is less**, and the company shall also be liable to **refund all monies received with interest** at the rate of **12% p.a.** from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- the **movement in share capital** during the year and wherever there is any issue,
- **Verify** that Company has not issued any of its shares at a discount by reading the **minutes** of meeting of its directors and shareholders
- **Verify** that whether the company has issued **shares at a discount** to its **creditors** when its **debt is converted** into **shares** in pursuance of any **statutory resolution plan** or **debt restructuring scheme** in accordance with any guidelines or directions or regulations specified by **RBI** under **RBI Act, 1934** or the **Banking (Regulation) Act, 1949**.

Q7. What audit points are to be borne in mind in case of issue of "Sweat Equity Shares" by a limited company? (MTP1, Nov 2019, 3 marks)

The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54):

- The issue is authorized by a **special resolution** passed by the company;
- The resolution specifies the **number** of shares, the **current market price**, **consideration**, if any, and the **class** or classes of directors or employees to whom such equity shares are to be issued;
- where the equity shares of the company are **listed** on a recognised stock exchange, the sweat equity shares are issued in accordance with the **regulations made by the SEBI** in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.
- The rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank **pari passu** with other equity shareholders.

Q8. BNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how will you proceed for verifying the reduction of Capital. (MTP1, Nov 2020, 6 Marks)

**Reduction of Capital:** For verifying reduction of capital, the auditor needs to undertake the following procedures:

- Confirm that the shareholders' **meeting**, which was held to pass the **special resolution**, was duly convened and that the **proposal was circularised** in advance to all the shareholders;
- Check that the **Articles of Association** authorises reduction of capital;
- Evaluate that there has been **no default w.r.t repayment of deposits accepted by company or payment of interest on such deposits**. Reduction of capital shall not be affected if such default exists.



- iv) Examine the **order of the Tribunal** confirming the reduction and ensure that a **copy of the order** and the minutes have been **registered and filed** with the ROC.
- v) Check the **Registrar's Certificate** as regards to reduction of capital;
- vi) Vouch the **accounting entries** recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence;
- vii) Check whether the **requirements of Schedule III** wrt reduced capital have been complied with.
- viii) Confirm whether the **revaluation of assets** has been properly disclosed in the Balance Sheet;
- ix) Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid-up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
- x) Confirm that the words **"and reduced"**, if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- xi) Check if the company has complied with all the **terms and conditions imposed by the tribunal** while confirming reduction of share capital.
- xii) Verify that the **Memorandum of Association** of the company has been suitably amended.

Q9. S & Co., Chartered Accountants, are appointed as the auditors of ABC Ltd. CA S, the engagement partner, has come across the following while verifying equity share capital of the company:

- He noticed that some of the equity shares are held by promoters.
- Some shares are issued as sweat equity shares to the employees.

What is the meaning of sweat equity shares? What are the disclosure requirements of such promoter's shareholding? (SA, Nov 2022, 4 marks)

**Meaning Sweat Equity Shares:** According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'. "Sweat Equity Shares" mean equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

**Disclosure requirements of such promoter's shareholding:**

A company shall disclose Shareholding of Promoters as below

Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	
Total				

\*\* Details shall be given separately for each class of shares.

\*\*\* percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.

## Audit of Reserves and Surplus

Q10. Explain the difference between revenue reserve and capital reserve. (RTP, May 2019, NA)

**Difference between Revenue Reserves and Capital Reserves:**

- Revenue Reserves:** Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose. Ex- to supplement divisible profits in lean years, to finance an extension of business, to augment the working capital of the business or to generally strengthen the company's financial position.
- Capital Reserves:** Capital Reserve represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss. Capital reserves include share premium, capital redemption reserve.
- It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.
- A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption



reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

Q11.

While auditing the accounts of ABC Ltd, a member of audit team is not clear about Classification of Reserves and Surplus. You being the senior member of audit team guide the member of the audit team about such criteria and classification as per general instructions for preparation of balance sheet as per Schedule III. (MTP2, May 2022, 3 marks)

Reserves and Surplus shall be classified as:

- Capital Reserves;
- Capital Redemption Reserve;
- Securities Premium;
- Debenture Redemption Reserve;
- Revaluation Reserve;
- Share Options Outstanding Account;
- Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof);
- Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

Note: A reserve specifically represented by earmarked investments shall be termed as a 'fund'.

Note: Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative

Q12.

Reserves are a vital source of financing by internal means. Explain and also discuss the meaning of reserves along with revenue reserve and capital reserve. (MTP1, Nov 2022, 3 Marks)

- Reserves are the amounts **appropriated out of profits** that are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist as at the date of the Balance Sheet.
  - Reserves are a vital source of financing by internal means. They are held for the purpose of distribution of dividend or financing the expansion of the company or strengthening the company financially. The company utilizes the reserves according to the nature and type of such reserve.
  - The reserves can be segregated as **revenue or capital reserves**.
  - Revenue reserves represent profits that are available for distribution to shareholders or below purposes such as:
    - to **supplement** divisible profits in lean years,
    - to **finance** an extension of business,
    - to **augment** the working capital of the business or
    - to generally **strengthen** the company's financial position.
  - Capital Reserves represents a reserve which does **not** include any amount regarded as **free for distribution**. They can be utilized only for certain limited purposes. Example: Securities premium, capital redemption reserve.
- If a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.

## Audit of Borrowings

Q13.

A company has availed cash credit facility of ₹ 2 crore (O/s balance ₹ 2 crore as at year end) from a bank for meeting its working capital requirements against security of stocks and debtors and guaranteed by directors of the company. Discuss, how the above cash credit facility, would be classified and disclosed in financial statements of company

(ICAI Study Material - Test Your Understanding)

It shall be shown under the head "**Borrowings**" and classified as **Short-term secured borrowings** specifying nature of security.

The above said outstanding amount shall be further sub-classified under heading "**Loans repayable on Demand**" from Banks. As per requirements of Schedule III of Companies Act, 2013, where loans have been guaranteed by directors or others, aggregate amount of such loans under each head shall be disclosed.



## ICAI Study Material - Test Your Knowledge

Q14.

How will you vouch and/or verify the Borrowing from Banks. (ICAI Study Material - Test Your Knowledge)

**Borrowing from Banks:**

Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows-

- Reconcile** the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a **certificate** from the bank showing the balance in the accounts as at the end of the year.
- Obtain **independent balance confirmation** from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- Verify the **authority** under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
- Confirm, in the case of a company, that the restraint contained in **Section 180** of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
- Ascertain the **purpose** for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

Q15.

On going through the financial statements of PQR Ltd, its auditors Kamal Gagan and Associates observed that company has taken Loans from banks and financial institutions. Further, the audit team discusses the following about Liabilities: "Liabilities are the financial obligations of an enterprise other than owners' funds. Liabilities include loans/ borrowings, trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, for, if any liability is omitted (or understated) or over stated, the Balance Sheet would not show a true and fair view of the state of affairs of the company." Advise stating clearly the audit procedures generally required to be undertaken for verification of existence of Borrowings (MTP1, May 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks)

**Verification of existence of Borrowings:**

- Review board minutes** for approval of new lending agreements. During review, make sure that any new loan agreements or bond issuances are **authorised**.
- Ensure that **significant debt commitments** should be approved by the board of directors.
- Agree** details of loans recorded such as interest rate, nature and repayment terms to the **loan agreement**.
- Verify** that the loans obtained are within the **borrowing limits** of the entity.
- Roll out** and obtain independent **balance confirmations** (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.).
- Agree** details of leases and hire purchase creditors recorded to **underlying contracts/agreements**.
- In case of **Debentures**, examine **trust deed** for terms and dates of redemption borrowing restrictions and compliance with covenants.
- When debt is **retired**, ensure that a discharge is received on assets securing the debt.
- Obtain **Written Representation** that all the liabilities which have been recorded represent a valid claim by the lenders.

**Audit of Trade Receivables**

Q16.

Write the audit Procedure for verification of existence of Trade Receivables.  
(ICAI Study Material- Test Your Knowledge) (MTP2, Nov 2021, 6 marks)

**For Verification of Existence of Trade Receivables, the auditor should check the following:**

- Check whether there are **controls** in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.
- Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.
- Check whether **realization** is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.
- If any **large balance** is due for a long time, auditor should ask for reasons and justification for the same.



- v) A list of trade receivables selected for **confirmation** should be given to the entity for preparing request letters for confirmation which should be properly addressed.
- vi) The auditor should maintain strict control to ensure the correctness and proper **dispatch** of request letters. It should be ensured that **confirmations** as well as any **undelivered letters** are returned to the auditor and not to the client.
- vii) Any **discrepancies revealed** by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.
- viii) Where **no reply is received**, the auditor should perform **alternative procedures** regarding the balances. This could include:
- Agreeing the **balance to cash received** subsequently;
  - Preparing a detailed analysis of the balance, ensuring it consists of identifiable transaction and confirming that these revenue transactions actually occurred. (**examination in depth** for those balances)
- ix) If there are any **related party receivables**, review them for **collectability** as well as whether they were **properly authorized** and the value of such transactions were reasonable and at arm's length.
- x) Check that receivables for **other than sales or services** are not included in the list.
- xi) Review a **trend line of sales and accounts receivable**, or a **comparison** of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

Q17. Mercury Ltd. is a company engaged in the manufacture of floor mats. The company sells its goods on credit. The debtors balance as on 31.03.2024 amounted to ₹ 20 cr. What is the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company?  
(ICAI Study Material - Test Your Knowledge) (MTP1, May 2023, 6 marks)

The following is the disclosure requirement for Studymate Limited with respect to the ageing schedule of the trade receivables in terms of Schedule III (Part I) to the Companies Act, 2013

#### Trade Receivables ageing schedule

Trade Receivables ageing schedule							(Amount in Rs)
Particulars	Outstanding for following periods from due date of payment#					Total	
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years		
(i) Undisputed Trade receivables – considered good							
(ii) Undisputed Trade Receivables – considered doubtful							
(iii) Disputed Trade Receivables considered good							
(iv) Disputed Trade Receivables considered doubtful							

# similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

Q18. "Until the invoice is paid, the invoice amount is recorded on the organisation's balance sheet as accounts receivable. If balances are not recoverable, then these amounts will need to be written off as an expense in the income statement/ profit and loss account." It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. Verify to ensure that the system for receivables has the necessary features. (MTP1, May 2018, 5 Marks)

OR

"Trade receivables are an essential part of any organisation's balance sheet. Often referred to as debtors, these are monies which are owed to an organisation by a customer. The most common form of an account receivable is a sale made on credit, via an invoice, to a customer." It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. Verify to ensure that the system for receivables has the necessary features. (MTP2, Nov 2018, 5 Marks)

It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. In summary,



check to ensure that the system for receivables has the following features:

- i) Only **bona fide** sales lead to receivables
- ii) Sales are made to **approved customers**
- iii) All such sales are **duly recorded** in the books
- iv) Once recorded, the debts can only be **eliminated** by receipt of cash or on the authority of a responsible official
- v) Debts are **collected promptly**
- vi) Balances are regularly **reviewed** and **aged**, a proper system of **follow up** exists and if necessary **adequate provision** for bad debt exists
- vii) Clear **segregation of duties** relating to identification of debt, receipt of income, reconciliations and write off of debts

Q19.

Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances. (RTP, May 2021, NA) (MTP1, Nov 2021, 4 Marks)

**Analytical Review Procedures:** The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

- comparison of **closing balances** of trade receivables, loans and advances **with** the corresponding figures for the **previous year**;
- comparison of the **relationship between current year** trade receivable balances and the **current year sales** with the corresponding **budgeted** figures, if available;
- comparison of **actual closing balances** of trade receivables, loans and advances with the corresponding **budgeted** figures, if available;
- comparison of **current year's ageing schedule** with the corresponding figures for the **previous year**;
- comparison of **significant ratios** relating to trade receivables, loans and advances with **similar ratios for other firms in the same industry**, if available;
- comparison of **significant ratios** relating to trade receivables, loans and advances with the **industry norms**, if available

Q20.

PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2024. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during month of March 2023. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables. (RTP, Nov 2022, NA)

OR

While auditing books of accounts of SOLAR Ltd., you observed that an amount due from a debtor for invoice issued on 31.03.2024 has not been recognized in the books of accounts. As an auditor, you want to ensure that all trade receivable balances that are supposed to be recorded have been recognized in the financial statements. How will you achieve the stated objective? (SA, Nov 2022, 3 marks)

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

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

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



## Audit of Cash and cash equivalents

Q21. What are the disclosures requirements as per Part I of Schedule III to the Companies Act with respect to the cash & cash equivalents held by a company? (ICAI Study Material- Test Your Knowledge)

OR

How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (part 1) to Companies Act, 2013? (SA, Dec 2021, 3 Marks)

OR

What are the required disclosures for cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013? (RTP, May 2023, NA) (MTP1, May 2023, 4 marks)

The following are the disclosure requirements as per Schedule III to the Companies Act, 2013, with respect to the cash & cash equivalents held by the company: Cash and cash equivalents

- i) Cash and cash equivalents shall be classified as:
  - a) Balances with banks;
  - b) Cheques, drafts on hand;
  - c) Cash on hand;
  - d) Others (specify nature)
- ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately
- iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- v) Bank deposits with more than 12 months' maturity shall be disclosed separately.

Q22. A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, etc. as at the end of the reporting period under audit. Explain the audit procedure in this context. (RTP, Nov 2020, NA)

## Audit procedures

- The auditor is required to confirm all account balances maintained with the bank as at the period-end.
- The client should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries.
- The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
  - Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence;
  - Sending the audit team member to the bank branch along with the entity's personnel to obtain balance confirmation from the bank directly.

## Audit of Inventories

Q23. How will you vouch/verify the Goods sent on consignment? (ICAI Study Material - Test Your Knowledge)

## Goods Sent on Consignment:

- i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.
- iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
- iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.



v) See that goods in hand with the consignee have been shown **separately** under the head inventories.

Q24. The auditor of Saturn Ltd. wants to verify whether the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2024. What audit procedures should the statutory auditor of the company perform? (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2023, 4 marks)

The statutory auditor of Saturn Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2024. The auditor should:

- vouch recorded purchases to underlying **documentation** (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- evaluate the **consigned** goods.
- examine client **correspondence**, sales and receivables records, purchase documents.
- determine the existence of **collateral agreements**.
- review **consignment agreements**.
- review **material purchase commitment agreements**.
- examine **invoices** for evidence of ownership i.e. the invoices shall be in the name of the client.
- obtain **confirmation** for significant items of inventory as per **SA 501**.
- For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

Q25. Write the audit procedures to be performed as an auditor for valuation (assertion) related to Finished goods and goods for resale. (SA, Nov 2018, 5 Marks) (MTP1, May 2020, 3 Marks)

**Audit procedure for valuation of finished goods and goods for resale**

- Enquire as to what costs are included, how these have been established and ensure that the **overheads** included have been determined based on **normal costs** and appear reasonable in relation to the information disclosed in the financial statements.
- Ensure that inventories are valued at **net realizable value** if they are likely to fetch a value **lower** than their **cost**.
- **Follow up** for items that are **obsolete, damaged**, slow moving and ascertain the possible realizable value of such items. For the purpose, request the client to provide inventory ageing split between less than 30 days, 30-60 days old, 60- 90 days old, 90- 180 days old, 180- 365 days old and more than 365 days old.
- **Follow up** any inventories which at time of observance of physical counting were noted as being **damaged** or **obsolete**.
- Examine **vendor price** lists to determine if recorded cost is less than current prices.
- Calculate **inventory turnover ratio**. Obsolete inventory may be revealed if the ratio is significantly lower.
- In manufacturing environments, test overhead allocation rates and ensure that **only direct labor, direct material and overhead** have been **included**.

Q26. ABC Limited has a closing balance of work in progress of inventories aggregating Rs 850 lakhs in their balance sheet as at March 31, 2024. As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices. (SA, Jan 2021, 3 marks)

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

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

Q27. Management of Z Ltd. wants to include all the cost incurred by the Company in valuing the cost of its inventories. The Accountant is, however, of the view that certain costs should be excluded from the cost of inventories and should be recognised as expenses for the period in which they are incurred. What are such costs that should be excluded while



determining the cost of inventories? (MTP2, Nov 2021, 4 marks)

**Examples of costs to be excluded in determining cost of inventory:**

In determining the cost of inventories, it is appropriate to **exclude** certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- **abnormal** amounts of **wasted** materials, labour, or other production costs;
- **storage costs**, unless those costs are **necessary** in the **production** process prior to a further production stage;
- **administrative overheads** that do **not** contribute to **bringing** the inventories to their **present location** and condition; and
- **selling and distribution** costs.

In the given situation, contention of Z Ltd. is not correct to include all the cost of its inventories while determining the cost of inventory. However, the contention of the accountant is **correct** that certain cost should be excluded from the cost of inventories and to be recognised as expenses in the period in which they are incurred.

Q28. While conducting an audit of Vee Ltd, CA Aman, auditor of the company, found that some goods were lying with third parties for a long period. Advise Aman how he will verify them. (MTP1, Nov 2021, 4 marks)

**Goods Lying with Third Party:** The auditor should check that the materiality of the item under this caption is included in inventories.

- i) He should obtain **confirmation** of the amount of goods lying with them.
- ii) He should inquire into the **necessity** of sub contractors retaining the inventory.
- iii) The **goods lying** with them for a **very long period** would merit auditors' special attention for making provision.
- iv) The **records, voucher/slips** for **regulating** the **movement** of **inventory** into and out of entity for sub-contracting work be reviewed by vouching for few transactions for ensuring existence and working of internal control systems for them.
- v) The **valuation** of inventories should be **correctly made** for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.
- vi) Evaluate the **condition** of **goods** and see whether **adequate provision** has been made.
- vii) Check whether **subsequently** the goods lying with third party were sold or received back after the expiry of the stipulated time period.
- viii) Ensure that the **goods** have been **included** in the **closing inventory** though lying with third party.

## Audit of Tangible Fixed Assets

Q29. The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

(ICAI Study Material- Test Your Knowledge) (RTP, May 2018, NA) (RTP, Nov 2019, NA) (MTP1, Nov 2019, 3 Marks)

OR

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

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

Advise the auditor on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE. (SA, Dec 2021, 4 Marks) (MTP2, May 2023, 3 marks)

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



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

Q30. You are the statutory auditor of Jupiter Ltd. for the FY 2023-24. During the course of audit, you noticed that the company has PPE under construction i.e. Capital Work in Progress. What disclosures should the company give with respect to the ageing schedule of such capital work in progress as required by Schedule III to the Companies Act, 2013?

(ICAI Study Material- Test Your Knowledge)

#### Capital-Work-in Progress

- a) For Capital-work-in progress, following ageing schedule shall be given:

					(Amount in ₹)
	Amount in CWIP for a period of				Total*
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

\*Total shall tally with CWIP amount in the balance sheet

- b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given\*\*:

					(Amount in ₹)
	To be completed in				
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Project 1					
Project 2					

\*\*Details of projects where activity has been suspended shall be given separately

Q31. Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe such expenses.  
(SA, May 2018, 5 Marks) (MTP2, May 2021, 3 marks)

#### Examples of revenue expenditure regarded as capital expenditure:

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

Q32. The auditor has to ensure whether PPE has been valued appropriately and as per generally accepted accounting policies and practices and also the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Explain how the auditor will verify the same. (MTP2, Nov 2022, 6 Marks)

The auditor has to ensure whether PPE has been valued appropriately and as per generally accepted accounting policies and practices.



The value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of PPE would be shown at higher amounts.

The auditor should:

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

To verify whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements

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

Q33. While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. Explain (RTP, May 2023, NA)

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

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

## Audit of Intangible Assets

Q34. Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period-end. (RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks) (RTP, Nov 2019, NA)

- Since an intangible asset is an **identifiable non-monetary asset**, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others or for administrative purposes.
- Example- for verifying the existence of **software**, the auditor should verify whether such software is in **active use** by the entity and for the **purpose**, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.
- Example- For verifying the existence of **design/ drawings**, the auditor should verify the **production data** to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.
- In case any intangible asset is **not in active use**, **deletion** should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion



- Q35. You are an auditor of PQR Ltd. which has spent ₹10 lakhs on Research activities of the product during period under audit. Board of Directors want to recognize it as an internally generated intangible assets. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements.  
(SA, May 2019, 4 marks) (MTP1, Nov 2020, 3 marks) (MTP1, May 2021, 4 marks) (MTP2, May 2023, 3 marks)

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

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

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

- Q36. The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The domination of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that intangible assets have been valued appropriately and as per generally accepted accounting policies and practices. (SA, July 2021, 3 Marks)

The auditor should:

- Verify that the entity has charged **amortization** on **all** intangible assets;
- Verify that the amortization **method** used reflects the pattern in which the asset's **future economic benefits** are **expected** to be consumed by the entity.
- The auditor should also verify whether the management has done an **impairment assessment** to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

- Q37. XYZ Ltd made huge additions to Intangible assets during the period 01-04-2023 to 31-03-2024 i.e period under audit. You have been appointed as an auditor and you want to verify the additions made to intangible assets during the period. Suggest the audit procedure to verify the additions to intangible assets (MTP1, May 2022, 6 marks) (MTP1, Nov 2022, 6 marks)

**Audit Procedures to verify the additions to intangible assets:**

- Verify the **movement** in the intangible assets **schedule** (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions - Deletions = Closing balances.
- Tally the closing balances to the entity's books of account.
- Check the **arithmetical accuracy** of the movement in intangible assets schedule.

For additions during the period under audit, obtain a **listing** of **all additions** from the **management** and undertake the following procedures:

- For all material additions, verify whether such **expenditure** meets the **criterion for recognition** of an intangible asset as per **AS 26**.
- Ensure that no **cost related to research** gets recognized as intangible asset.
- Check the **certificate** or **report** or other similar **documentation** maintained by the entity to **verify the date of use** of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- Verify whether the **additions** (acquisitions) have been **approved** by appropriate entity's personnel.
- Verify whether **proper internal processes** and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.
- In relation to **deletions** of intangible assets,
  - understand from the management the **reason** and rationale for deletion and the manner of disposal.
  - Obtain the management **approval** and disposal note authoring disposal of the asset from its active use.
  - Verify the **process** followed for sale of discarded asset, example inviting competitive quotes, tenders and



- the basis of calculation of sales proceeds.
- Verify that the management has **accurately recorded** the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account

### Audit of Trade Payables and Other Current Liabilities

Q38.

Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Explain stating also criteria for a liability to be classified as current liability. (RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks)

OR

While auditing the accounts of ABC Ltd, a member of audit team is not clear about the criteria regarding classification of liability into current liability and non-current liability. You being the senior member of audit team guide the member of the audit team about such criteria and classification as per general instructions for preparation of balance sheet as per Schedule III (MTP2, May 2022, 3 marks)

A liability shall be classified as current when it satisfies any of the following criteria:

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

All other liabilities shall be classified as non-current.

Q39.

Liabilities include trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Advise stating clearly the audit procedure to establish the existence of trade payables and other current liabilities as at the period-end.

(MTP1, Nov 2018, 10 marks)

**Audit Procedure to establish the existence of trade payables and other current liabilities:**

- Check whether there are **controls** in place to ensure that any purchase/ expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense.
- Obtain the **accounts payable ageing report** and trace its balances to the **general ledger**. If there are any differences, investigate reconciling items. Journal entries specially for large amounts should be carefully examined.

**Direct confirmation procedure**

- An **important audit activity** is to contact vendors directly/independently and ask them to confirm the amounts of accounts payable. This should necessarily be done for **all significant account payable balances** as at the period-end and for parties from whom material purchases have been made during the period under audit **even if period-end balance of such parties is not significant**.
- The auditor employs direct confirmation procedure with the **consent** of the entity under audit. There may be situations where the **management of the entity requests the auditor not to seek confirmation** from certain trade payables. In such cases, the auditor should consider whether there are valid grounds for such a request.
- While determining the information to be obtained, the form of confirmation, as well as the extent and timing of application of the confirmation procedure, the auditor should consider all relevant factors such as the effectiveness of internal control, the apparent possibility of disputes, inaccuracies or irregularities in the accounts, the probability that requests will receive consideration, and the materiality of the amounts involved.
- The trade payables may be requested to confirm the balances either (a) as **at the date of the balance sheet**, or (b) as at any other selected date which is reasonably **close** to the **date of the balance sheet**.
- The **form** of requesting confirmation from the trade payables may be either (a) the 'positive' form of request, wherein the creditor is requested to respond whether or not he is in agreement with the balance shown, or (b) the 'negative' form of request, wherein the creditor is requested to respond only if he disagrees with the balance shown.

Q40.

M/s MP & Co, Chartered Accountants, have been appointed as auditors of LMP Private Limited. The partner of the firm



asked the Audit assistant to carry out the 'examination-in depth' of the payment made to a creditor. Advise him about the documents to be verified (RTP, Nov 2023, NA)

#### Examination – in depth of the payment made to creditor:

The Audit Assistant of M/s MP & Co., should verify the following documents of LMP Private Limited in case of payment to a creditor is to be verified "in depth":

- The **invoice** and statement of account received from the supplier.
- The **entry** in the inventory record showing that the goods were received.
- The **Goods Received Note** and Inspection Certificate showing that the goods on receipt were verified and inspected.
- The copy of the **original order** and authority showing that the goods in fact were ordered by an authority which was competent to do so.

### Audit of Loans and Advances and Other Current Assets

- Q41. MNO & Associates are the statutory auditor of Venus Ltd. for the FY 2023-24. During the course of audit, one of the audit team members, Mr. Viaan noticed that the company has made loans totaling to ₹ 50 lakhs to the promoters of the company, namely, Mr. Raj and Mr. Rajeev without specifying the period of repayment. Mr. Viaan discussed with Mr. Manik, the engagement partner, about the disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan? (ICAI Study Material - Test Your Knowledge)

Mr. Manik should advise Mr. Viaan to consider whether the following disclosures as required by Schedule III to the Companies Act, 2013, has been made in respect of the loans granted to promoters, namely, Mr. Raj and Mr. Rajeev, either severally or jointly with any other person, that are:

- repayable on demand or
- without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

- Q42. Write the audit procedures to be performed as an auditor for valuation (assertion) related to Loans and Advances and other current assets. (SA, Nov 2018, 5 Marks) (MTP1, May 2020, 3 Marks)

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

- Assess the allowance for doubtful accounts.
  - Review the **process** followed by the Company to derive an allowance for doubtful accounts.
  - Compare** the process used in the **last year** and determine the **appropriateness** of the method used.
- Obtain the **ageing report** of loans and advances, split between not currently due, 30 days old, 30-60 days old, 60-180 days old, 180-365 days old and more than 365 days old.
- Obtain the **list** of loans and advances under **litigation** and **compare** with previous year.
- Identify those loans and advances that appear **doubtful**; discuss with management about the **reasons** as to why these loans/ advances are not included in the provision for doubtful balances.
- Examine **bad loans/** advances write-offs. Prepare schedule of movements on Bad loans/ advances – Provision Accounts and loans/ advances written off
- Examine that **write-offs** or other reductions in the recoverable balances have been approved by the appropriate authority.
- Check that the **restatement** of **foreign currency loans** and advances/ other current assets has been done properly in accordance with AS 11.



## Audit of Provisions and Contingent Liabilities

Q43. How will you vouch/verify Provision for income tax? (ICAI Study Material- Test Your Knowledge)

## Provision for Income Tax:

- Obtain the **computation** of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
- Review **adjustments**, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
- Examine relevant **records and documents** pertaining to advance tax, self-assessment tax and other demands.
- Compute **tax payable** as per the latest applicable rates in the Finance Act.
- Ensure that **overall provisions** on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.
- Ensure that the requirements of **AS 22** on Accounting for Taxes on Income have been appropriately followed for the period under audit

Q44. From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in financial statements as required by AS 29. What type of disclosures should be made for each class of contingent liability as at the balance sheet date? (MTP1, May 2021, 3 marks) (MTP2, May 2021, 4 marks)

## Disclosure for each class of Contingent Liability:

From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in the financial statement as required by AS 29.

As per, AS 29, unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

- an **estimate** of its financial effect
- an **indication** of the uncertainties relating to any outflow; and
- the **possibility** of any reimbursement.

Where any of the information as required above is not disclosed because it is not practicable to do so, that fact should be stated.

Q45. CA Q, the auditor of XYZ Ltd, while conducting audit observes that the company has made various provisions in the books of account. What are the audit procedures that CA Q will follow to verify the existence, completeness, and valuation of the provisions made? (SA, May 2023, 3 marks)

Audit procedures that CA Q will follow to verify the existence, completeness, and valuation of the provisions made are:

## Existence

- Obtain a list of **all provisions** and compare them with balances in the ledger.
- Inspect** the underlying **agreements** like agreements with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.

## Valuation

- Wherever required, obtain the **expert's report**, calculation and underlying working for the provision amount. For example - for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote as defined above. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.

## Completeness

- Obtain the **underlying working** and the **basis** for each of the provisions made from the management and verify whether the same is **complete** and **accurate**.
- The auditor shall obtain a **written representation** from the management that it has made all the provisions which were required to be made as per the recognized accounting principles.



**Audit of Sale of Products and Services**

Q46.	<p>An auditor of a company is focusing upon revenues of a company. In this regard, besides performing usual detailed checking of sales, he wants to perform substantive analytical procedures in respect of sales. Discuss how he can perform such procedures. (ICAI Study Material- Test Your Understanding)</p> <p>Substantive analytical procedures in respect of sales will consist of sales <b>trend</b> analysis, <b>comparison</b> with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales <b>expectation</b> and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.</p>
Q47.	<p>How will you vouch and/or verify the Goods sent out on Sale or Return Basis? (ICAI Study Material- Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>Discuss the audit procedures generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis. (SA, Nov 2020, 3 Marks) (MTP1, Nov 2023, 3 marks)</p> <p><b>Goods Sent Out on Sale or Return Basis:</b></p> <ol style="list-style-type: none"> <li>Check whether a <b>separate memoranda record</b> of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.</li> <li>Verify that the <b>price</b> of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.</li> <li>Ensure that the goods in respect of which the period of approval has <b>expired</b> at the end of the year, have either been received back or customers' accounts have been debited.</li> <li>Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had <b>not expired</b> till the end of the year lying with the party, has been <b>included</b> in the closing <b>inventory</b>.</li> </ol>
Q48.	<p>Auditor of ABC Ltd while auditing its financial statements wants to ensure whether the disclosures regarding sales has been made as required under Schedule III to Companies Act, 2013. Explain such disclosure requirements. (MTP1, May 2021, 3 marks)</p> <p>Ensure whether the following disclosures as required under Schedule III (Part II) to Companies Act, 2013 have been made:</p> <ol style="list-style-type: none"> <li>In respect of a <b>company other than a finance company</b>, revenue from operations shall disclose separately in the notes revenue from—             <ol style="list-style-type: none"> <li>Sale of <b>products</b>;</li> <li>Sale of <b>services</b>;</li> <li>(ba) Grants or <b>donations</b> received (relevant in case of section 8 companies only)]</li> <li><b>Other</b> operating revenues;</li> </ol>             Less: Excise duty.           </li> <li>In respect of a <b>finance company</b>, revenue from operations shall include revenue from—             <ol style="list-style-type: none"> <li><b>Interest</b>; and</li> <li><b>Other</b> financial services.</li> </ol> </li> <li><b>Brokerage</b> and discount on sales other than usual trade discount to be disclosed separately</li> <li>Transactions with <b>related parties</b> to be disclosed appropriately in notes to accounts.</li> </ol>
Q49.	<p>CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated? (SA, July 2021, 4 Marks)</p> <p>CA X, having doubts about fictitious sales being recorded by Joyful Ltd would ensure that revenue is not overstated by performing following audit procedures: (any 4 points can be written)</p> <ul style="list-style-type: none"> <li>Check whether a <b>single sales invoice</b> is recorded twice or a <b>cancelled sales invoice</b> could also be recorded.</li> <li>Test check a few <b>invoices</b> with their relevant <b>entries</b> in the <b>sales journal</b>.</li> <li>Obtain <b>confirmation</b> from few customers to ensure <b>genuineness</b> of sales transaction</li> <li>Whether any fictitious customers and sales have been recorded.</li> <li>Whether any <b>shipments</b> were done <b>without</b> the <b>consent</b> and agreement of the customer, <b>especially</b> at the year end</li> </ul>



to inflate the sales figure

- Whether **unearned revenue** recorded as earned.
- Whether any substantial **uncertainty** exists about collectability
- Whether **customer obligations** are contingent on other actions (financing, resale etc.)

Q50.

While checking sales of the client, the auditor has to ensure that all sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted. Explain the audit procedures to ensure the same. (MTP2, Nov 2022, 3 Marks)

While checking sales of the client, the auditor has to ensure that all sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted. The auditor can perform the following procedures to ensure the same.

- Trace a **few transactions** from **inception to completion**. (Examination in depth)  
E.g: Take a few sales transactions, and check from the receipt of sales order to the payment of receivable balance, every underlying document to ensure if it is properly recorded at every stage and measured accurately taking into consideration all the incentives, discounts, if any. The recognition shall be according to the revenue recognition policy of the entity.
- If the client is engaged in **export sales**, then **compliance** with **AS 11** shall be ensured.
- Auditor must **understand the client's operations** and related **GAAP** issues e.g. point of sale revenue recognition vs. percentage of completion, wherever applicable.
- **Compare the rate** of sales affected with **related parties** and review them for collectability, as well as whether they were properly **authorized** and the value of such transactions were reasonable and at **arm's length**.

### Audit of Other Income comprising interest income, dividend income, Gain/ Loss on sale of investments

Q51. How will you vouch/verify the Receipt of capital subsidy. (ICAI Study Material- Test Your Knowledge)

#### Receipt of Capital Subsidy:

- Check the **application** made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- Examine **documents** for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- Ensure that the **conditions** to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- Check relevant **entries** for receipt of subsidy.
- Check **compliance** with requirements of **AS 12** on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

Q52. How would you vouch/verify the Sale of Scrap.? (ICAI Study Material- Test Your Knowledge)

OR

Explain how you will verify the items "Sale proceeds of scrap material" while conducting an audit of an entity.

(RTP, Nov 2021, NA) (RTP, May 2022, NA)

OR

X Ltd. is a hardware manufacturing company. At each and every stage of production processes large amount of scrap is generated in the factory and subsequently sold. As an auditor how will you vouch/ verify the sale of scrap?

(SA, May 2023, 3 marks)

#### Sale of Scrap:

- Review the **internal control** as regards generation, storage and disposal of scrap.
- Check whether the organization is maintaining **reasonable record** for generation of scrap.
- Analyze the raw **material used**, production and generation pattern of scrap and **compare** the same with figures of earlier year.
- Check the **rates** at which scrap has been sold and compare the rate with previous year.
- Vouch **sales**, with **invoices** raised, advertisement for tender, rate contract with scrap dealers.



	<p>vi) Ensure that there exists a <b>proper control</b> procedure to identify scrap and good units and they are not mixed up and sold as scrap.</p> <p>vii) Make an overall <b>assessment</b> of the value of realization from scrap as to its reasonableness.</p>
Q53.	<p>As statutory auditor of the company, list out audit procedures required to be undertaken for the following:</p> <p>i) Interest income from fixed deposits. (4 Marks)</p> <p>ii) Dividend income. (2 Marks)</p> <p>iii) Gain/(loss) on sale of investment in Mutual funds. (2 Marks)</p> <p>Also indicate disclosure requirements of above as per Companies Act, 2013. (2 Marks)</p> <p>(SA, May 2018, 10 Marks)</p> <p>i) <b>For verifying interest income on fixed deposits:</b></p> <ul style="list-style-type: none"> <li>Obtain a <b>listing of fixed deposits</b> opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period.</li> <li>Verify the <b>arithmetical accuracy</b> of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.</li> <li>For <b>deposits still outstanding</b> as at the period-end, trace the same to the <b>direct confirmations</b> obtained from the respective bank/ financial institution.</li> <li>Obtain a <b>confirmation of interest</b> income from the <b>bank</b> and verify that the <b>interest</b> income as per <b>bank reconciles</b> to the <b>calculation</b> shared by the <b>entity</b>.</li> <li>Obtain a copy of <b>Form 26AS</b> and <b>reconcile</b> the <b>interest</b> reflected therein to the <b>calculation</b> shared by client.</li> </ul> <p>ii) <b>Dividend Income:</b></p> <p>Verify that the dividend is <b>recognised</b> in the statement of profit and loss <b>only when</b> the entity's <b>right to receive</b> payment of the dividend is <b>established</b>, provided it is probable that the economic <b>benefits</b> associated with the dividend will <b>flow</b> to the entity and the <b>amount</b> of the dividend can be measured <b>reliably</b>.</p> <p>iii) <b>Gain/(loss) on sale of investment in mutual funds:</b></p> <p>Verify that <b>Gain/(loss)</b> on sale of <b>investment in mutual funds</b> is <b>recorded</b> as other income <b>only on transfer</b> of title from the entity and is <b>determined</b> as the <b>difference</b> between the <b>redemption</b> price and <b>carrying</b> value of the investments. For the purpose, <b>obtain</b> the mutual fund <b>statement</b> and trace the gain / loss as recorded in the <b>books of account</b> to the gain/ loss as reflected in the statement.</p> <p><b>Disclosure Requirements:</b> Whether 'other income' has been classified as:</p> <ul style="list-style-type: none"> <li>Interest Income (in case of a company other than a finance company);</li> <li>Dividend Income;</li> <li>Net gain/loss on sale of investments;</li> <li>Other non-operating income (net of expenses directly attributable to such income)</li> </ul>
Q54.	<p>ABC limited appointed XYZ &amp; Company, Chartered Accountants, as a Statutory Auditor of the Company for the year 2023-24. CA X, partner of XYZ &amp; Company, was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA X verify interest income on fixed deposits for the year 2023-24? (SA, Nov 2020, 4 Marks)</p> <p>CA X, partner of XYZ &amp; Company, would carry out the following audit procedure for verifying interest income on fixed deposits of ABC Limited:</p> <p>ii) Obtain a <b>listing of fixed deposits</b> opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period.</p> <p>iii) Verify the <b>arithmetical accuracy</b> of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.</p> <p>iv) For <b>deposits still outstanding</b> as at the period-end, trace the same to the <b>direct confirmations</b> obtained from the respective bank/ financial institution.</p> <p>v) Obtain a <b>confirmation of interest</b> income from the <b>bank</b> and verify that the <b>interest</b> income as per <b>bank reconciles</b> to the <b>calculation</b> shared by the <b>entity</b>.</p> <p>vi) Obtain a copy of <b>Form 26AS</b> and <b>reconcile</b> the <b>interest</b> reflected therein to the <b>calculation</b> shared by client.</p>



- Q55. As a Statutory Auditor of the company list out audit procedure required to be undertaken for the recognition of following other income:
- Interest income from fixed deposit
  - Dividend income
  - Gain/(loss) on sale of investment in mutual funds.
- (SA, Jan 2021, 3 marks)

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

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

### Audit of Purchases

- Q56. While auditing purchases which types of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price. (SA, May 2019, 4 Marks)

OR

Discuss the audit procedure to be considered by an auditor while performing analytical procedure to obtain audit evidence as to overall reasonableness of purchase quantity and price. (SA, Nov 2019, 3 Marks)

OR

CA Saurabh is the statutory auditor of UVW Ltd. for the FY 23-24. While verifying the purchases made by UVW Ltd., CA Saurabh decided to perform analytical procedures to obtain audit evidence regarding the overall reasonableness of purchase quantity and price of purchases. What analysis should CA Saurabh perform? (RTP, May 2023, NA)

Auditor needs to perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include:

- Consumption Analysis:** Auditors should examine **raw material consumed** as per manufacturing account and **compare** the same with **previous years** with closing stock and ask for the **reasons** from management for any significant **variations** noticed.
- Stock Composition Analysis:** The auditor should collect the reports from management for composition of stock i.e. **raw materials** as a **percentage** of **total stock** and **compare** the same with **previous years** and ask for the **reasons** from management for any significant **variations** noticed
- Ratios:** Auditors should compare the **creditors turnover** ratios and **stock turnover** ratios of the current year with previous years.
- Quantitative Reconciliation:** Auditors should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

### Audit of Employee Benefits Expenses

- Q57. While reviewing Employee benefits expenses of a company, how you as an auditor you will evaluate its hiring, appraisal and retirement process? (SA, May 2019, 3 Marks)

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

- Tests the controls** the entity has set around the employee benefit payment process to determine how effective they are. If they are **effective**, the auditor can **reduce** the **substantive testing**.  
Common internal controls over the employee benefit payment cycle includes maintaining of attendance records, employee master, authorisation and approval of monthly payroll processing and disbursement, computation of employee deductions like payroll taxes, accrual of other benefits like gratuity, leave encashment, bonus etc.



	<ul style="list-style-type: none"> <li>The auditor <b>selects a random sample</b> of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.</li> <li>Performing <b>substantive analytical procedures</b> which will consist of monthly expense <b>reasonability, comparison</b> with previous accounting period, setting an <b>expectation</b> in relation to the expense incurred during the period under audit and comparing that with the client's business operations and overall trend in the industry.</li> </ul>
Q58.	<p>Explain how you would verify Employee Benefit Expense incurred by a Company. (MTP1, Nov 2022, 3 Marks)</p> <p><b>Verification of Employee Benefit Expenses:</b></p> <ol style="list-style-type: none"> <li>Obtain an <b>understanding</b> of the entity's <b>process</b> of recording employee attendance.</li> <li>Obtain a <b>list of employees</b> as at the period-end along with a monthly movement <b>split</b> between <b>new hires, leavers</b> and <b>continuing</b> employees.</li> <li>Select sample on random basis of <b>new hires</b>, obtain the <b>appointment letter</b> and verify whether the <b>salary</b> for first month and subsequent months was <b>processed</b> as per the agreed terms.</li> <li>Select sample on random basis of <b>resigned employees</b>, obtain their <b>full and final computation</b> and verify whether <b>all their dues</b> including post-retirement benefits like gratuity, leave encashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained.</li> <li>Obtain the <b>monthly salary registers</b> for <b>all 12 months</b>. Calculate the average salary per employee per month and compare with the PY and preceding month and analyse the reasons for variance</li> <li>Verify if accrual/ <b>provision</b> has been made for all employee benefits and obligations like bonus, gratuity, leave encashment, etc.</li> <li>In case <b>provident fund (PF)</b>, employee state insurance (ESI) are <b>applicable</b> to the entity, compile a <b>reasonability</b> by applying the rate to the basic wages and comparing to the amount recorded in books and analyse <b>reasons</b> for variance, if any.</li> <li>Perform <b>analytical procedures</b> to obtain audit evidence as to overall reasonableness of employee benefit expenses</li> </ol>
Q59.	<p>How is "Employee Benefit Expense" disclosed in the Financial Statements as required under Schedule III (Part II) to Companies Act, 2013? (SELF)</p> <p>Ensure whether employee benefit expenses has been classified as:</p> <ol style="list-style-type: none"> <li>salaries and wages,</li> <li>contribution to provident and other funds,</li> <li>expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP),</li> <li>staff welfare expenses</li> </ol>

### Audit of Depreciation and Amortisation

Q60.	<p>While verifying depreciation charged to statement of profit and loss account of a company, it is noticed by auditor that one new machinery was purchased and installed in month of April. The necessary trials were carried out and machinery was ready for use in April itself. However, owing to lack of orders in the market, the said machinery was put into actual operation from 1<sup>st</sup> October. The company has, accordingly, provided depreciation in its books on this machinery w.e.f. 1<sup>st</sup> October. Is above recording of depreciation by company proper in its books? (ICAI Study Material- Test Your Understanding)</p> <p>Depreciation of an asset begins when it is <b>available for use</b> i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Depreciation on asset is charged on asset from the date when it is <b>ready for use and not from the date of actual usage</b>. Hence, recording of depreciation by company w.e.f. 1<sup>st</sup> October is <b>not proper</b>.</p>
Q61.	<p>Mention any five attributes to be considered by an auditor while verifying for a depreciation and amortisation expenses. (SA, May 2018, 5 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortisation expense. (SA, Jan 2021, 4 marks) (MTP2, Nov 2023, 4 marks)</p> <p>Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately</p>



calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.

- Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:
- Obtain the **understanding** of the entity's **accounting policy** related to depreciation and amortisation.
  - Ensure that the Company's **policy** for **charging** depreciation and amortisation is as per the relevant provisions of **Companies Act** and **applicable accounting standards**.
  - The accounting policy has been applied **consistently** year on year. Any **change** in the accounting policy has been adequately **disclosed**.
  - Whether the **depreciation** has been **calculated** after making adjustment of **residual value** from the cost of the assets.
  - Whether depreciation and amortisation charges are **valid**.
  - Whether depreciation and amortisation charges are **accurately calculated** and **recorded**.
  - Whether all depreciation and amortisation charges are recorded in the **appropriate period**.
  - Ensure the **parts** (components) of each item of property, plant and equipment that are to be **depreciated** separately has been **properly identified**.
  - Whether the **most appropriate depreciation method** for each separately depreciable component has been used.

### Audit of Other Expenses like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous Expenses

Q62. How will you vouch/verify the Foreign travel expenses? (ICAI Study Material- Test Your Knowledge)

#### Foreign Travel Expenses:

- Examine **Travelling Allowance bills** submitted by the employees stating the details of tour, details of expenses, etc.
- Verify that the tour programme was properly **authorised** by the competent authority.
- Check the T.A. bills along with accompanying **supporting documents** such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- See that the **tour report** accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.
- Check **Reserve Bank of India's permission**, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed **separately** in the accounts as per requirement of **Schedule III** to the Companies Act, 2013 and **AS 11** "The Effects of Changes in Foreign Exchange Rates".

Q63. How would you vouch/verify the Advertisement Expenses. (ICAI Study Material- Test Your Knowledge)

#### Advertisement Expenses:

- Verify the **bills/invoices** from advertising agency to ensure that rates charged for different types of advertisement are as per the contract.
- See that the advertisement **relates** to client's **business**.
- Inspect** the **receipt** issued by the agency.
- Ascertain the **nature** of expenditure – revenue or capital expenditure and see that it has been recorded properly.
- Ascertain the **period** for which payment is made and see that prepaid amount, if any, is carried to the balance sheet.
- See that **all outstanding** advertisement bills have been provided for.

Q64. How will you vouch and/or verify payment of taxes? (ICAI Study Material- Test Your Knowledge)

OR

Explain how you will verify Payment of Taxes while conducting an audit of an entity  
(RTP, Nov 2021, NA) (RTP, May 2022, NA)

#### Vouching of Payment of Taxes:

- Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the **copy** of the assessment **order**, assessment form, **notice of demand** and the receipted **challan**.
- Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted



	<p>challan acknowledging the amount paid.</p> <p>iii) The <b>interest</b> allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.</p> <p>iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.</p> <p>v) The entity can make electronic payment of taxes also from the <b>account of any other person</b>. However, the challan for making such payment <b>must</b> clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.</p> <p>vi) It is <b>not necessary</b> for the entity to make payment of taxes from his <b>own account</b> in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.</p>
Q65.	<p>"While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes. (SA, Nov 2018, 5 Marks) (MTP1, Nov 2021, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>Profit and Loss account of an organisation shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations. What are the attributes that an auditor generally prefers for vouching these types of expenses? (SA, Dec 2021, 3 Marks)</p> <p style="text-align: center;">OR</p> <p>M/s SS &amp; Associates have been appointed as statutory auditors of Green Limited, a company engaged in the business of manufacturing of hardware products. They are analyzing the monthly trends for other expenses like rent, power and fuel, repairs, etc. and are also verifying attributes of such types of expenses. List down the attributes for verifying such expenses. (SA, Nov 2022, 4 marks)</p> <p>An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations</p> <p>While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:</p> <ol style="list-style-type: none"> <li>Whether the expenditure pertained to <b>current period under audit</b>;</li> <li>Whether the expenditure qualified as a <b>revenue and not capital expenditure</b>;</li> <li>Whether the expenditure had a <b>valid supporting</b> like travel tickets, insurance policy, third party invoice etc.;</li> <li>Whether the expenditure has been <b>classified under the correct expense head</b>;</li> <li>Whether the expenditure was <b>authorised</b> as per the delegation of authority matrix;</li> <li>Whether the expenditure was in relation to the entity's business and <b>not a personal expenditure</b></li> </ol>
Q66.	<p>Explain how you would verify rent expense incurred by a Company. (RTP, May 2019, NA) (MTP2, Nov 2022, 3 Marks)</p> <p>Rent expense can be verified by:</p> <ol style="list-style-type: none"> <li>Obtain a <b>month wise expense schedule</b> along with the <b>rent agreements</b>.</li> <li>Examine whether expense has been <b>recorded</b> for <b>all 12 months</b> and whether the rent paid is as per the underlying agreement.</li> <li>Examine whether the agreement contains any <b>escalation clause</b> and if yes, verify whether the rent has been <b>increased</b> or adjusted during the period only as per escalation clause.</li> <li>Verify whether the <b>agreement</b> is in the <b>name of the entity</b></li> <li>Verify whether the expense pertains to <b>premises</b> used for running <b>business</b> operations of the entity.</li> </ol>
Q67.	<p>Explain the audit procedure to vouch/verify Power and Fuel expenses (RTP, May 2019, NA)</p> <p style="text-align: center;">OR</p> <p>The auditor may choose to analyse the monthly trend for Power &amp; Fuel expense. Explain how this analysis will be performed by the auditor. (MTP2, Nov 2021, 4 marks)</p> <p><b>Power and fuel expense:</b></p>



- i) Obtain a **month wise expense schedule** along with the power bills.
- ii) Verify whether expenses have been **recorded** for **all 12 months**.
- iii) Compile a **month wise summary of power units consumed** and the applicable rate and **check the arithmetical accuracy** of the bill raised on a monthly basis.
- iv) Analyse the **monthly power units** consumed by linking it to units of **finished goods produced** and **investigate reasons** for variance in monthly trends

Q68. While verifying the legal and professional expenses of the client company, what audit procedures should the auditor perform? (MTP1, May 2023, 3 marks)

**Legal and professional expenses:**

- i) Obtain a **month-wise** and **consultant-wise summary**.
- ii) In case of **monthly retainership** agreements, verify whether the expenditure for **all 12 months** has been recorded correctly.
- iii) For **non- recurring expenses**, select a sample and **vouch** for the **attributes** discussed above.
- iv) The auditor should be **cautious** while vouching for legal expenses as the same may highlight a **dispute** for which the entity may **not** have **made** any **provision** and the **matter** may also **not** have been **discussed/ highlighted** to the auditor for his **specific consideration**

### Miscellaneous Questions

Q69. Various ratios of current year and preceding year are disclosed in financial statements of a company in accordance with requirements of Schedule III of Companies Act, 2013. Discuss requirements of law in this regard (Do not list out names of ratios) (ICAI Study Material- Test Your Understanding)

A company has to disclose various ratios in its financial statements in accordance with requirements of Schedule III of Companies Act, 2013.

The company shall also explain the terms included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any **change** in the ratio by **more than 25%** as compared to the preceding year.

Q70. Proceedings have been initiated against the company ABC Ltd for holding one of its property as benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder. State the disclosure requirements to be complied with by ABC Ltd as per Schedule III to the Companies Act, 2013. (MTP2, May 2022, 4 marks)

**OR**

Proceedings have been initiated against False Limited for holding benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, but such property is not recorded in books of accounts. As a consultant to the company, what will you advice to the company as far as disclosure requirements are concerned in relation to said proceedings? (SA, May 2022, 4 marks)

**Details of Benami Property held**

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:-

- a) **Details** of such property, including year of acquisition,
- b) **Amount** thereof,
- c) Details of **Beneficiaries**,
- d) If property is in the books, then **reference** to the item in the Balance Sheet,
- e) If property is **not** in the books, then the **fact** shall be stated with reasons,
- f) Where there are **proceedings** against the company under this law as an abetter of the transaction or as the transferor then the **details** shall be provided,
- g) **Nature** of proceedings, **status** of same and company's view on same.

Q71. B Ltd. is covered u/s 135 of the Companies Act, 2013 i.e. Corporate Social Responsibility (CSR). What matters (other than the amount spent, amount not spent, amount required to be spent etc.) shall be disclosed by the company with regard to CSR activities done by the company? (SA, May 2022, 4 marks)

**OR**



Mayank Ltd. is covered u/s 135 of the Companies Act, 2013 i.e. Corporate Social Responsibility (CSR). What matters shall be disclosed by the company with regard to CSR activities done by the company? (MTP2, May 2023, 4 marks)

Where the company covered under section 135 of the companies act, the following shall be disclosed with regard to CSR activities:-

- amount required to be spent by the company during the year,
- amount of expenditure incurred,
- shortfall at the end of the year,
- total of previous years shortfall,
- reason for shortfall,
- nature of CSR activities,
- details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
- where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

Q72. A Ltd. has traded for 50.00 Lacs in "TETRA", a virtual currency, during the F.Y. 2023-2024 and earned a profit of 20.00 Lacs on it. What disclosure requirements are prescribed for such type of transactions done by the company? (SA, Nov 2022, 3 marks)

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:-

- profit or loss on transactions involving Crypto currency or Virtual Currency
- amount of currency held as at the reporting date,
- deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

## Part II: Correct/Incorrect Questions

Q1. If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume only one point that the management has only asserted that the building recognized in the balance sheet exists as at the period-end (ICAI Study Material - Test Your Knowledge)

**Incorrect.** If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet **exists** as at the period end (**existence** assertion);
- Company X **owns** and **controls** such building (**Rights** and **obligations** assertion);
- The building has been valued **accurately** in accordance with the measurement principles (**Valuation** assertion);
- All buildings **owned** and **controlled** by Company X are included within the carrying amount of ₹ 100 lakh (**Completeness** assertion).

Q2. The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. (ICAI Study Material - Test Your Knowledge)

**Incorrect.** As per Sec 52 of the Companies Act, 2013, the securities premium account can be utilized for:

- towards the issue of unissued shares of the company to the members of the company as fully paid **bonus** shares;
- in writing off the **preliminary expenses** of the Company;
- in writing off the **expenses** of, or the **commission** paid or **discount** allowed on, any issue of shares or debentures of the company;
- in providing for the **premium payable** on the **redemption** of any **redeemable preference** shares or of any **debentures** of the company; or
- for the **purchase** of its **own shares** or other securities under section 68

Q3. "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. (ICAI Study Material - Test Your Knowledge)



	<b>Incorrect.</b> "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.
Q4.	Increase in authorised capital of the company requires special resolution to be passed at the general meeting. (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> Increase in Authorised capital requires alteration of capital clause of memorandum of Association. Therefore, ordinary resolution is passed for increase in authorised capital of the company as per the Companies Act, 2013.
Q5.	Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose. (ICAI Study Material- Test Your Knowledge)
	<b>Incorrect.</b> Capital Reserve represents a reserve which does not include any amount regarded as free for distribution. They can be utilised only for certain limited purposes. Example: Securities premium, CRR. Revenue reserves represent profits that are available for distribution to shareholders.
Q6.	A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. (ICAI Study Material- Test Your Knowledge)
	<b>Correct.</b> A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.
Q7.	Capital redemption reserve can be used for distribution of dividends. (ICAI Study Material- Test Your Knowledge)
	<b>Incorrect.</b> Capital Redemption reserve is not a free reserve. It is a restrictive reserve and can be used only for purposes given in the Act. Since it is not a free reserve, it cannot be utilised for payment of dividends. CRR can be used only for the purpose of issuing fully paid up bonus shares.
Q8.	In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity. (ICAI Study Material- Test Your Knowledge)
	<b>Correct.</b> While auditing trade receivable balance, direct confirmations as per SA 505, is considered to be the most important audit activity. Direct confirmation can be sought from the debtors directly confirming their balance due. The replies to the confirmation can be then matched with the records maintained by the client. Any discrepancies so revealed, can be investigated and checked in detail for possibility of any risk of material misstatement. Auditor selects a few debtors' balances and ask the client to prepare the confirmations properly addressed to the debtors. Auditor maintains strict control over this process.
Q9.	PPE are depreciated when the asset is actually put to active use. (ICAI Study Material- Test Your Knowledge) (MTP2, Nov 2023, 2 Marks) OR Tangible assets are depreciated when the asset is actually put to active use. (MTP1, Nov 2020, 2 Marks)
	<b>Incorrect.</b> Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time, Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criteria for charge of depreciation.
Q10.	Material and wages are considered to be revenue expenditure when incurred for construction of building. (ICAI Study Material- Test Your Knowledge)
	<b>Incorrect.</b> Material and Wages incurred on construction of building qualify to be capital expenditure as per AS 10 "Property, Plant and Equipment". Therefore, these have to be added to the cost of the asset i.e building and shall not be expensed off to Statement of Profit and Loss.
Q11.	Dividends are recommended by the Board, and declared by the Shareholders. (ICAI Study Material- Test Your Knowledge)
	<b>Correct.</b> The dividends are recommended by the Board of Directors by passing a resolution at the board meeting. The



**Shareholders declare** the dividends at the AGM by passing an ordinary resolution. Declaration of dividend is an item of ordinary business. However, the shareholders can decrease the amount of dividends recommended by the board but cannot increase it.

Q12. Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established. (ICAI Study Material- Test Your Knowledge)

OR

Dividends are recognized in the statement of profit and loss only when the amount of dividend can be measured reliably (SA, Nov 2020, 2 Marks) (MTP2, Nov 2023, 2 marks)

**Incorrect.** Dividends are recognised in the statement of profit and loss **only** when:

- the entity's **right** to **receive** payment of the dividend is **established**;
- it is probable that the economic **benefits** associated with the dividend will **flow** to the entity; and
- the **amount** of the dividend can be measured **reliably**

Q13. Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only. (ICAI Study Material- Test Your Knowledge)

**Incorrect.** Employee benefits expenses, commonly called payroll expenses, represent the aggregate **sum** an **entity** pays to its **employees** for their labour/ efforts, as well as **associated expenses** such as perquisites/ benefits, postemployment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their **hiring**, their **welfare** and **training**

Q14. According to Section 53 of the Companies Act, 2013, a company can issue shares at a discount. (RTP, Nov 2019, NA)

**Incorrect.** According to **Section 53** of the Companies Act, 2013, a company **shall not issue shares at a discount**, except in the case of an issue of **sweat equity shares** given under **Section 54** of the Companies Act, 2013.

Q15. An intangible asset is an identifiable monetary asset. (RTP, Nov 2019, NA)

**Incorrect.** An intangible asset is an **identifiable non-monetary asset**, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Q16. Depending on how the business operates, the management may value inventory using weighted average basis. (MTP1, May 2020, 2 Marks)

**Incorrect.** Depending on how the business operates, the management may value inventory using **First-in first-out (FIFO)** or **weighted average basis**

Q17. One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. (RTP, Nov 2020, NA)

**Correct.** One of the key principles of accrual basis of accounting requires that an asset's **cost** is **proportionally expensed based** on the **period** over which the asset is **expected** to be **used**. Both depreciation and amortization are methods that are used to prorate the cost of a specific type of asset over its useful life. **Depreciation** represents systematic allocation of the depreciable value of an item of **PPE** over its useful life while **amortization** represents systematic allocation of the depreciable amount of an **intangible asset** over its useful life

Q18. Mr. Z, a team member of auditor of Grateful and Competent Limited was of the opinion that while conducting an audit of a company no distinction is required to be made between revenue expenditure and capital expenditure. (MTP1, Nov 2020, 2 Marks)

**Incorrect.** The opinion of Mr. Z is **incorrect** because one of the important aspects to be followed while conducting an audit of a company is that a **distinction** is required to be made **properly between revenue** expenditure and **capital** expenditure.

Q19. If the purpose of an audit procedure is to test for understatement in the existence or valuation of accounts payable then testing the recorded accounts payable may be relevant audit procedure. (SA, Jan 2021, 2 marks)



- Incorrect.** If the purpose of an audit procedure is to test for **overstatement** in the existence or valuation of accounts payable, testing the recorded accounts **payable** may be a **relevant** audit procedure.
- On the other hand, when testing for **understatement** in the existence or valuation of accounts payable, testing the recorded accounts **payable** would **not** be **relevant**, but testing such information as **subsequent disbursements, unpaid invoices, suppliers' statements**, and unmatched receiving reports may be relevant.
- Q20. No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the Bank. (MTP1, May 2021, 2 marks) (RTP, May 2022, NA) (MTP1, Nov 2022, 2 marks)
- Incorrect.** The person who is controlling the trade receivables should ensure that **proper accounting entries** have been passed by crediting the respective trade receivables account. The balance of **cheque in hand** should be **disclosed** along with the cash and bank balances in the financial statements.
- Q21. As per AS 26, internally generated goodwill is not recognised as an asset. (MTP1, May 2021, 2 marks)
- Correct.** As per AS 26, Intangible Assets, internally generated goodwill is **not recognised** as an asset because it is **not** an **identifiable** resource controlled by the enterprise that can be measured reliably at cost.
- Q22. It is the function of an audit to establish that payments have been made validly to the persons who are shown to be recipients. (MTP2, May 2021, 2 Marks)
- Correct.** It is the function of audit to establish that payments have been made validly to persons who are shown to be recipients. For checking the validity of a transaction, it is usually necessary to refer to **documentary evidence**.
- Q23. Computer software which is the integral part of the related hardware should be treated as fixed asset/tangible asset (RTP, Nov 2021, NA)
- Correct.** As per AS 26 on Intangible Assets, computer software for a computer controlled machine tool that **cannot operate without that specific software** is an **integral part** of the **related hardware** and it is treated as a fixed asset. Therefore, computer software which is the integral part of the related hardware should be treated as fixed asset/tangible asset.
- Q24. Electronic payment of Income Tax cannot be made by an assessee from the account of any other person. (MTP2, May 2022, 2 marks)
- Incorrect.** Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards. The assessee can make electronic payment of taxes also from the account of any other person. However, the **challan** for making such payment **must** clearly indicate the **Permanent Account Number (PAN)** of the assessee on whose behalf the payment is made. It is **not necessary** for the assessee to make payment of taxes from his **own account** in an authorized bank
- Q25. An unexplained decrease in GP Ratio may result due to fictitious sales. (RTP, Nov 2022, NA)
- Incorrect.** A fictitious sale will **increase** the **GP Ratio**, instead of decreasing it. GP ratio normally comes down if there are unrecorded sales or reversal of fictitious sale entries recorded in the previous year or fictitious purchase or decrease in closing stock
- Q26. Amortization represents systematic allocation of the depreciable amount of an item of Property, Plant and Equipment (PPE) over its useful life. (SA, May 2023, 2 marks)
- Incorrect.** **Depreciation** represents systematic allocation of the depreciable value of an item of **PPE** over its useful life whereas **amortisation** represents systematic allocation of the depreciable amount of an **intangible asset** over its useful life.
- Q27. Internally generated Goodwill can be recognized as an asset. (RTP, Nov 2023, NA)
- Incorrect.** As per AS 26, internally generated goodwill is **not** recognized as an **asset** because it is **not** an **identifiable** resource controlled by the enterprise that can be measured reliably at cost.



**Part III: Multiple Choice Questions**

Q1. An auditor is verifying purchases to ensure their genuineness. Consequently, he is also trying to verify that no fake "trade payables" are present in financial statements. Which assertions concerning purchase transactions and trade payables respectively are being verified by auditor?

- (a) Occurrence; Existence
- (b) Occurrence; Completeness
- (c) Existence; Occurrence
- (d) Completeness; Occurrence

(ICAI Study Material- Test Your Knowledge)

**Correct answer:** (a) Occurrence; Existence

Q2. Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?

- (a) No separate disclosure of goods in transit is required.
- (b) Disclosure of total goods in transit under head of inventories is required.
- (c) Disclosure of goods in transit under each sub-head of inventories is required.
- (d) Disclosure of goods in transit for raw material and finished goods is required.

(ICAI Study Material- Test Your Knowledge)

**Correct answer:** (c) Disclosure of goods in transit under each sub-head of inventories is required.

Q3. Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:-

- (a) Directors only
- (b) Clients only
- (c) Directors or employees
- (d) Auditors only

(ICAI Study Material- Test Your Knowledge)

**Correct answer:** (c) Directors or employees

Q4. Which of the following is not an element of cost of an item of machinery included under head "Property, Plant and Equipment"?

- (a) Installation costs
- (b) Freight cost of bringing the item to its location
- (c) Inaugural costs
- (d) Employee benefit cost for making such an item suitable for production

(ICAI Study Material- Test Your Knowledge)

**Correct answer:** (c) Inaugural costs

Q5. Which of the classification is not required by a company in respect of its "Cash and cash equivalents?"

- (a) Balance with Banks
- (b) Balance with scheduled banks
- (c) Cash on hand
- (d) Cheques on hand

(ICAI Study Material- Test Your Knowledge)

**Correct answer:** (b) Balance with scheduled banks

Q6. Which assertion is common among the statement of profit and loss and balance sheet captions:

- (a) Existence
- (b) Valuation
- (c) Completeness



(d) Measurement  
(ICAI MCQs)

**Correct answer:** (c) Completeness

**Explanation:** Existence and Valuation are the assertions for account balance.

Direct confirmation procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion:

- (a) Rights and obligations
  - (b) Existence
  - (c) Valuation
  - (d) Completeness
- (ICAI MCQs)

**Correct answer:** (b) Existence

**Explanation:** Existence means assets, liabilities, and equity interests exist at the period end.

Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:

- (a) Valuation
- (b) Rights and obligations
- (c) Existence
- (d) Completeness

(ICAI MCQs) (MTP1, May 2022, 1 mark)

**Correct answer:** (a) Valuation

**Explanation:** Valuation and allocation means assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded. Obtain the ageing report of accounts receivable and analysis and identification of doubtful debts addresses the valuation assertion.

Q9. Observing inventory being counted and personally performing test counts to verify counts is performed during audit of inventory balances to address the following balance sheet assertion:

- (a) Rights and obligations
- (b) Valuation
- (c) Completeness
- (d) Existence

(ICAI MCQs)

**Correct answer:** (d) Existence

**Explanation:** Existence means all assets, liabilities, and equity interests exist.

Q10. Search for unrecorded liability is performed during audit of current liabilities to address the following balance sheet assertion:

- (a) Valuation
- (b) Rights and obligations
- (c) Existence
- (d) Completeness

(ICAI MCQs)

**Correct answer:** (d) Completeness

**Explanation:** Completeness assertion means all assets, liabilities and equity interests that should have been recorded have been recorded.

Q11. Cut-off testing is performed during audit of sales to address the following assertion:

- (a) Occurrence



- (b) Measurement  
(c) Cut-off  
(d) All of the above  
(ICAI MCQs) (MTP2, May 2023, 1 mark)

**Correct answer:** (c) Cut-off

Q12. All inventory units held by the audit entity and that should have been recorded, have been recognized in the financial statements. The assertion involved is:

- (a) Existence  
(b) Completeness  
(c) Rights and Obligations  
(d) Valuation  
(ICAI MCQs)

**Correct answer:** (b) Completeness

Q13. Sec. 52 of the Companies Act states that Security Premium Account can be applied by the Company for one of the purposes mentioned below. Which of the following is a CORRECT option?

- (a) To adjust loss on revaluation of Assets  
(b) To pay dividend to equity shareholders  
(c) Providing for the premium payable on redemption of Preference shares  
(d) To use it as working capital for its business.

(ICAI MCQs) (MTP1, Nov 2021, 2 marks)

**Correct answer:** (c) Providing for the premium payable on redemption of Preference shares

Q14. Statement I : A capital reserve cannot be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.  
Statement II : The amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.

- (a) only Statement I is correct  
(b) only Statement II is correct  
(c) both the statements are correct  
(d) both the statements are incorrect.

(ICAI MCQs) (MTP2, Nov 2021, 2 Marks)

**Correct answer:** (b) only Statement II is correct

**Explanation:** Statement 1 is incorrect. A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.

Q15. Where no reply is received during the performance of direct confirmation procedures as part of audit of accounts receivable balances, the auditor should perform:

- (a) No additional testing  
(b) Additional testing including subsequent collections testing and agreeing the detail of the respective balance to the customer's remittance advice.  
(c) Additional testing including preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred.  
(d) Both (b) and (c)

(ICAI MCQs)

**Correct answer:** (d) Both (b) and (c)

Note: Option B is the correct answer as per ICAI MCQs booklet.

Q16. Wages paid to workers would qualify as:



- (a) Revenue expenditure
  - (b) Capital expenditure
  - (c) Revenue or capital expenditure depending upon facts and circumstances.
  - (d) None of the above
- (ICAI MCQs)

**Correct answer:** (c) Revenue or capital expenditure depending upon facts and circumstances.

- Q17. Which of the following is not an example of revenue expenditure -
- (a) Salaries and wages of employees engaged directly or in-directly in production
  - (b) Repairs, maintenance and renewals of fixed assets
  - (c) Legal and professional expenses
  - (d) development expenditure on land
- (ICAI MCQs)

**Correct answer:** (d) development expenditure on land

- Q18. While auditing the books of accounts of QHMP Ltd., CA. Ranker, the statutory auditor of the company, came to know that the management of the company has recognized internally generated goodwill as a fixed asset. CA. Ranker discussed with the management that according to accounting standards, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. However, the management is quite rigid to the accounting treatment followed for internally generated goodwill and not paying attention to the auditor. Thus, through an example, CA. Ranker explained which type of goodwill may be recognized as a fixed asset for which the management got justified. State which of the following examples the auditor must have given to the management?
- (a) If an item meeting the definition of an intangible asset is acquired in a business combination, it forms part of the goodwill to be recognized at the date of the amalgamation.
  - (b) Only those goodwill needs to be recognized as a fixed asset which can be touched like physical assets, for example, land and buildings.
  - (c) Goodwill is recognised only when there is a contractual or other legal rights for a physical asset which shall not be amortized over the period.
  - (d) All of the above.

(Sample MCQs) (RTP, May 2019, NA)

**Correct answer:** (a) If an item meeting the definition of an intangible asset is acquired in a business combination, it forms part of the goodwill to be recognized at the date of the amalgamation.

- Q19. Which of the following item should not be treated as an asset, as per provisions of Accounting Standard 26 :
- (a) Computer software
  - (b) Internally generated goodwill
  - (c) Fishing License
  - (d) Brand Names
- (ICAI MCQs)

**Correct answer:** (b) Internally generated goodwill

**Explanation:** As per AS 26 "Intangible Assets", internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

- Q20. During the course of audit of intangible assets, expenditure incurred during following phase is not capitalised:
- (a) Development phase
  - (b) Research phase
  - (c) None of the above
  - (d) Both (a) and (b)
- (ICAI MCQs)

**Correct answer:** (b) Research phase



**Explanation:** Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

- Q21. Which of the following is not correct:-  
 (a) AS 18 – Related Party Disclosures  
 (b) AS 10 – Property, Plant & Equipment  
 (c) AS 28 – Impairment of Assets  
 (d) AS 16 – Intangible Assets  
 (ICAI MCQs) (MTP2, May 2022, 1 mark) (RTP, May 2023, NA)

**Correct answer:** (d) AS 16 – Intangible Assets  
**Explanation:** AS 26 – Intangible Assets is correct.

- Q22. The notes to the account statement of ASD Ltd. shows the break-up of accounts payable for the Financial Year 2023-24 as follows:

Accounts Payable	Amount (in ₹)
Mr. Kraby	1,20,000
Mr. Runny	40,000
Mr. Bluffy	14,56,000
<b>Total</b>	<b>16,16,000</b>

CA. Sandy, the auditor of ASD Ltd., wants to investigate the valuation of accounts payable of Mr. Bluffy amounting to ₹ 14,56,000. Which of the following procedures is best fitted & more reliable to be followed by CA. Sandy to get more reliable evidence for the existence of such balance as on 31st March, 2024?

- (a) Inspect each and every journal entry passed in the books of ASD Ltd.  
 (b) Ask ASD Ltd. to provide the details of payment made during the year 2023-24.  
 (c) Inspect the invoices issued by Mr. Bluffy and the payments made.  
 (d) Interrogate the cash manager of ASD Ltd.

(Sample MCQs)

**Correct answer:** (c) Inspect the invoices issued by Mr. Bluffy and the payments made.

- Q23. The management of BOB Ltd. could not differentiate between any obligation for which either provisions need to be made or the contingent liability to be shown. The auditor of the company clarifies the management that the provisions are the amounts charged against revenue to provide for a known liability, the amount whereof cannot be determined with substantial accuracy. On the other hand, a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The auditor further explains the concept with the help of examples. State which of the following examples the auditor must have provided in respect of contingent liability?  
 (a) Depreciation.  
 (b) Clean-up costs for unlawful environmental damage.  
 (c) Product warranties.  
 (d) Lawsuit against the company where it is more likely that no present obligation exists.  
 (Sample MCQs)

**Correct answer:** (d) Lawsuit against the company where it is more likely that no present obligation exists.

- Q24. \_\_\_\_\_ are charges against profits to provide for known liabilities for which amounts cannot be determined with accuracy  
 (a) Contingent Liabilities  
 (b) Provision  
 (c) Securities Premium Reserve.



(d) Liabilities  
(ICAI MCQs) (MTP2, May 2023, 1 mark)

Correct answer: (b) Provision

Q25. ABC's investee company- XYZ declares final dividend for financial year 2022-23 in the meeting of board of directors held on April 10, 2023. In which financial year should ABC account for the dividend income:

- (a) Proportionately i.e. considering 10 days of financial year 2023-24 and 355 days of financial year 2022-23
- (b) Financial year 2022- 23
- (c) Financial year 2023- 24
- (d) Equally between financial year 2022-23 and financial year 2023-24

(ICAI MCQs)

Correct answer: (c) Financial year 2023- 24

Q26. Useful life of assets is given in Schedule \_\_\_\_\_ of Companies Act 2013.

- (a) II
- (b) IV
- (c) V
- (d) VII

(ICAI MCQs)

Correct answer: (a) II

Q27. An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure that are essential and incidental to running of business operations. One of such expenses is the legal and professional expenses. These are the fees paid for professional advices regarding specific deals.

Iconic Ltd. is having a retainer agreement with a lawyer, Mr. Avi, to whom the company is paying a huge sum as legal and professional expenses on monthly basis. While vouching such expenses, what should be kept in mind by the auditor?

- (a) In case of monthly retainer agreement, only verify if the expenditure for all 12 months has been recorded correctly.
- (b) The auditor should verify that the payments have been only through bank vouchers.
- (c) The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.
- (d) In case of monthly retainer agreement, only verify that all the payments have been made and there is no outstanding balance to be shown as liability in the Balance Sheet.

(Sample MCQs)

Correct answer: (c) The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

Q28. While auditing the accounts of ThoughtCo Ltd., CA. Bliss, the auditor of the company came across certain accounts payable balances for which direct confirmation procedure needs to be applied. Thus, for the year ending 31st March, 2024, he sent positive confirmation requests wherein the trade payables are requested to respond whether or not they are in agreement with the balance shown. The auditor received all the confirmation replies from the trade payables on time as correct except from five of them. What other option the auditor is left with regard to trade payables from which no reply for confirmation requests received?

- (a) Perform additional testing which may include agreeing the balance to subsequent cash paid.
- (b) Accept the balances as it is assuming other replies against received confirmation requests being correct.
- (c) Accept the balances as it is assuming that the trade payables must have replied in case of any discrepancies.
- (d) None of the above.

(Sample MCQs) (RTP, May 2019, NA)

Correct answer: (a) Perform additional testing which may include agreeing the balance to subsequent cash paid



**Explanation:** Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:

- Testing of subsequent payments in respect of the trade payables to whom confirmations were rolled out but no replies received;
- Agreeing the details of the respective balance to the underlying vendor invoices;
- Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these purchases/ expense transactions actually occurred. (examination in depth)

Q29. While conducting the audit of Saraswati Ltd, a packaged water making company, it was found that a purchase of motor car was made in the name of the company. Your Article Assistant has performed the following audit procedures. Identify which of the following procedure is incorrect.

- Ascertain whether the purchase of car has been properly authenticated.
- Check invoice of the car dealer to confirm the purchase price
- Examine registration with Transport Authorities to verify the ownership
- Ensure that the motor car has been included in the Closing inventory of goods

(RTP, Nov 2020, NA)

**Correct answer:** (d) Ensure that the motor car has been included in the Closing inventory of goods

**Explanation:** Since the company is engaged in the business of packaged water, the purchase of a motor car would not form part of the inventory. The motor car purchased would form part of the company's fixed assets.

Q30. \_\_\_\_\_ is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non occurrence of one or more uncertain future events not wholly within the control of the entity:-

- Provisions
- Reserves
- Contingent Liabilities
- Liability

(MTP1, Nov 2020, 2 Marks) (RTP, May 2021, NA) (MTP2, May 2022, 1 mark) (MTP1, Nov 2022, 1 Mark)

**Correct answer:** (c) Contingent Liabilities

Q31. Which of the following is an example of revenue expenditure-

- Wages on installation of Machinery
- Regular repairs incurred on PPE
- Legal expenses in purchase of land and building
- Freight inwards on purchase of PPE

(MTP1, May 2021, 1 mark)

**Correct answer:** (b) Regular repairs incurred on PPE

**Explanation:** Certain revenue expenses qualify as capital expenditure like wages on installation of machinery, legal expenses in purchase of land and building, freight inwards on purchase of assets. Expenses have to be analysed and properly classified. The revenue expense like regular repairs on assets have to be charged off to the Statement of Profit and Loss.

Q32. ABC Limited is engaged in manufacturing of electric two-wheelers. During the year, a customer has gone to court due to incident of fire in battery-operated vehicle. The damages claimed are to tune of ₹ 5 lakhs. The company insists that this incident was due to improper charging of battery and has nothing to do with manufacturing design of vehicle. The company's lawyers advise that it is probable that company is not likely to be held liable. It is likely to be reflected in financial statements of company under \_\_\_\_\_?

- Provisions
- Reserves
- Contingent liabilities
- Other current Liabilities

(RTP, Nov 2023, NA)

**Correct answer:** (c) Contingent liabilities



Q33

The securities premium account may be applied by the Company for which of the following purpose:

- (a) payment to creditors for material
- (b) purchase of fixed assets
- (c) repayment of loans
- (d) writing off the preliminary expenses

**(MTP1, Nov 2023, 1 mark)**

**Correct answer:** (d) writing off the preliminary expenses

Q34

During the audit of sales, the auditor found that recorded sales represent goods which were ordered by valid customers and were dispatched and invoiced in the period. The auditor is addressing which of the following assertions:

- (a) Occurrence
- (b) Measurement
- (c) Cut-off
- (d) Accuracy

**(MTP1, Nov 2023, 1 mark)**

**Correct answer:** (a) Occurrence

Q35

ABC Ltd is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. ABC Ltd raises bills of its labour charges only on mills for converting yarn into fabrics. The auditor of ABC Ltd tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation:

- (a) completeness
- (b) Occurrence
- (c) rights and obligations
- (d) cut-off

**(MTP1, Nov 2023, 1 mark)**

**Correct answer:** (c) rights and obligations



## Chapter 6 - Audit Documentation

### Part I : Descriptive Questions

#### Meaning, Nature and Purpose of Audit Documentation

Q1. Define audit documentation. Also give some examples (ICAI Study Material - Test Your Knowledge)

Audit Documentation refers to the **record** of audit **procedures performed**, relevant audit **evidence obtained**, and **conclusions** the auditor **reached**.

Examples of Audit Documentation are-

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

Q2. A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company. Explain whether Audit Documentation has any relation with regard to planning the audit of a company. (ICAI Study Material - Illustration)

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

Q3. While auditing the books of accounts of Very Careful Limited for the financial year 2023-24, a team member of the auditors of Very Careful Limited was of the view that with regard to audit of the company, no relation exists between Audit File and Audit Documentation. Explain the relationship between Audit File and Audit Documentation. (ICAI Study Material - Illustration)

**Relationship between Audit File and Audit Documentation:**

- Audit Documentation refers to the **record** of audit **procedures performed**, relevant audit **evidence obtained**, and **conclusions** the auditor **reached**.
- Audit file may be defined as **one or more** folders or other storage media, in **physical** or **electronic** form, containing the records that comprise the audit **documentation** for a specific engagement.
- The auditor shall **assemble** the audit documentation in an audit file and complete the **administrative** process of assembling the final audit file on a **timely** basis after the date of the auditor's report.

Q4. Discuss any two purposes of audit documentation. (ICAI Study Material - Test Your Knowledge)

OR

Audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. Explain stating clearly purpose of audit documentation. (MTP1, Nov 2018, 5 Marks)

OR

A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain. (RTP, May 2021, NA)

OR

Audit documentation serves a number of purposes. List such purposes. (MTP1, May 2021, 3 Marks)

OR

CA M is the engagement partner of S Ltd. He has instructed his audit team to maintain proper audit documentation. The audit team members are not sure about the purpose for which the documentation should be made. Explain the various purposes of audit documentation with reference to SA 230 (SA, Nov 2022, 3 marks)

OR

SA 230, "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial



statements. Such audit documentation serves various purposes. Explain. (RTP, May 2023, NA)

The following are the purpose of Audit documentation:

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

Audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. Explain clearly stating the nature and purpose of Audit Documentation. (MTP2, Nov 2018, 5 Marks)

OR

What do you mean by Audit Documentation? Also explain the nature and purpose of audit documentation. (RTP, May 2019, NA)

OR

Discuss the meaning and nature of Audit Documentation. (RTP, Nov 2019, NA)

**Meaning of Audit documentation:**

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

**Nature of Audit Documentation:**

Audit documentation provides:

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

**Purpose of Audit Documentation:**

The following are the purpose of Audit documentation:

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

Q6. Audit Documentation refers to the record of three items. Explain stating clearly the objective and nature of audit documentation. (RTP, Nov 2023, NA)

Audit Documentation refers to the **record** of audit **procedures performed**, relevant audit **evidence obtained**, and **conclusions** the auditor **reached**.

The objective of the auditor is to prepare documentation that provides:

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

**Nature of Audit Documentation**

Audit documentation provides:

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



requirements.

**Form, Content and Extent of Audit Documentation**

Q7. During the course of audit of a company, an issue arose relating to treatment of interest costs of company on its restructured loans taken from a bank. This important matter was discussed with CFO of the company and was properly resolved. Is it necessary for the auditor to include in its working papers?

(ICAI Study Material - Test Your Understanding)

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

Q8. The form, content and extent of audit documentation depends upon number of factors. List out any four such factors.

(ICAI Study Material - Test Your Knowledge)

OR

The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc. Explain in detail. (RTP, Nov 2018, NA)

OR

Discuss with reference to SA-230, factors affecting form, contents and extent of audit documentation.

(MTP1, May 2019, 4 Marks)

**Form, Content and Extent of Audit Documentation:** Working papers should record the audit plan, nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

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

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

Q9. While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor should record. (RTP, May 2021, NA)

In documenting the nature, timing and extent of audit procedures performed, the auditor of PQR Ltd shall record:

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

**Assembly of the Final Audit File**

Q10. CA Sonali Morarka has completed audit of a listed company. The audit report dated 15th July, 2023 has been issued. However, audit working papers including record of discussions with management, details of audit procedures performed to obtain audit evidence and conclusions reached by her have not been properly assembled. More than six months have elapsed after issue of audit report. Subsequently, she has received a letter from regulator in connection with audit of the company requesting her to share copy of audit file



The letter has woken up her from deep slumber. She hurriedly assembled audit file and inserted some more papers which were necessary. However, she put current date on these inserted papers and the copy of audit file was sent to regulator. Discuss, the issues involved, in context of "audit documentation".  
(ICAI Study Material - Test Your Understanding)

#### Assembly of the Final Audit File:

- An appropriate time limit within which to complete the assembly of the final audit file is ordinarily **not more than 60 days after the date of the auditor's report**.
- Further, preparing sufficient and appropriate audit documentation on a **timely** basis helps to enhance the **quality** of the audit and facilitates the **effective review** and **evaluation** of the audit **evidence** obtained and **conclusions** reached before the auditor's report is finalized. Documentation prepared **after the audit work** has been performed is likely to be **less accurate** than documentation prepared at the time such work is performed.
- In the given case, even after passage of more than six months, she has not assembled audit file. Besides, she has put in some papers with current date which is not permissible at all.
- It shows that part of audit documentation has been prepared afterwards putting a question mark on the quality of the audit.

Q11.

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

(MTP1, May 2018, 5 Marks) (RTP, Nov 2018, NA) (MTP1, May 2019, 4 Marks) (RTP, Nov 2023, NA)

OR

SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. Explain (RTP, Nov 2019, NA)

OR

Briefly explain the policies and procedures of assembling the final audit file on a timely basis after the date of the auditor's report under SQC-1. (SA, Nov 2019, 3 Marks)

OR

TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required. (RTP, May 2022, NA)

OR

M/s Samar Amar & Associates are the statutory auditors of Ganga Ltd. for FY 2023-24. CA Samar is the engagement partner for such assignment. While discussing with the engagement team, CA Samar briefed his team that "the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation." Explain. (RTP, May 2023, NA)

- The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a **timely** basis after the date of the auditor's report.
- **SQC 1** "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
- An appropriate time limit within which to complete the assembly of the final audit file is ordinarily **not more than 60 days after the date of the auditor's report**.
- The completion of the assembly of the final audit file after the date of the auditor's report is an **administrative process** that **does not involve the performance of new audit procedures** or the drawing of new conclusions.
- **Changes** may, however, be made to the audit documentation during the final assembly process, if they are **administrative** in nature.
- Examples of such changes include:
  - Deleting or discarding **superseded** documentation.
  - **Sorting, collating** and cross referencing working papers.
  - **Signing off** on completion checklists relating to the file assembly process.
  - **Documenting audit evidence** that the auditor has **obtained, discussed** and **agreed** with the relevant members of the engagement team before the date of the auditor's report.
- After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.



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

### Documentation of Significant Matters and Related Significant Professional Judgements

- Q12. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Explain with the help of examples. (RTP, May 2019, NA)

OR

What are the significant matters? How documentation is done in case of significant matters? How documentation is done with respect to professional judgment of significant matters? (SELF)

#### Documentation of Significant Matters and Related Significant Professional Judgments

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

#### Examples of significant matters include:

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

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

#### Documentation of the professional judgments

- Helps in explaining
  - auditor's **conclusions** and
  - to reinforce the **quality** of the judgment.
- **reviewing** audit documentation,
- carrying out **subsequent audits**

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

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

- Q13. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters. (RTP, Nov 2020, NA)

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

#### Examples of significant matters include:

- Matters that give rise to significant **risks**.



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

An important factor in determining the **form, content** and **extent** of audit **documentation** of **significant matters** is the extent of **professional judgment** exercised in performing the work and evaluating the results. Documentation of the professional judgements made, where significant, serves to explain the auditor's **conclusions** and to reinforce the **quality** of the judgment. Such matters are of particular interest to those responsible for **reviewing** audit documentation, including those carrying out **subsequent audits**, when reviewing matters of continuing significance

Q14. Give some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment where the matters and judgments are significant. (MTP1, Nov 2020, 3 Marks)

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

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

Q15. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters. (RTP, Nov 2022, NA)

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions

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

Examples of significant matters include:

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

### Completion Memorandum or Audit Documentation Summary

Q16. Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain. (ICAI Study Material - Test Your Knowledge)

OR

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

(SA, May 2019, 3 Marks) (MTP1, May 2020, 3 Marks)



**Completion Memorandum or Audit Documentation Summary:**

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

- the **significant matters** identified during the audit.
- how they were **addressed**.

Such a summary may **facilitate** effective and efficient **review** and **inspection** of the audit documentation, particularly for **large** and **complex audits**. Preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether there is any **individual relevant SA objective** that the auditor cannot achieve that would prevent the auditor from achieving the **overall objectives** of the auditor

**Ownership of Audit Documentation**

- Q17. A director of Very Different Limited was of the view that Audit Documentation of a company is the property of that company. Comment on the contention of the director regarding the audit documentation of the company  
(ICAI Study Material - Illustration)

**Ownership of Audit Documentation:**

Audit Documentation of a company is not the property of the company rather Audit Documentation is the **property** of the **Auditor** of that company.

- Q18. The working papers of the branch auditor are also the property of the Principal Auditor and the Management of the Company, so they have right to access them. State the relevant SA and comment. (MTP1, May 2021, 3 Marks)

**Ownership of Working Papers:**

- SA 230 "Audit Documentation" and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the **property** of the **auditor**.
- The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.
- He may at his **discretion**, make portions of, or extracts from, audit documentation available to **clients**, provided such disclosure **does not undermine** the **validity** of the work performed, or, in the case of assurance engagements, the **independence** of the auditor or of his personnel.
- An auditor is not required to provide the management/ clients or other auditors' access to his working papers. Main auditor of the company does not have the right of access to the working papers of the branch auditor.
- In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but **cannot** ask for the **copy of working paper** and therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor.

**Conclusion:** From above, it is clear that working papers of the branch auditor are his property only and neither the Principal auditor nor management has the right to access that. Therefore, the statement given in the question is **incorrect**.



## Chapter 7 - Completion and Review

### Part I : Descriptive Questions

#### SA 560 Subsequent Events

- Q1. CA PK Jacob is conducting audit of a company for year 2022-23. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2023. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2023 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August, 2022. The management of company has decided to agree to an out of court settlement of Rs.5 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA PK Jacob should proceed to deal with above issue. (ICAI Study Material - Test Your Understanding)
- In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of company has agreed to an out of court settlement of Rs.5 crore.
  - It is an example of a **subsequent event between** the date of the **financial statements** and the date of the **auditor's report**. It provides **evidence** of conditions that existed at the date of the financial statements and requires adjustment in financial statements.
  - He should ask company management to make **necessary adjustment** to the financial statements. If adjustment is **not** made by management, he should consider **impact** on auditor's report.
- Q2. CA Chandni Khanna is going to complete audit of a company within next few days. She has performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings held after date of financial statements, going through books of accounts after date of financial statements to make sure that all subsequent events before signing audit report have been considered by her. Still, she wants to be certain that no such events have been left out. What she should do in such a situation? Also, discuss the rationale of doing so. (ICAI Study Material - Test Your Understanding)
- The auditor has already performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings after date of financial statements and going through books after date of financial statements.
  - Now, she should request management and, where appropriate, those charged with governance, 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.
  - The rationale of obtaining written representations is that even after performing above said procedures, she may not come to know all subsequent events. Therefore, it is **necessary** from an auditor's point of view to obtain **acknowledgment** from management in the form of Written representations that all such events for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.
- Q3. Discuss meaning of "Date the financial statements are issued" under SA 560. (ICAI Study Material - Test Your Knowledge)
- Meaning of "Date the financial statements are issued"**
- It reflects the date that the auditor's report and audited financial statements are made available to **third parties**. The date the financial statements are issued generally depends on the **regulatory environment** of the entity.
  - In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority.
  - Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued **must not only be at or later than the date of the auditor's report**, but must also be at or later than the date the auditor's report is provided to the entity.
- Q4. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. Explain. (RTP, May 2019, NA)
- OR
- The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the



auditor's risk assessment ? (SA, July 2021, 4 Marks)

### Audit Procedure Regarding Events Occurring Between The Date Of The Financial Statements And The Date Of The Auditor's Report

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

The auditor shall take into account the auditor's risk assessment which shall include the following:

- Obtaining an **understanding** of any procedures management has established to ensure that subsequent events are identified.
- **Inquiring** of management and, where appropriate, TCWG as to whether any subsequent events have occurred which might affect the financial statements.
- Read the **minutes** of meeting of board of directors, executive committee, meeting of shareholders held after balance sheet date
- Reading the entity's **latest** subsequent **interim financial statements**, if any.

- Q5. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation.  
(RTP, May 2020, NA) (MTP2, Nov 2021, 3 Marks)

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

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

- Q6. SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Explain those events and also define subsequent events. (RTP, Nov 2021, NA) (MTP1, Nov 2023, 3 marks)

**SA 560**, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks 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**.

SA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.

### Meaning of Subsequent events

Subsequent events refer to 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

## SA 570 Going Concern

- Q7. During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in going out from their native villages. Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result,



company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of company are also not willing to help the company to tide over liquidity crisis. The auditor is having doubts over going concern status of the company. How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditor in such a situation? (ICAI Study Material - Test Your Understanding)

- Significant **shortage of skilled labour**, **inability to pay creditors** on time and overall **liquidity crisis** faced by the company are examples of **events or conditions** that, individually or collectively, may **cast significant doubt** on the **entity's ability** to continue as a **going concern**.
- In such a situation, management should try to address auditor's concerns by preparing its **future plan** of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address the auditor's concerns regarding liquidity crisis being faced by the company.
- The auditor should **perform audit procedures** to evaluate the **reliability** of the underlying data to prepare the forecast and determining whether there is **adequate support** for the assumptions underlying the forecast.
- The auditor should also consider whether any **additional facts or information** have become available since the date on which management made its assessment.

Q8.

The auditor of a company is having concerns about following of going concern basis of accounting followed by management for preparation of financial statements. It asks the management to justify preparation of financial statements. However, management is not willing to make its assessment and share with auditor. What are implications for auditor's report in such a scenario? (ICAI Study Material - Test Your Knowledge)

**Management unwilling to make or extend its assessment**

- If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the **implications** for the auditor's **report**.
- In such a situation, a **qualified opinion** or a **disclaimer** of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.

Q9.

M/s ANS & Associates has been appointed as the statutory auditors of MNO Ltd. The company has been suffering losses due to the emergence of highly successful competitor, thereby leading to negative networth. Also, the sales head, key management personnel, of the company left the company due to health issues. When CA Amar, the engagement partner discussed the scenario with the management of the company, he did not get any satisfactory reply from the management. What is the responsibility of M/s ANS & Associates with regard to SA 570? (Old ICAI Study Material)

As per **SA 570**, one of the objectives of the auditor regarding going concern is to **obtain sufficient and appropriate audit evidence** regarding the same and to conclude on the **appropriateness** of the **management's use** of the going concern basis of accounting in the preparation of the financial statements.

- Further it also contains the list of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern which are:
  - **Financial indicator- Negative networth**
  - **Operating indicator- Loss of key management and emergence of highly successful competitor.**
- In the present case, MNO Ltd. has negative net worth on account of emergence of highly successful competitor and the sales head of the company has also left the company.
- Also, CA Amar did not get any satisfactory reply when he discussed the going concern matter with the management.

**Conclusion:** Thus, from the above facts, it appears that MNO Ltd. is **not going concern**. If the management of MNO Ltd. has used the going concern basis of accounting, the auditor should first **ask** the management to **adjust** the financial statements. If the management of MNO Ltd. does **not** agree with the same, CA Amar shall consider the **impact** on his audit **report**.

Q10.

On the basis of which assumption the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern. (RTP, May 2019, NA)

OR

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern. (RTP, Nov 2019, NA)

OR

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a



going concern and will continue its operations for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standards on auditing. (RTP, May 2021, NA) (MTP2, May 2022, 4 marks)

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

General purpose financial statements are prepared using the going concern basis of accounting, **unless** management either

- **intends to liquidate** the entity or to **cease** operations,
- or has **no realistic alternative** but to do so.

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

The objectives of the auditor regarding Going Concern are:

- 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.

Q11. Management's assessment of the entity's ability to continue as a going concern involves making a judgment about inherently uncertain future outcomes of events or conditions. What are relevant factors to that judgment?  
(SA, Jan 2021, 4 Marks)

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

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

Q12. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor has determined that management of XYZ Ltd has already performed a preliminary assessment of the entity's ability to continue as a going concern. Explain how would auditor of XYZ Ltd proceed in the above case. Also explain how would the auditor proceed if such an assessment has not yet been performed by the management. (RTP, May 2021, NA)

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.

In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

- If such an assessment has been performed, the auditor shall **discuss** the **assessment** with **management** and determine whether management has **identified events** or **conditions** that, individually or collectively, may **cast significant doubt** on the **entity's ability to continue** as a **going concern** and, if so, management's plans to address them; or
- If such an assessment has **not** yet been performed, the auditor shall **discuss** with **management** the basis for the intended use of the going concern basis of accounting, and **inquire** of management whether **events** or **conditions** exist that, individually or collectively, may **cast significant doubt** on the **entity's ability to continue** as a **going concern**.



Q13.

As described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. Explain stating the auditor's responsibilities with regard to going concern. (RTP, May 2021, NA)

The auditor's responsibilities are:

- 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, and
- to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

Q14.

While doing an audit of ABC Pvt Ltd, on the basis of sufficient and appropriate evidence, the auditor comes to a conclusion that use of the Going Concern Basis of Accounting is appropriate, but a material uncertainty exists. Discuss the implications for auditor's report if:

- Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements
- Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements

(RTP, Nov 2021, NA)

OR

S Ltd., a large textile manufacturing company, due to heavy recession in the market was unable to collect amount of huge receivables in time and also holding large amounts of stock of raw materials and finished goods since last 9 months of the Financial Year 2023-24. From your primary observations of audit evidences you feel that there is a material uncertainty exists about going concern. How will you deal in your audit report? What will be the effect on your audit opinion in the following situations?

- If adequate disclosure of such material uncertainty is already made in the financial statements.
- If adequate disclosure of such material uncertainty is not made in the financial statements"

(SA, May 2023, 4 marks)

**Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists:**

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

- Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements**

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an **unmodified opinion** and the auditor's report shall include a **separate section** under the heading "**Material Uncertainty Related to Going Concern.**"

- Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements**

If adequate disclosure about the material uncertainty is **not made** in the financial statements, the auditor shall:

- Express a **qualified opinion** or **adverse opinion**, as appropriate, in accordance with SA 705 (Revised); and
- In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements **do not adequately disclose this matter.**

Q15.

Give examples of financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. (RTP, Nov 2021, NA)

The following are examples of Financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern :

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



- iv) **Negative operating cash flows** indicated by historical or prospective financial statements.
- v) **Adverse key financial ratios.**
- vi) **Substantial operating losses** or significant deterioration in the value of assets used to generate cash flows.
- vii) **Arrears** or discontinuance of **dividends.**
- viii) **Inability to pay creditors** on due dates.
- ix) **Inability to comply** with the **terms** of loan agreements.
- x) Change from **credit to cash-on-delivery** transactions with suppliers.
- xi) **Inability to obtain financing** for essential new product development or other essential investments

### SA 450 Evaluations of Misstatements Identified during the audit

- Q16. You are nearing completion of audit of a company. On going through your working papers, it is noticed that finished goods inventory was overvalued by ₹ 2 crore. It has also been noticed that freight of ₹ 10 lacs paid on import of machinery was charged to statement of profit and loss. Discuss, how you should, proceed and communicate in above situation before signing audit report. (ICAI Study Material - Test Your Understanding)
- The instances highlighted in above situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by ₹ 2 crore and wrongly charging freight of ₹ 10 lacs paid on machinery to statement of profit and loss instead of capitalizing are **examples of misstatements.**
  - The auditor should **communicate** above identified misstatements to **those charged with governance** and request for **correction** of these misstatements. In case, these are **not** corrected, **understand** the **reasons** for not making the corrections and **reassess materiality.**
  - It should also be considered whether uncorrected statements are **material** individually or in aggregate. Effect of uncorrected misstatements on the opinion in the auditor's report should be communicated to those charged with governance.
- Q17. Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450. (ICAI Study Material - Test Your Knowledge)
- The audit documentation shall include: -
- The amount below which misstatements would be regarded as **clearly trivial**;
  - All **misstatements accumulated** during the audit and **whether** they have been **corrected**; and
  - The **auditor's conclusion** as to whether **uncorrected misstatements** are **material**, individually or in aggregate, and the basis for that conclusion

### SA 580 Written Representation

- Q18. CA R Gurumurthy is about to complete audit of a company. Before completion, he asks management to provide him a written representation confirming that management has fulfilled its responsibilities regarding preparation of financial statements. He also wants management to confirm in writing about providing of all the necessary information and completeness of transactions to him. The management feels that auditor is seeking irrelevant documents near the completion of audit. Why view of management is not proper? What possible implications it may lead to? (ICAI Study Material - Test Your Understanding)
- The view of management is **not proper**. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of those responsibilities.
  - This is because the auditor is **not able** to judge **solely on other audit evidence** whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.
  - In case of **refusal** of management to provide such a confirmation, it may lead to **disclaimer** of opinion by the auditor.



Q19.

The auditor P of PAR and Co., a firm of Chartered Accountants, is conducting an audit of AB Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter. Analyse how would you deal as an auditor. (RTP, May 2018, NA)

- In the given question, the auditor P requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter
- Although written representations provide necessary audit evidence, they **do not provide sufficient appropriate audit evidence** on their own about any of the matters with which they deal.
- Furthermore, the fact that management has provided reliable written representations does **not affect** the **nature** or **extent** of other audit **evidence** that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.
- Applying the above to the given problem, the auditor would further **request** the **management** to provide him with the Banker's certificate in support of fixed deposits held by the company.

Q20.

Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation. (RTP, May 2020, NA)

OR

Explain the objectives of the auditor regarding written representations.

(RTP, Nov 2019, NA) (SA, Jan 2021, 3 Marks) (MTP2, Nov 2021, 3 Marks)

Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Written representations are requested from those responsible for the preparation and presentation of the financial statements.

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

#### Objectives of the auditor regarding written representation

- To **obtain** written representations from management and, where appropriate, TCWG that they believe that they have fulfilled their responsibility for the **preparation** of the **financial statements** and for the **completeness** of the **information** provided to the auditor;
- To **support other audit evidence** relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs
- To **respond** appropriately to written representations provided by management and, where appropriate, TCWG, or if management or, where appropriate, TCWG do not provide the written representations requested by the auditor.

Q21.

CA K is re-appointed as the auditor of B Ltd. He wants to re-confirm certain matters and has asked the management to give written representations for the same. Under what circumstances can an auditor ask the management to reconfirm its acknowledgement and understanding of responsibilities in written representation? (SA, Dec 2021, 4 Marks)

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

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

- 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



	<ul style="list-style-type: none"> <li>• <b>Changes in circumstances</b> make it appropriate to do so.</li> </ul>
Q22.	<p>Akash &amp; Associates are the statutory auditors of Deluxe Ltd. for the FY 2023-24. During the course of audit, CA Akash, the engagement partner requested the management of the company to provide written representation with respect to valuation of a transaction. The management, however does not provide the same to CA Akash. What course of action should CA Akash follow in such situation? (RTP, May 2023, NA) (MTP1, May 2023, 3 marks)</p> <p>If management does not provide one or more of the requested written representations, CA Akash should:</p> <ul style="list-style-type: none"> <li>• <b>Discuss</b> the matter with <b>management</b>;</li> <li>• <b>Re-evaluate</b> the <b>integrity</b> of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and</li> <li>• Take <b>appropriate actions</b>, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.</li> </ul>
Q23.	<p>Written representations are to be provided by the management to the auditor when requested. Explain (RTP, Nov 2023, NA)</p> <p><b>Management from Whom Written Representations Requested:</b></p> <p>SA 580, "Written Representations", the auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.</p> <p>Written representations are requested from those responsible for the <b>preparation</b> and <b>presentation</b> of the <b>financial statements</b>. Those individuals may vary depending on the <b>governance structure</b> of the entity, and relevant law or regulation; however, <b>management</b> (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.</p> <p>If management does not provide one or more of the requested written representations, the auditor shall-</p> <ol style="list-style-type: none"> <li><b>discuss</b> the matter with <b>management</b>;</li> <li><b>re-evaluate</b> the <b>integrity</b> of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and</li> <li>take <b>appropriate actions</b>, including determining the possible effect on the opinion in the auditor's report.</li> </ol> <p>The auditor shall <b>disclaim</b> an opinion on the financial statements if management does not provide the written representations.</p>

### SA 260 Communication With Those Charged With Governance

Q24.	<p>In what ways an effective two-way communication between auditor and those charged with governance is important? (ICAI Study Material - Test Your Knowledge)</p> <p>Communication from an auditor is important with those charged with governance. An effective two-way communication is important in assisting: -</p> <ol style="list-style-type: none"> <li><b>Constructive working relationship</b> and understanding the matters related to audit. This relationship is developed while maintaining auditor's Independence and objectivity</li> <li>Auditor in <b>obtaining</b> from those charged with governance <b>information</b> relevant to the audit. For example, TCWG may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and</li> <li>TCWG in fulfilling their <b>responsibility</b> to <b>oversee</b> the <b>financial reporting</b> process, thereby reducing the risks of material misstatement.</li> </ol>
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## SA 265 Communicating Deficiencies in Internal Control to Those Charged With Governance and Management

Q25.

On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories. He points it out to the management in a one-liner as under: - "Physical verification of inventories is not being conducted at regular intervals as stipulated by management." Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard. (ICAI Study Material - Test Your Understanding)

- While pointing out significant deficiencies in internal control, auditor has **not only** to communicate significant deficiencies giving their description but also **explain** the **potential effects** and sufficient information to those charged with governance and management to understand context of communication.
- Therefore, the above communication is **not proper**.
- **Not only significant deficiency** has to be communicated, it should also be explained to management the **potential effects** of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company.
- Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control

Q26.

List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" (ICAI Study Material - Test Your Knowledge)

- The **likelihood** of the deficiencies leading to material misstatements in the financial statements in the future.
- The **susceptibility** to loss or fraud of the related asset or liability.
- The **subjectivity and complexity** of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The **volume** of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The **importance** of the controls to the financial reporting process, for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of **fraud**.
  - Controls over the selection and application of significant **accounting policies**.
  - Controls over significant transactions with **related parties**.
  - Controls over significant transactions **outside** the entity's normal course of business.
  - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The **cause and frequency** of the **exceptions** detected as a result of the deficiencies in the controls.
- The **interaction** of the **deficiency** with **other** deficiencies in internal control

Q27.

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization.

As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", Indicators of significant deficiencies in internal control include, for example:

- Evidence of ineffective aspects** of the control environment, such as:
  - Indications that **significant transactions** in which management is financially interested are not being **appropriately scrutinised** by those charged with governance.
  - Identification of management fraud**, whether or not material, that was not prevented by the entity's internal control.
  - Management's failure** to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process** within the entity where such a process would **ordinarily be expected** to have been established.



iii)	Evidence of an <b>ineffective entity risk assessment process</b> , such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
iv)	Evidence of an <b>ineffective response to identified significant risks</b> (e.g., absence of controls over such a risk).
v)	Misstatements detected by the auditor's procedures that were <b>not prevented, or detected and corrected</b> , by the <b>entity's internal control</b> .
vi)	<b>Disclosure</b> of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
vii)	Evidence of management's <b>inability to oversee the preparation of the financial statements</b> .

## Chapter 8 - Audit Report

### Part I : Descriptive Questions

#### SA 700 "Forming an Opinion and Reporting on Financial Statements"

Q1.	<p>Maithili Thakur, a CA student, was perusing audit report of a company. Her eyes fell on an 18-digit alpha numeric number stated at end of audit report below the signatures of auditor and membership number. Make her understand objective and significance of such a randomly generated number. Is it required to be stated in case of audit reports only? (ICAI Study Material - Test Your Understanding)</p>
	<ul style="list-style-type: none"> <li>The 18-digit alpha numeric number noticed by her at end of audit report is <b>Unique Document Identification number (UDIN)</b>. It is a system generated unique number.</li> <li>Its basic objective is to <b>curb the malpractices</b> of non-CAs impersonating themselves as CAs. It helps in <b>securing</b> reports and documents issued by practising CAs.</li> <li>It is required to be stated in case of audit <b>reports and certificates</b>.</li> </ul>
Q2.	<p>CA. Maya Memani has conducted audit of a company. She has asked Sana, a CA student undergoing training in her office, to prepare draft audit report. Sana was part of engagement team conducting the audit. She has been further told to prepare draft report expressing unmodified opinion. After drafting para comprising unmodified opinion, Sana feels no need to provide basis for opinion. Discuss why her thinking is not proper. (ICAI Study Material - Test Your Understanding)</p> <p>"<b>Basis for Opinion</b>" is one of basic elements of an audit report in accordance with SA 700. Even in cases where unmodified opinion is expressed by auditor, "Basis for opinion" has to be provided by auditor. Basis for opinion section provides context about auditor's opinion. Therefore, Sana's thinking is <b>not proper</b></p>
Q3.	<p>M/s Smart &amp; Associates are the statutory auditors of Hotmeals Ltd. for the FY 2023- 24. How will the auditor address the audit report issued on the financial statements for the FY 2023-24? Also give a title to the report (ICAI Study Material - Illustration)</p> <p><b>Title:</b> Independent Auditor's Report <b>Addressee:</b> To the Members of Hotmeals Ltd.</p>
Q4.	<p>Richa International is a partnership firm dealing in export of blankets. The partners of the firm are Richa and Ashish. Explain how the statutory auditor of the firm will address the auditor's report. (ICAI Study Material - Illustration)</p> <p><b>Title:</b> Independent Auditor's Report <b>Addressee:</b> To the Partners of Richa International</p>
Q5.	<p>M/s Amitabh &amp; Associates are the statutory auditors of Ringston Ltd. which is a company engaged in the business of manufacture of pen drives. The auditor has started drafting the audit report for the FY 2023-24. CA Amitabh, the engagement partner is of the view that the financial statements of Ringston Ltd. represent a true and fair view. Give the draft of the opinion paragraph of the audit report. (ICAI Study Material - Illustration)</p> <p><b>Draft of the opinion paragraph</b></p> <p>We have audited the financial statements of Ringston Limited which comprise the <b>Balance Sheet</b> as at 31.03.2024 and the statement of <b>Profit and Loss</b> Account and the notes to the financial statements, including a summary of <b>significant accounting policies</b> and other explanatory information.</p> <p>In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Act in the manner so required and give a <b>true</b> and <b>fair</b> view in conformity with the accounting principles generally accepted in India, of the state of affairs of the company as at 31.03.2024 and the Profit &amp; Loss for the year ending on that date.</p>
Q6.	<p>M/s Kite Rite &amp; Associates are the statutory auditors of Prime Deluxe Limited, for the FY 2023-24. At the time of finalising the audit report, one of the engagement team members, Mr. Robin, asked the engagement partner, CA Kite as to what all should be included in the Basis of Opinion Paragraph. The engagement partner CA Kite, explained the team in detail and asked Mr. Robin to draft such section for the auditor's report of Prime Deluxe Limited. Help Mr. Robin to draft the Basis for opinion</p>

	<p>section. (ICAI Study Material - Illustration)</p> <p><b>Basis for Opinion</b></p> <p>We conducted our audit in accordance with the <b>Standards on Auditing</b> specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.</p> <p>We are <b>independent</b> of the Company in accordance with the Code of Ethics issued by ICAI together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other <b>ethical responsibilities</b> in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is <b>sufficient</b> and <b>appropriate</b> to provide a basis for our opinion</p>
Q7.	<p>Diamond Shine Ltd. is a company engaged in the manufacture of detergent. M/s Bright &amp; Associates are the statutory auditors of the company. Explain how the paragraph related to the management's responsibility will come in the auditor's report. (ICAI Study Material - Illustration)</p> <p><b>Management's Responsibility for the Standalone Financial Statements</b></p> <p>The Company's Board of Directors is responsible for the matters stated in section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, (changes in equity) and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act.</p> <p>This responsibility also includes <b>maintenance</b> of adequate accounting <b>records</b> in accordance with the provisions of the Act for <b>safeguarding</b> of the assets of the Company and for <b>preventing</b> and <b>detecting frauds</b> and other irregularities; selection and application of appropriate <b>accounting policies</b>; making <b>judgements</b> and <b>estimates</b> that are reasonable and prudent; and design, implementation and maintenance of <b>adequate internal financial controls</b>, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the <b>preparation</b> and <b>presentation</b> of the <b>financial statement</b> that give a <b>true</b> and <b>fair</b> view and are free from material misstatement, whether due to fraud or error.</p> <p>In preparing the financial statements, <b>management</b> is responsible for <b>assessing</b> the Company's <b>ability to continue</b> as a <b>going concern</b>, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. Those Board of Directors are also responsible for overseeing the <b>Company's financial reporting process</b>.</p>
Q8.	<p>M/s Ajay Vijay &amp; Associates are the statutory auditors of Sarovar Ltd. for the FY 2023- 24. The company is engaged in the business of manufacture of water bottles. At the time of finalising the auditor's report, one of the audit team members asked CA Ajay, the engagement partner to advise as to how the auditor's responsibilities can be shown in an appendix to the auditor's report. Draft the auditor's responsibility paragraph so as to advise the audit team member. (ICAI Study Material - Illustration)</p> <p><b>Auditor's Responsibilities for the Audit of the Financial Statements</b></p> <p>Our objectives are to obtain <b>reasonable assurance</b> about whether the financial statements as a whole are <b>free</b> from <b>material misstatement</b>, whether due to fraud or error, and to issue an auditor's <b>report</b> that includes our opinion. Reasonable assurance is a <b>high level</b> of assurance, but is <b>not</b> a <b>guarantee</b> that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are <b>considered material</b> if, individually or in aggregate, they could reasonably be <b>expected</b> to <b>influence</b> the <b>economic decisions</b> of <b>users</b> taken on the basis of these financial statements.</p> <p>A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [indicate page number or other specific reference to the location of the description], forms part of our auditor's report.</p>
Q9.	<p>M/s TUV &amp; Associates are the statutory auditors of Venus Ltd. for the FY 2023-24. At the time of finalising the auditor's report, one of the audit team members asked the engagement partner, CA Tarun, to explain as to how the auditor's report will be signed. Help CA Tarun in explaining the same. (ICAI Study Material - Illustration)</p> <p>The following is the correct way of signing an audit report.</p>



	<p>M/s TUV &amp; Associates Chartered Accountants (Firm's Registration No.) Signature (Name of the Member Signing the Audit Report) (Designation) (Membership No. XXXXX) UDIN: 20037320AAAAAH1111</p> <p>Place of Signature: Date:</p>
Q10.	<p>"The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements." Discuss stating clearly qualitative aspects of the entity's accounting practices (<b>ICAI Study Material - Test Your Knowledge</b>)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. Advise about qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (RTP, May 2018, NA) (MTP1, Nov 2019, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor evaluated, in respect of T Ltd., whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. Auditor's evaluation included consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. Advise the qualitative aspects of the entity's accounting practices. (MTP1, May 2018, 5 marks) (MTP2, Nov 2018, 5 Marks) (MTP1, May 2019, 4 marks)</p> <p>Qualitative Aspects of the Entity's Accounting Practices</p> <ol style="list-style-type: none"> <li>Management makes a number of <b>judgments</b> about the amounts and disclosures in the financial statements.</li> <li><b>SA 260</b> contains a discussion of the qualitative aspects of accounting practices.</li> <li>In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that <b>lack of neutrality</b> together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following: <ol style="list-style-type: none"> <li>The <b>selective correction</b> of <b>misstatements</b> brought to management's attention during the audit Example</li> <li><b>Possible management bias</b> in the making of accounting <b>estimates</b>.</li> </ol> </li> <li><b>SA 540</b> addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.</li> </ol>
Q11.	<p>"An auditor is required to make specific evaluations while forming an opinion in an audit report." State them. (<b>ICAI Study Material - Test Your Knowledge</b>) (SA, Nov 2018, 5 marks) (MTP2, May 2021, 4 marks) (MTP1, Nov 2021, 3 marks) (MTP1, May 2023, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. Explain stating clearly specific evaluations made by the auditor. (RTP, May 2022, NA)</p> <p><b>Specific Evaluations by the auditor:</b> In particular, the auditor shall evaluate whether :</p> <ul style="list-style-type: none"> <li>The financial statements adequately <b>disclose</b> the <b>significant accounting policies</b> selected and applied;</li> <li>The <b>accounting policies</b> selected and applied are <b>consistent</b> with the applicable financial reporting framework and are appropriate;</li> <li>The accounting <b>estimates</b> made by management are <b>reasonable</b>;</li> </ul>

	<ul style="list-style-type: none"> <li>• The <b>information</b> presented in the financial statements is relevant, reliable, comparable, and understandable;</li> <li>• The financial statements provide <b>adequate disclosures</b> to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and</li> <li>• The <b>terminology</b> used in the financial statements, including the title of each financial statement, is appropriate.</li> </ul>
Q12.	<p>In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Explain and analyse the indicators of lack of neutrality with examples, wherever required. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA) (RTP, May 2023, NA)</p> <p>In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that <b>lack of neutrality</b> together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:</p> <ul style="list-style-type: none"> <li>• The <b>selective correction</b> of <b>misstatements</b> brought to management's attention during the audit. Example <ul style="list-style-type: none"> <li>○ Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.</li> <li>○ The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives.</li> </ul> </li> <li>• <b>Possible management bias</b> in the making of accounting <b>estimates</b></li> </ul>
Q13.	<p>"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." Explain (ICAI Study Material - Test Your Knowledge)</p> <p style="text-align: center;"><b>OR</b></p> <p>M/s S &amp; Associates are the Statutory Auditors of Real Ltd., a company engaged in the business of manufacturing of garments. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2023-2024. CA K, the engagement partner, wants to conclude that whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. What factors he should consider to reach that conclusion? (SA, Dec 2021, 4 marks) (MTP1, Nov 2023, 4 marks)</p> <p><b>Factors to be considered to form an opinion:</b></p> <p>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.</p> <p>In order to <b>form</b> that <b>opinion</b>, the auditor shall <b>conclude</b> as to whether the auditor has obtained <b>reasonable assurance</b> about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:</p> <ul style="list-style-type: none"> <li>• The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit <b>evidence</b> has been obtained</li> <li>• The auditor's conclusion, in accordance with SA 450, whether <b>uncorrected misstatements</b> are material, individually or in aggregate.</li> <li>• The <b>evaluations</b> required <ul style="list-style-type: none"> <li>○ The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting <b>framework</b>.</li> <li>○ This evaluation shall include consideration of the <b>qualitative aspects</b> of the entity's accounting practices, including indicators of <b>possible bias</b> in management's judgments</li> </ul> </li> </ul>
Q14.	<p>The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2018, NA) (MTP2, May 2019, 4 marks) (MTP1, May 2020, 4 marks) (MTP2, May 2021, 4 marks) (MTP2, May 2023, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>The description of management's responsibilities in the auditor's report includes reference to management's responsibilities as it helps to explain to users the premise on which an audit is conducted. Explain (RTP, May 2023, NA)</p>

	<p><b>Responsibilities for the Financial Statements:</b> The auditor's report shall include a section with a heading "<b>Responsibilities of Management for the Financial Statements.</b>"</p> <p><b>SA 200</b> explains the premise, relating to the responsibilities of management and, where appropriate, TCWG, on which an audit in accordance with SAs is conducted. Management and, where appropriate, TCWG accept responsibility for the <b>preparation</b> of the <b>financial statements</b>. Management also accepts responsibility for such <b>internal control</b> as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.</p> <p>This section of the auditor's report shall describe management's responsibility for:</p> <ol style="list-style-type: none"> <li><b>Preparing the financial statements</b> in accordance with the applicable financial reporting framework, and for such <b>internal control</b> as management determines is <b>necessary</b> to <b>enable</b> the <b>preparation</b> of financial statements that are <b>free</b> from material misstatement, whether due to fraud or error and</li> <li><b>Assessing</b> the entity's <b>ability</b> to continue as a <b>going concern</b> and <b>whether</b> the <b>use</b> of the going concern basis of accounting is <b>appropriate</b> as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.</li> </ol>
Q15.	<p>The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section. (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2019, NA) (RTP, Nov 2020, NA) (MTP2, Nov 2023, 3 marks)</p> <p>Basis for Opinion: The auditor's report shall include a section, <b>directly following</b> the <b>Opinion</b> section, with the heading "Basis for Opinion", that:</p> <ul style="list-style-type: none"> <li>States that the <b>audit</b> was <b>conducted</b> in <b>accordance</b> with <b>Standards on Auditing</b>;</li> <li>Refers to the <b>section</b> of the auditor's report that <b>describes</b> the <b>auditor's responsibilities</b> under the SAs;</li> <li>Includes a <b>statement</b> that the auditor is <b>independent</b> of the entity in accordance with the relevant ethical requirements relating to the audit and has <b>fulfilled</b> the auditor's other <b>ethical responsibilities</b> in accordance with these requirements.</li> <li>States whether the auditor believes that the <b>audit evidence</b> the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.</li> </ul>
Q16.	<p>The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA) OR While drafting auditor's report of LK Ltd., what are the matter to be included by auditor in Opinion Section paragraph? (RTP, Nov 2022, NA)</p> <p>The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also:</p> <ul style="list-style-type: none"> <li><b>Identify</b> the <b>entity</b> whose financial statements have been audited;</li> <li><b>State</b> that the financial statements have been audited;</li> <li><b>Identify</b> the <b>title</b> of each statement comprising the financial statements;</li> <li><b>Refer</b> to the <b>notes</b>, including the summary of significant accounting policies; and</li> <li><b>Specify</b> the <b>date</b> of, or <b>period</b> covered by, each financial statement comprising the financial statements.</li> </ul>
Q17.	<p>In order to form the audit opinion as required by SA 700, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Explain the conclusions that the auditor shall take into account. Also explain the objective of auditor as per SA 700. (MTP1, Nov 2018, 5 Marks)</p> <p>The objectives of the auditor as per <b>SA 700</b>, "Forming an opinion and reporting on Financial Statements" are:</p> <ul style="list-style-type: none"> <li>To <b>form an opinion</b> on the financial statements based on an <b>evaluation</b> of the <b>conclusions</b> drawn from the <b>audit evidence obtained</b>; and</li> </ul>

	<ul style="list-style-type: none"> <li>To <b>express</b> clearly that <b>opinion</b> through a <b>written report</b>. 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.</li> </ul> <p>To form opinion - Auditor to obtain Reasonable assurance</p> <p>In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained <b>reasonable assurance</b> about whether the financial statements as a whole are <b>free</b> from <b>material misstatement</b>, whether due to fraud or error.</p> <p>That conclusion shall take into account:</p> <ul style="list-style-type: none"> <li>whether sufficient appropriate audit <b>evidence</b> has been obtained;</li> <li>whether <b>uncorrected misstatements</b> are material, individually or in aggregate;</li> <li>The <b>evaluations</b></li> </ul>
Q18.	<p>The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. What type of opinion can be given and give reasoning (MTP2, May 2019, 3 marks) (MTP1, May 2020, 3 marks) (RTP, May 2021, NA)</p> <p><b>Unqualified Opinion:</b></p> <p>As per <b>SA 700</b> "Forming an Opinion and Reporting on Financial Statements", the auditor shall express an unqualified opinion when he concludes that the financial statements give a <b>true</b> and <b>fair</b> view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.</p> <p>An unqualified opinion indicates that:</p> <ul style="list-style-type: none"> <li>the financial statements have been prepared using the <b>generally accepted accounting principles</b>, which have been consistently applied;</li> <li>the financial statements <b>comply</b> with relevant <b>statutory requirements</b> and regulations;</li> <li>there is adequate <b>disclosure</b> of all <b>material matters</b> relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.</li> </ul>
Q19.	<p>The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain (RTP, May 2021, NA)</p> <p>The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users.</p> <p>This SA promotes <b>consistency</b> in the auditor's report but recognizes the need for <b>flexibility</b> to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been <b>conducted</b> in accordance with <b>SAs</b>, promotes <b>credibility</b> in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards.</p> <p>It also helps to promote the <b>user's understanding</b> and to identify <b>unusual</b> circumstances when they occur</p>

### SA 701 "Communicating Key Audit Matters in the Auditor's Report"

Q20.	<p>Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse. (ICAI Study Material- Test Your Knowledge) (RTP, May 2018, NA) (RTP, Nov 2019, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items? (MTP2, May 2022, 3 marks) (RTP, Nov 2023, NA)</p> <p>As per <b>SA 701</b>, "Communicating Key Audit Matters in the Independent Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is <b>NOT</b></p> <ul style="list-style-type: none"> <li>A <b>substitute</b> for <b>disclosures</b> in the <b>financial statements</b> that the applicable Financial reporting framework requires</li> </ul>
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	<p>management to make, or that are otherwise necessary to achieve fair presentation;</p> <ul style="list-style-type: none"> <li>• A substitute for the auditor expressing a <b>modified opinion</b> when required by the circumstances of a specific audit engagement in accordance with <b>SA 705</b></li> <li>• A substitute for <b>reporting</b> in accordance with <b>SA 570</b> 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</li> <li>• A <b>separate opinion</b> on <b>individual</b> matters.</li> </ul>
Q21.	<p>Explain clearly the purpose of communicating key audit matters. (RTP, Nov 2018, NA)</p> <p><b>Purpose of communicating key audit matters:</b> As per <b>SA 701</b>, "Communicating Key Audit Matters in the Independent Auditor's Report", the purpose of communicating key audit matters is to</p> <ul style="list-style-type: none"> <li>• enhance the <b>communicative value</b> of the auditor's report by providing greater <b>transparency</b> about the audit that was performed.</li> <li>• Communicating key audit matters provides <b>additional information</b> to <b>intended users</b> of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.</li> <li>• Communicating key audit matters may also assist intended users in understanding the <b>entity</b> and <b>areas</b> of significant management <b>judgment</b> in the audited financial statements.</li> </ul>
Q22.	<p>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". What would the introductory language in this section of the auditor's report state. Also, state the purpose of communicating key audit matters. (MTP2, May 2018, 5 marks)</p> <p>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:</p> <ul style="list-style-type: none"> <li>• Key audit matters are those matters that, in the auditor's professional <b>judgment</b>, were of <b>most significance</b> in the audit of the financial statements [of the current period]; and</li> <li>• 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 <b>does not provide a separate opinion</b> on these matters.</li> </ul> <p><b>Purpose of communicating key audit matters - Refer to Qno 21</b></p>
Q23.	<p>How would an auditor determine Key Audit Matters as per SA - 701, "Communicating Key Audit Matters in the Independent Auditor's Report"? (SA, Nov 2020, 3 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters". (RTP, Nov 2021, NA) (MTP1, Nov 2021, 3 marks)</p> <p><b>Determining Key Audit Matters:</b> As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:</p> <ul style="list-style-type: none"> <li>• Areas of <b>higher assessed risk</b> of <b>material misstatement</b>, or significant risks identified in accordance with SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".</li> <li>• Significant <b>auditor judgments</b> relating to <b>areas</b> in the financial statements that involved <b>significant management judgment</b>, including <b>accounting estimates</b> that have been identified as having high <b>estimation uncertainty</b>.</li> <li>• The effect on the audit of <b>significant events</b> or <b>transactions</b> that occurred during the period.</li> </ul> <p>The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.</p>

## SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”

Q24.	<p>CA. Sarasbhai Patel, while conducting audit of an entity, feels that there is an atmosphere of non-cooperation all around. He has not been provided with necessary support for attending inventory count process of entity as at year end. Besides, CFO is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.</p> <p>He was not able to verify revenues of entity due to lack of complete details. For verifying expenses, he has been asking for bills on a sample basis, but staff has been making lame excuses. The matter was brought to knowledge of higher echelons of management, but of no avail. The auditor feels that there could be misstatements and their possible effects would be material and affecting many aspects of financial statements.</p> <p>Assuming it is not possible to withdraw from engagement, what type of opinion should be expressed by auditor? <b>(ICAI Study Material - Test Your Understanding)</b></p>
	<p>In the given case, auditor has <b>not</b> been able to <b>obtain sufficient appropriate audit evidence</b> relating to inventories, debtors, creditors, revenues and expenses. The matter has brought to knowledge of management but no result has been achieved. Besides, auditor opines that there could be misstatements and their <b>possible effects</b> could be <b>both material and pervasive</b>. In such circumstances, he should make <b>disclaimer of opinion</b> in accordance with SA 705</p>
Q25.	<p>M/s Daisy &amp; Associates are the statutory auditors of Zebra Ltd. for the FY 2023-24. CA Daisy, the engagement partner wants to verify the cash in hand as on 31.03.2024. The cash balance of the company as on 31.03.2024 is ₹ 1,00,000/- and the turnover of the company for the year is ₹ 6 crores. The management of the company informs CA Daisy that such cash verification is not possible as the cashier is on leave for his marriage and no other employee of the company is available as all are busy in year ending activities. Explain the relevant provisions to deal with such a situation.</p> <p><b>(ICAI Study Material - Illustration)</b></p>
	<ul style="list-style-type: none"> <li>• If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers is likely to result in the need to express a <b>qualified opinion or to disclaim</b> an opinion on the financial statements, the auditor shall request that management remove the limitation.</li> <li>• In the present case CA Daisy, the statutory auditor is unable to verify the cash in hand of Zebra Ltd. as on 31.03.2024. The same is due to a limitation imposed by the management of Zebra Ltd. which is due to the non availability of the cashier.</li> <li>• In such situation, CA Daisy should perform <b>alternate procedures</b> to verify the cash on hand of the company. Further, CA Daisy should consider the impact on the auditor’s report and may consider issuing a <b>qualified</b> opinion in this case.</li> </ul>
Q26.	<p>M/s Sun Moon &amp; Associates are the statutory auditors of Venus Ltd. for the FY 2023-24. Owing to the pervasive nature of material misstatements in the financial statements of the company, CA Moon, the engagement partner decided to give an adverse opinion. Explain the responsibility of CA Moon with respect to communication with those charged with governance</p> <p><b>(ICAI Study Material - Illustration)</b></p>
	<p>CA Moon, being the statutory auditor of Venus Ltd. should communicate with those charged with governance about the circumstances that led to the expected modification i.e. an <b>adverse</b> opinion. Further the wording of such modification also needs to be discussed.</p>
Q27.	<p>Super Duper Ltd. is a company engaged in the manufacture of office furniture. M/s Young Old &amp; Associates are the statutory auditors of the company for the FY 2023-24. During the year under audit, the engagement partner CA Young noticed that the company has not bifurcated its loans into long term and short term. CA Young understands that such misstatement is not pervasive though the same is material. Explain the type of opinion that should be given by M/s Young Old &amp; Associates in this case. <b>(ICAI Study Material - Illustration)</b></p>
	<p>M/s Young Old &amp; Associates should give a <b>qualified</b> opinion as the effect of the misstatement on account of the non-bifurcation of loans into long term and short term loans, is <b>material</b> but <b>not pervasive</b>.</p>
Q28.	<p>M/s Taj Raj &amp; Associates are the statutory auditors of Porex Ltd. engaged in the manufacture of premium watches, for the FY 2023-24. During the course of audit, CA Taj, the engagement partner found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realisable. Further, the cashier of the company has committed a fraud during the year under audit. Both the facts are not reflected in the financial statements for the year ending 31.03.2024. Accordingly, CA Taj is of the view that the impact of both the situations on the financial statements is material and pervasive and thus, the financial statements represent a distorted view of the state of affairs of the company. Explain the reporting requirements of CA Taj. <b>(ICAI Study Material - Illustration)</b></p>

	<p>The auditor shall express an <b>adverse</b> opinion when the auditor, having <b>obtained sufficient appropriate audit evidence</b>, concludes that <b>misstatements</b>, individually or in the aggregate, are <b>both material</b> and <b>pervasive</b> to the financial statements.</p> <p>In the case Porex Ltd., CA Taj found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realisable. Further, the cashier of the company has committed a fraud during the year under audit. Such situations are not reflected in the financial statements of the company despite having a material and pervasive impact on the financial statements. As such, CA Taj should give an <b>adverse opinion</b>.</p> <p>Further, CA Taj should also <b>consider</b> the reporting responsibilities under <b>CARO 2020</b> and section 143(12) of the Companies Act, 2013.</p>
Q29.	<p>Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2023-24 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period. As such the statutory auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team. Explain the kind of audit report that the statutory auditor of the company should issue in this case. (ICAI Study Material - Illustration)</p> <p style="text-align: center;"><b>OR</b></p> <p>Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2023- 24 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period. As such the statutory auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team. The auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. Explain the kind of audit report that the statutory auditor of the company should issue in this case. (RTP, Nov 2021, NA)</p> <ul style="list-style-type: none"> <li>• The auditor shall <b>disclaim</b> an opinion when the auditor is <b>unable to obtain sufficient appropriate audit evidence</b> on which to base the opinion, and the auditor concludes that the <b>possible effects</b> on the financial statements of undetected misstatements, if any, could be <b>both material</b> and <b>pervasive</b>.</li> <li>• 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.</li> <li>• In the present case Delightful Ltd, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. Moreover, the auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.</li> <li>• As such, the statutory auditor of Delightful Ltd. should give a <b>disclaimer of opinion</b>.</li> </ul>
Q30.	<p>Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report" (ICAI Study Material - Test Your Knowledge)</p> <p>As per <b>SA 705</b> "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:</p> <ul style="list-style-type: none"> <li>• The auditor concludes, based on the <b>audit evidence obtained</b>, that the financial statements as a whole are <b>not free from material misstatement</b>; or</li> <li>• The auditor is <b>unable to obtain sufficient appropriate audit evidence to conclude</b> that the financial statements as a whole are <b>free from material misstatement</b>.</li> </ul>
Q31.	<p>Distinguish between an adverse opinion and a qualified opinion. Also draft an opinion paragraph for both types of opinion. (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2023, 4 marks)</p> <p>An auditor shall express an <b>adverse</b> opinion, when the auditor having <b>obtained sufficient</b> and <b>appropriate</b> audit evidence, concludes that <b>misstatements</b>, individually or in aggregate are <b>both material</b> and <b>pervasive</b>.</p> <p>Whereas, when the auditor, having <b>obtained sufficient</b> and <b>appropriate</b> audit evidence, concludes that <b>misstatements</b> are</p>

	<p><b>material but not pervasive</b>, shall express a <b>qualified opinion</b>.</p> <p>SA705 – “Modifications To The Opinion In The Independent Auditor’s Report” deals with the form and content of both types of report. The following are the draft of the opinion paragraphs of the reports.</p> <p><b>Adverse Opinion</b></p> <p>We have audited the accompanying consolidated financial statements of ABC Company Limited and its subsidiaries, its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2024, the consolidated statement of profit and Loss, (consolidated statement of changes in equity) and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the “consolidated financial statements”).</p> <p>In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements <b>do not give a true and fair view</b> in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2024, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.</p> <p><b>Qualified Opinion</b></p> <p>We have audited the standalone financial statements of ABC Company Limited (“the Company”), which comprise the balance sheet as at March 31, 2024, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.</p> <p>In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31st, 2024 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.</p>
Q32.	<p>Discuss the factors affecting the decision of the auditor regarding which type of modified opinion is appropriate. (ICAI Study Material - Test Your Knowledge)</p> <p>The decision regarding which type of modified opinion is appropriate depends upon:</p> <ul style="list-style-type: none"> <li>• The <b>nature</b> of the matter giving rise to the modification, that is, whether the financial statements are <b>materially misstated</b> or, in the case of an <b>inability to obtain sufficient appropriate audit evidence</b>, may be materially misstated; and</li> <li>• The auditor’s <b>judgment</b> about the <b>pervasiveness</b> of the effects or possible effects of the matter on the financial statements.</li> </ul>
Q33.	<p>XYZ Ltd. which is in the business of trading of automobile components is following Cash Basis of Accounting for sale of spare parts. As Statutory Auditor of XYZ Ltd. explain the reporting requirements, manner of qualification and disclosure, if any, to be made in the auditor’s report in line with AS-1 ‘Disclosure of Accounting Policies’. (SA, Jan 2021, 3 marks)</p> <p>Reporting requirements, Manner of qualification and disclosure to be made in the auditor’s report in line with AS 1, “Disclosure of Accounting Policies” are given hereunder :</p> <ul style="list-style-type: none"> <li>• In the case of a company, members should <b>qualify</b> their audit reports in case –             <ol style="list-style-type: none"> <li>a) <b>accounting policies</b> required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013 have <b>not been disclosed</b>, or</li> <li>b) accounts have <b>not been prepared</b> on <b>accrual</b> basis, or</li> <li>c) the <b>fundamental accounting assumption</b> of going concern has <b>not been followed</b> and this fact has not been disclosed in the financial statements, or</li> <li>d) <b>proper disclosures</b> regarding <b>changes</b> in the accounting policies have <b>not been made</b>.</li> </ol> </li> <li>• Where a company has been given a <b>specific exemption</b> regarding any of the matters stated above but the <b>fact</b> of such exemption has <b>not</b> been adequately <b>disclosed</b> in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.</li> <li>• In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.</li> <li>• In making a qualification / disclosure in the audit report, the auditor should consider the <b>materiality</b> of the relevant item. Thus, the auditor need not make qualification / disclosure in respect of items which, in his judgment, are not</li> </ul>



	<p>material.</p> <ul style="list-style-type: none"> <li>• A disclosure, which is not a subject matter of audit qualification, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.</li> </ul>
Q34.	<p>What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section ? (SA, Jan 2021, 4 marks) (RTP, Nov 2023, NA)</p> <p>An auditor should state in "Basis for Opinion" section of Auditor's Report as under:</p> <p>Basis for Opinion: The auditor's report shall include a section, <b>directly following the Opinion</b> section, with the heading "Basis for Opinion", that:</p> <ul style="list-style-type: none"> <li>• States that the <b>audit</b> was <b>conducted</b> in <b>accordance</b> with <b>Standards on Auditing</b>;</li> <li>• Refers to the <b>section</b> of the auditor's report that <b>describes</b> the <b>auditor's responsibilities</b> under the SAs;</li> <li>• Includes a <b>statement</b> that the auditor is <b>independent</b> of the entity in accordance with the relevant ethical requirements relating to the audit and has <b>fulfilled</b> the auditor's other <b>ethical responsibilities</b> in accordance with these requirements.</li> <li>• States whether the auditor believes that the <b>audit evidence</b> the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.</li> </ul> <p><b>Amendments an Auditor should make:</b></p> <p>When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):</p> <ul style="list-style-type: none"> <li>• <b>Amend</b> the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and</li> <li>• Within this section, include a <b>description</b> of the matter giving rise to the modification.</li> </ul>
Q35.	<p>CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)? (SA, July 2021, 3 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700. Explain (RTP, May 2022, NA)</p> <p>When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 to include only the following:</p> <ul style="list-style-type: none"> <li>• A <b>statement</b> that the <b>auditor's responsibility</b> is to conduct an audit of the entity's financial statements in <b>accordance</b> with <b>Standards on Auditing</b> and to issue an auditor's <b>report</b>;</li> <li>• A statement that, however, <b>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</b>, and</li> <li>• The statement about auditor <b>independence</b> and other <b>ethical responsibilities</b> required by SA 700 (Revised)</li> </ul>
Q36.	<p>While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation? (MTP1, May 2022, 4 marks)</p> <p>As per <b>SA 705</b>, "Modifications to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a <b>qualified</b> opinion <b>or to disclaim</b> an opinion on the financial statements, the auditor shall request that management remove the limitation.</p> <p>If management refuses to remove the limitation, the auditor shall <b>communicate</b> the matter to <b>those charged with governance</b>, unless all of those charged with governance are involved in managing the entity and determine whether it is</p>

	<p>possible to perform alternative procedures to obtain sufficient appropriate audit evidence.</p> <p>If the auditor is <b>unable to obtain sufficient appropriate audit evidence</b>, the auditor shall determine the implications as follows:</p> <ul style="list-style-type: none"> <li>• If the auditor concludes that the <b>possible effects</b> on the financial statements of undetected misstatements, if any, could be <b>material</b> but <b>not pervasive</b>, the auditor shall <b>qualify</b> the opinion; or</li> <li>• If the auditor concludes that the <b>possible effects</b> on the financial statements of undetected misstatements, if any, could be <b>both material</b> and <b>pervasive</b> so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall: <ul style="list-style-type: none"> <li>◦ <b>Withdraw</b> from the audit, where practicable and possible under applicable law or regulation; or</li> <li>◦ If withdrawal from the audit before issuing the auditor's report is <b>not</b> practicable or possible, <b>disclaim</b> an opinion on the financial statements.</li> </ul> </li> </ul> <p>If the auditor withdraws, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.</p>
Q37.	<p>What are the circumstances in which auditors are required to qualify their reports of companies for matters related to AS-1 'Disclosure of Accounting Policies'? <b>(MTP1, May 2022, 3 marks)</b></p> <p>While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards. As per AS 1 - Disclosure of Accounting Policies, in the case of a company, members should qualify their audit reports in case:</p> <ol style="list-style-type: none"> <li><b>accounting policies</b> required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, have <b>not</b> been <b>disclosed</b>, or</li> <li><b>accounts</b> have <b>not</b> been <b>prepared</b> on <b>accrual</b> basis, or</li> <li>the <b>fundamental accounting assumption</b> of going concern has <b>not</b> been <b>followed</b> and this fact has not been disclosed in the financial statements, or</li> <li><b>proper disclosures</b> regarding changes in the accounting policies have <b>not</b> been <b>made</b>.</li> </ol>
Q38.	<p>Elucidate the circumstances when a modification to the Auditor's opinion is required. Also state the factors for making the decision regarding which type of modified opinion is appropriate. <b>(SA, May 2023, 3 marks)</b></p> <p>As required by SA 705 "Modifications To The Opinion In The Independent Auditor's Report" The auditor shall modify the opinion in the auditor's report in the following circumstances:</p> <ul style="list-style-type: none"> <li>• The auditor concludes, based on the <b>audit evidence obtained</b>, that the financial statements as a whole are <b>not free</b> from <b>material misstatement</b>; or</li> <li>• The auditor is <b>unable to obtain sufficient appropriate audit evidence</b> to <b>conclude</b> that the financial statements as a whole are <b>free</b> from <b>material misstatement</b>.</li> </ul> <p>The decision regarding which type of modified opinion is appropriate depends upon:</p> <ul style="list-style-type: none"> <li>• The <b>nature</b> of the matter giving rise to the modification, that is, whether the financial statements are <b>materially</b> misstated or, in the case of an <b>inability to obtain sufficient appropriate audit evidence</b>, may be materially misstated; and</li> <li>• The auditor's <b>judgment</b> about the <b>pervasiveness</b> of the effects or possible effects of the matter on the financial statements.</li> </ul>

### SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report"

Q39.	<p>Lomaxe Ltd. is a company engaged in the business of manufacture of candles. CA Kamalnath is the statutory auditor of the company for the FY 2023-24. During the year under audit, there was a fire in the company's factory as a result of which, some of the company's plant and machinery was destroyed. The same was disclosed by the company in the notes to accounts annexed to the financial statements for the year ending 31.03.2024. CA Kamalnath decided to communicate this matter in the auditor's report as he is of the view that the matter is of such importance that it is fundamental to the user's understanding of the financial statements. Help CA Kamalnath to deal with this situation in the auditor's report <b>(ICAI Study Material - Illustration)</b></p>
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	<p>In the present case there is a need to add Emphasis on Matter Paragraph in the Auditor's Report. The draft of the same is as under:</p> <p><b>Emphasis of Matter – Effects of Fire in Company's Factory</b></p> <p>We draw attention to Note Y of the financial statements, which describes the effects of a fire in the Company's factory. Our opinion is <b>not modified</b> in respect of this matter.</p>
Q40.	<p>Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report? (ICAI Study Material- Test Your Knowledge) (SA, May 2018, 5 marks) (RTP, Nov 2020, NA)</p> <p style="text-align: center;"><b>OR</b></p> <p>Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report? (RTP, May 2019, NA)</p> <p><b>Emphasis of Matter paragraph</b> – A paragraph included in the auditor's report that refers to a matter appropriately <b>presented</b> or <b>disclosed</b> in the financial statements that, in the auditor's <b>judgment</b>, is of such importance that it is <b>fundamental</b> to <b>users'</b> understanding of the financial statements.</p> <p><b>Emphasis of Matter Paragraphs in the Auditor's Report</b></p> <p>If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:</p> <ul style="list-style-type: none"> <li>• The auditor would <b>not</b> be required to <b>modify</b> the opinion in accordance with SA 705 (Revised) as a result of the matter; and</li> <li>• When <b>SA 701 applies</b>, the <b>matter</b> has <b>not</b> been <b>determined</b> to be a <b>key audit matter</b> to be communicated in the auditor's report.</li> </ul> <p><b>Separate section for Emphasis of Matter paragraph:</b></p> <p>When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:</p> <ul style="list-style-type: none"> <li>• <b>Include</b> the <b>paragraph</b> within a <b>separate section</b> of the auditor's report with an <b>appropriate heading</b> that includes the term "Emphasis of Matter";</li> <li>• Include in the paragraph a clear <b>reference</b> to the <b>matter</b> being emphasized and to <b>where relevant disclosures</b> that fully describe the matter can be <b>found</b> in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and</li> <li>• <b>Indicate</b> that the auditor's <b>opinion</b> is <b>not modified</b> in respect of the matter emphasized</li> </ul>
Q41.	<p>State clearly the objective of the Auditor as per SA 706. Also define emphasis of matter paragraph and other matter paragraph. (MTP1, Nov 2020, 4 marks)</p> <p>As per <b>SA 706</b> (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:</p> <ul style="list-style-type: none"> <li>• A matter, although appropriately <b>presented</b> or <b>disclosed</b> in the financial statements, that is of such importance that it is <b>fundamental</b> to <b>users'</b> understanding of the financial statements; or</li> <li>• As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.</li> </ul> <p><b>Emphasis of Matter paragraph</b> – A paragraph included in the auditor's report that refers to a matter appropriately <b>presented</b> or <b>disclosed</b> in the financial statements that, in the auditor's <b>judgment</b>, is of such importance that it is <b>fundamental</b> to <b>users'</b> understanding of the financial statements.</p> <p><b>Other Matter paragraph</b> – A paragraph included in the auditor's report that refers to a matter <b>other than those presented</b> or <b>disclosed</b> in the financial statements that, in the auditor's <b>judgment</b>, is relevant to <b>users'</b> understanding of the audit, the <b>auditor's responsibilities</b> or the auditor's report</p>
Q42.	<p>Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. (MTP2, Nov 2021, 3 marks) (RTP, Nov 2022, NA) (MTP1, Nov 2023, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>What is meant by Emphasis of Matter Paragraph? Give some examples of circumstances where the auditor may consider it</p>

necessary to include an Emphasis of Matter paragraph. (MTP1, Nov 2022, 4 Marks)

Emphasis of Matter paragraph is a paragraph included in the auditor's report that refers to a matter appropriately **presented** or **disclosed** in the financial statements that, in the auditor's **judgment**, is of such importance that it is **fundamental** to users' understanding of the financial statements.

**Examples of circumstances to include Emphasis of Matter Paragraph:**

The examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are;

- An **uncertainty** relating to the future outcome of an exceptional litigation or regulatory action.
- A significant **subsequent event** that occurs between the date of the financial statements and the date of the auditor's report.
- Early **application** (where permitted) of a **new accounting standard** that has a material effect on the financial statements.
- A major **catastrophe** that has had, or continues to have, a significant effect on the entity's financial position.

## SA 710 "Comparative Information - Corresponding Figures and Comparative Financial Statements"

Q43. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement. Advise the essential audit reporting differences between the approaches Also explain the audit procedure regarding comparative information. (MTP2, May 2018, 5 marks)

OR

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information. (RTP, May 2019, NA)

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

The essential audit reporting differences between the approaches are:

- For **corresponding** figures, the auditor's opinion on the financial statements refers to the **current period only**; whereas
- For **comparative financial statements**, the auditor's opinion refers to **each period** for which **financial statements** are **presented**.

**Definition of Comparative information** – The **amounts** and **disclosures** included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

**Audit Procedures regarding comparative information**

- The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately **classified**. For this purpose, the auditor shall evaluate whether:
  - The comparative information **agrees** with the **amounts** and **other disclosures presented** in the **prior period**; and
  - The accounting **policies** reflected in the comparative information are **consistent** with those applied in the current period or, if there have been **changes** in accounting policies, whether those changes have been properly **accounted** for and adequately **presented** and **disclosed**.
- If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such **additional** audit procedures as are necessary in the



	<p>circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.</p> <ul style="list-style-type: none"> <li>The auditor shall request <b>written representations</b> for <b>all periods</b> referred to in the auditor's opinion. The auditor <b>may</b> requests a <b>specific written representation</b> regarding <b>any prior period</b> item that is separately disclosed in the current year's financial statement</li> </ul>
Q44.	<p>When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in some circumstances. Explain those circumstances <b>(MTP1, Nov 2018, 5 Marks) (MTP1, Nov 2022, 4 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited. <b>(SA, Nov 2019, 4 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The senior member of the firm Kaur &amp; Associates, Chartered Accountants, informed to its auditing staff that at the time of audit reporting regarding corresponding figures, when corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in specified circumstances. What are those exceptional circumstances? <b>(SA, May 2022, 4 Marks)</b></p> <hr/> <p>When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures <b>except</b> in the following circumstances.</p> <ul style="list-style-type: none"> <li>If the auditor's report on prior period FS was <b>modified</b> and the subject of modification is still <b>unresolved</b>, the auditor shall <b>modify</b> the <b>current audit report</b> also. In the Basis for Modification paragraph in the auditor's report, the auditor shall either             <ul style="list-style-type: none"> <li>Refer to <b>both</b> the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the <b>effects</b> or <b>possible effects</b> of the matter on the current period's figures are <b>material</b>; or</li> <li>In <b>other</b> cases, explain that the audit opinion has been modified because of the <b>effects</b> or <b>possible effects</b> of the <b>unresolved matter</b> on the comparability of the current period's figures and the corresponding figures.</li> </ul> </li> <li>If the auditor obtains audit evidence that a <b>material misstatement exists</b> in the <b>prior</b> period FS on which an <b>unmodified opinion</b> has been previously issued, the auditor shall verify whether the misstatement has been <b>dealt</b> with as <b>required</b> under the applicable financial reporting framework and, if that is not the case, the auditor shall express a <b>qualified</b> opinion or an <b>adverse</b> opinion in the auditor's report on the current period financial statements, modified.</li> <li><b>Prior Period Financial Statements Not Audited</b>- If the prior period financial statements were not audited, the auditor shall state in an <b>Other Matter paragraph</b> in the auditor's report that the corresponding figures are unaudited. Such a statement <b>does not</b>, however, <b>relieve</b> the auditor of the requirement to <b>obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements</b> that materially affect the current period's financial statements</li> </ul>
Q45.	<p>If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, what is required to be stated by the auditor in an Other Matter paragraph. <b>(MTP1, Nov 2022, 3 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>NG Ltd. appointed CA N as the statutory auditor for the F.Y. 2023-2024. Previous year's auditor gave a qualified opinion on the Comparative Financial Statements for the year ended 31.03.2023. What will be the reporting responsibility casted on CA N when he forms an opinion and prepares audit report on the Comparative Financial Statements for the F.Y. 2023-2024? <b>(SA, Nov 2022, 4 marks)</b></p> <hr/> <p>As per SA 710, if the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:</p> <ul style="list-style-type: none"> <li>That the financial statements of the prior period were <b>audited</b> by a <b>predecessor</b> auditor;</li> <li>The <b>type</b> of <b>opinion</b> expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and</li> <li>The <b>date</b> of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements</li> </ul>

## SA 299 "Joint Audit of Financial Statements"

Q46.	<p>The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit. (ICAI Study Material - Test Your Knowledge) (RTP, Nov 2019, NA) (MTP2, May 2023, 4 marks)</p> <p><b>Joint Audit:</b> The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.</p> <p>In specific terms the advantages that flow may be the following:</p> <ol style="list-style-type: none"> <li><b>Sharing of expertise.</b></li> <li>Advantage of <b>mutual consultation.</b></li> <li><b>Lower workload.</b></li> <li>Better <b>quality</b> of performance.</li> <li><b>Improved</b> service to the client.</li> <li>In respect of multinational companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.</li> <li><b>Lower staff</b> development <b>costs.</b></li> <li><b>Lower costs</b> to carry out the work.</li> <li>A sense of <b>healthy competition</b> towards a better performance</li> </ol>
Q47.	<p>"Before the commencement of audit, the joint auditors should discuss and develop a joint audit plan." Discuss the points to be considered in developing the joint audit plan by the joint auditors. (SA, Nov 2019, 4 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>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. Explain stating the other relevant considerations in this regard. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p> <p>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:</p> <ul style="list-style-type: none"> <li>identify <b>division</b> of audit areas and <b>common</b> audit areas;</li> <li>ascertain the <b>reporting objectives</b> of the engagement;</li> <li>consider and <b>communicate</b> among all joint auditors the factors that are significant in <b>directing</b> the engagement team's efforts;</li> <li>consider the results of <b>preliminary engagement</b> activities, or similar engagements performed earlier.</li> <li>ascertain the nature, timing and extent of <b>resources</b> necessary to accomplish the engagement.</li> </ul>
Q48.	<p>HMB Limited's business has grown from one state of India to various countries of the world. Since the business has increased manifold, the management decided to appoint joint auditors for conducting the statutory audit of the company. They appointed three CA firms for it. For which audit work the joint auditors will be jointly &amp; severally responsible? (SA, Nov 2022, 4 marks)</p> <p><b>Joint Audit of Financial Statements:</b> As per SA 299, "Joint Audit of Financial Statements", all the joint auditors shall be jointly and severally responsible for:</p> <ul style="list-style-type: none"> <li>the audit work which is <b>not divided</b> among the joint auditors and is carried out by all joint auditors;</li> <li><b>decisions</b> taken by <b>all</b> the joint auditors under audit planning in respect of common audit areas;</li> <li><b>matters</b> which are <b>brought</b> to the <b>notice</b> of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;</li> <li>examining that the financial statements of the entity comply with the <b>requirements</b> of the relevant <b>statutes</b>;</li> <li><b>presentation</b> and <b>disclosure</b> of the financial statements as required by the applicable financial reporting framework;</li> <li>ensuring that the audit <b>report</b> complies with the requirements of the relevant <b>statutes</b>, applicable <b>Standards</b> on <b>Auditing</b> and other relevant <b>pronouncements</b> issued by ICAI.</li> </ul>

## Audit of Branch Office Accounts

Q49.	<p>CA. Dicky Yadav is auditor of a company having four branches. The four branches are audited by another auditor CA. Yamini Jain. The reports in respect of accounts of branches examined by her have already been sent to company auditor. During the course of audit, CA Dicky Yadav asks the branch auditor to share with her summary of audit procedures and findings in respect of accounts of branches examined. CA. Yamini Jain feels it as encroachment of her domain. Discuss the issue (ICAI Study Material - Test Your Understanding)</p>
	<p>As per <b>SA 600</b> - "Using the Work of Another Auditor", the <b>principal</b> auditor <b>might discuss</b> with the other auditor the audit <b>procedures</b> applied or <b>review</b> a written <b>summary</b> of the other auditor's procedures and findings which may be in the form of a completed <b>questionnaire</b> or check-list.</p> <p>Such review of audit procedures and findings can be undertaken if the principal auditor feels that it is <b>necessary</b> to apply such procedures to obtain sufficient appropriate audit evidence. It is <b>not</b> an encroachment of another auditor's domain.</p>
Q50.	<p>ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report. (ICAI Study Material - Test Your Knowledge) (RTP, May 2020, NA)</p> <p><b>Branch Auditor:</b></p> <ul style="list-style-type: none"> <li>• <b>Section 143(8)</b> of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.</li> <li>• Where a company has a branch office, the accounts of that office shall be audited either by             <ul style="list-style-type: none"> <li>◦ the auditor appointed for the company i.e. <b>company's auditor</b></li> <li>◦ any other person <b>qualified</b> for appointment as an auditor of the company under this Act</li> <li>◦ where the branch office is situated in a country <b>outside India</b>, the accounts of the branch office shall be audited either by the <b>company's auditor</b> or by an <b>accountant</b> or by <b>any other</b> person duly <b>qualified</b> to act as an auditor of the accounts of the branch office in <b>accordance</b> with the <b>laws of that country</b></li> </ul> </li> <li>• The branch auditor shall prepare a <b>report</b> on the accounts of the branch examined by him and <b>send</b> it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.</li> <li>• Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall <b>submit</b> his report to the company's auditor and <b>reporting of fraud</b> by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.</li> </ul>
Q51.	<p>When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain. (RTP, Nov 2018, NA) (MTP1, Nov 2020, 4 Marks)</p> <p><b>SA 600</b> "Using the work of Another Auditor" establishes the standard when an auditor, reporting on the financial statements of a company, uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity. There should be sufficient liaison between the principal auditor and the other auditor. SA 600 provides the following in this regard:</p> <ul style="list-style-type: none"> <li>• Where another auditor has been appointed for the component, the principal auditor would normally be entitled to <b>rely</b> upon the work of such auditor <b>unless</b> 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.</li> <li>• When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:             <ul style="list-style-type: none"> <li>◦ 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 <b>co-ordination</b> of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring <b>special consideration</b>, procedures for the identification of inter-component transactions that may require <b>disclosure</b> and the time-table for completion of audit; and</li> <li>◦ advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.</li> </ul> </li> <li>• The <b>principal</b> auditor <b>might discuss</b> with the other auditor the audit <b>procedures</b> applied or <b>review</b> a written <b>summary</b> of the other auditor's procedures and findings which may be in the form of a completed <b>questionnaire</b> or check-list.</li> <li>• The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the <b>circumstances</b> of the engagement and the principal auditor's knowledge of the professional</li> </ul>

	competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.
Q52.	<p>RJ Limited is in the business of trading of cycles having Head Office at Delhi and branch at Mumbai. Statutory audit of Head Office was to be done by CA D and statutory audit of branch at Mumbai was to be done by CA M. During the course of audit by CA D at head office, CA D Wanted to visit branch at Mumbai and verify the inventory records at Mumbai. The management of RJ Limited did not allow CA D to visit Mumbai office and verify the inventory records as the branch audit of Mumbai was already being undertaken by another CA M. In the above situation, discuss the rights available with CA D in terms of the Companies Act, 2013. <b>(SA, Nov 2020, 3 Marks)</b></p> <ul style="list-style-type: none"> <li>• <b>Section 143(1)</b> of the Companies Act, 2013, provides that company auditor, <b>at all times</b>, shall have a <b>right of access</b> to the <b>books</b> of account and <b>vouchers</b> of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.</li> <li>• The right of access is <b>not limited</b> to those books and records maintained at the registered or head office so that in the case of a company with branches, the <b>right also extends to the branch records</b>, if the auditor considers it necessary to have access thereto as per Section 143(8).</li> <li>• In the given case where CA D was appointed as Statutory Auditor of Head office of RJ Ltd and CA M was appointed to conduct Statutory Audit of Branch office of RJ Ltd., CA D wanted to visit Mumbai Branch to verify the inventory records at Mumbai but management of RJ Ltd did not allow CA D to verify the inventory records at its Mumbai Branch on the ground that branch audit was already being undertaken by another CA M.</li> <li>• It can be concluded that CA D has a <b>right to visit</b> the branch for verifying inventory records at Mumbai even if the branch accounts are audited by another auditor CA M, if he considers it <b>necessary</b> to do so for the performance of his duties as an auditor.</li> </ul>

### Reporting Requirements Under The Companies Act, 2013

Q53.	<p>Mr. A is appointed as statutory auditor of a company for the Financial Year ended 31st March, 2024. During the course of audit, it was found that few doubtful transactions had been committed by finance manager who retired in March, 2024. The fraud was going on since last 2 -3 years and the total amount misappropriated exceeding ₹ 100 lakhs. As a statutory auditor, what would be reporting responsibilities of Mr. A? <b>(SA, May 2018, 5 marks) (MTP1, May 2021, 4 marks)</b></p> <p><b>Reporting Fraud to Central Government:</b></p> <ul style="list-style-type: none"> <li>• As per <b>section 143(12)</b> of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has <b>reason to believe</b> that an offence of fraud, which involves or is <b>expected</b> to involve individually an amount of <b>₹ 1 crore or above</b>, is being or has been committed in the company by its officers or employees, the auditor shall <b>report</b> the matter to the <b>Central Government</b> within such time and in such manner as prescribed.</li> <li>• However, in case of a fraud involving lesser than the specified amount, i.e. <b>below ₹ 1 Cr.</b>, the auditor shall <b>report</b> the matter to the <b>audit committee</b> constituted u/s 177 <b>or</b> to the <b>Board</b> in other cases within such time and in such manner as may be prescribed</li> <li>• The companies, whose auditors have reported frauds to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.</li> </ul>
Q54.	<p>Explain the duties of Auditor to inquire under Section 143(1) of the Companies Act, 2013. <b>(RTP, Nov 2018, NA)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor is not required to report on the matters specified in sub-section (1) of Section 143 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. Explain clearly stating the matters for which the auditor has to perform his duty of inquiry under this section. <b>(MTP1, Nov 2018, 5 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>The auditor has to make inquiries on certain matters under section 143(1) of Companies Act, 2013. Discuss those matters. <b>(MTP1, Nov 2020, 6 Marks)</b></p> <p><b>Reporting requirement relating to matters stated in section 143(1)</b></p> <p>Under section 143(1), auditor shall inquire into following matters given as under: -</p>



	<p>a) whether <b>loans</b> and <b>advances</b> made by the company on the basis of <b>security</b> have been properly secured and whether the <b>terms</b> on which they have been made are <b>prejudicial</b> to the <b>interests</b> of the company or its members;</p> <p>b) whether transactions of the company which are <b>represented</b> merely by <b>book entries</b> are prejudicial to the interests of the company;</p> <p>c) where the company <b>not</b> being an <b>investment</b> company or a <b>banking</b> company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a <b>price less than</b> that at which they were <b>purchased</b> by the company;</p> <p>d) whether loans and advances made by the company have been shown as <b>deposits</b>;</p> <p>e) whether <b>personal expenses</b> have been charged to revenue account;</p> <p>f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether <b>cash</b> has <b>actually</b> been <b>received</b> in respect of such allotment, and if no cash has actually been so received, whether the <b>position</b> as stated in the account books and the balance sheet is <b>correct</b>, regular and <b>not misleading</b>.</p> <p>The auditor should make a report to the members in case he finds an answer to any of these matters in <b>adverse</b>.</p>
Q55.	<p>The auditor shall make a report to the members of the company on the accounts examined by him. Explain with reference to relevant provisions of the Companies Act, 2013. <b>(RTP, Nov 2019, NA) (MTP1, May 2023, 3 marks)</b></p> <p><b>Reporting on accounts examined</b></p> <ul style="list-style-type: none"> <li>As per <b>Section 143(2)</b> of the Companies Act, 2013, the auditor shall make a <b>report</b> to the <b>members</b> of the company on the <b>accounts examined</b> by him and on every <b>financial statements</b> which are required by or under this Act to be laid before the company in <b>general meeting</b> and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section</li> <li>Auditor has to report whether to best of his information and knowledge, the said accounts, financial statements give a <b>true</b> and <b>fair</b> view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as prescribed</li> </ul>
Q56.	<p>The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor? <b>(RTP, May 2020, NA)</b></p> <ul style="list-style-type: none"> <li>As per <b>section 143(12)</b> of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, the auditor of the company is required to report the fraudulent activity to the <b>Board</b> or <b>Audit Committee</b> (as the case may be) within <b>2 days</b> of his knowledge of fraud.</li> <li>Further, the company is also required to <b>disclose</b> the same in the <b>Board's Report</b>.</li> <li>It may be noted that the auditor need <b>not</b> to <b>report</b> the <b>central government</b> as the amount of fraud involved is less than ₹ 1 crore, however, reporting under CARO, 2020 is required.</li> </ul>
Q57.	<p>As per Sec 143(3)(j) of the Companies Act, 2013, the auditor's report shall also include such other matters as may be prescribed by Rule 11 of the Companies (Audit and Auditors) Rule, 2014. Discuss those matters on which views and comments of the auditor are required. <b>(SA, Dec 2021, 4 marks) (RTP, Nov 2023, NA)</b></p> <p>Matters on which views and comments of the auditor are required:</p> <ol style="list-style-type: none"> <li>whether the company has disclosed the impact, if any, of <b>pending litigations</b> on its financial position in its financial statement;</li> <li>whether the company has made provision, as required under any law or accounting standards, for <b>material foreseeable losses</b>, if any, on long term contracts including derivative contracts;</li> <li>whether there has been any <b>delay</b> in transferring amounts, required to be transferred, to the <b>Investor Education and Protection Fund</b> by the company.</li> <li> <ol style="list-style-type: none"> <li>Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;</li> <li>Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed</li> </ol> </li> </ol>

	<p>in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and</p> <p>(iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.</p> <p>v) Whether the <b>dividend</b> declared or paid during the year by the company is in <b>compliance</b> with <b>section 123</b> of the Companies Act, 2013</p> <p>vi) Whether the company has used such <b>accounting software</b> for maintaining its books of account which has a feature of recording <b>audit trail</b> (edit log) facility and the same has been <b>operated</b> throughout the year for all transactions recorded in the software and the audit trail feature has <b>not been tampered</b> with and the audit trail has been <b>preserved</b> by the company as per the statutory requirements for record retention.</p>
Q58.	<p>CA R is the statutory auditor and Mr. P is the cost auditor of DEF Ltd., a company engaged in the production of tyres. Mr. P noticed a fraud of INR 1.25 crores done by the senior manager of the company and immediately informed the audit committee even before CA R was aware of the fraud. State the duty of CA R under section 143(12) of the Companies Act on reporting on frauds already detected and reported (<b>SA, Dec 2021, 4 marks</b>)</p> <p><b>Reporting on Frauds already detected and reported:</b></p> <ul style="list-style-type: none"> <li>The auditor, CA R should apply <b>professional skepticism</b> to evaluate/verify that the fraud was indeed identified/detected in all aspects by the management or through the company's vigil/whistle blower mechanism so that distinction can be clearly made with respect to frauds identified/detected due to matters raised by the auditor vis -à-vis those identified/detected by the company through its internal control mechanism.</li> <li>Since reporting on fraud under <b>section 143(12)</b> is required even by the cost auditor and the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the auditor became aware of the fraud.</li> <li>Here too, if a suspected offence of fraud has already been reported under section 143(12) by such other person, and the auditor becomes aware of such suspected offence involving fraud, he need not report the same since he has not per se identified the suspected offence of fraud.</li> <li>However, in case of a <b>fraud</b> which <b>involves</b> or is <b>expected</b> to involve individually, an amount of <b>₹ 1 crore or more</b>, the auditor should <b>review</b> the <b>steps</b> taken by the management/those charged with governance with respect to the reported instance of suspected offence of fraud stated above, and if he is <b>not satisfied</b> with such steps, he should state the reasons for his dissatisfaction in writing and request the management/ those charged with governance to perform <b>additional procedures</b> to enable the auditor to satisfy himself that the matter has been appropriately addressed. If the management/those charged with governance fail to undertake appropriate additional procedures <b>within 45 days</b> of his request, the auditor would need to evaluate if he should report the matter to the <b>Central Government</b> in accordance with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.</li> </ul>
Q59.	<p>Under provisions of Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him. Explain along with relevant rule of The Companies (Audit and Auditors) Rules, 2014 (<b>MTP1, May 2022, 4 marks</b>)</p> <p>Report to the members of the company on the accounts examined by him - <b>Refer Qno 55</b> Matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014 - <b>Refer Qno 57</b></p>
Q60.	<p>CA E was appointed statutory auditor of XYZ Private Limited in AGM held in the month of August, 2023 for the first time for audit of financial statements of the company from year 2023-24 onwards. Since he is new to the company, he wants to be sure about integrity of accounting records. In this regard, he wants to ensure that software used by company for maintenance of its books of accounts is capable of tracking user activities and changes made to entries in books of accounts, if any, during the course of year. What CA E is looking for in the given situation? Discuss the reporting requirements for CA E in this matter to be included in audit report to be issued under the Companies Act, 2013. (<b>MTP2, Nov 2023, 3 marks</b>)</p> <p>In the given situation, the auditor is looking for a feature of "audit trail" in software used by a company for maintenance of books of accounts. Under section 143(3) of Companies Act, 2013, it has to be reported by the auditor as under: -</p>

	Whether the company has used such <b>accounting software</b> for maintaining its books of account which has a feature of recording <b>audit trail</b> (edit log) facility and the same has been <b>operated</b> throughout the year for all transactions recorded in the software and the audit trail feature has <b>not</b> been <b>tampered</b> with and the audit trail has been <b>preserved</b> by the company as per the statutory requirements for record retention.
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## CARO - Companies (Auditor's Report) Order, 2020

Q61.	<p>CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ₹ 4 crores were released to the company by branch of a bank for meeting its working capital requirements. He finds that out of above funds, ₹ 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements. Is there any reporting obligation upon him under CARO, 2020? <b>(ICAI Study Material - Test Your Understanding)</b></p> <ul style="list-style-type: none"> <li>• <b>Clause (ix)(d)</b> of CARO, 2020 whether funds raised on short term basis have been utilised for long term purposes, if yes, the <b>nature</b> and <b>amount</b> to be indicated.</li> <li>• In the given situation, funds have been raised for meeting working capital requirements for ₹ 4 crores. Cash credit facilities for meeting working capital requirements are, by their very nature, short term borrowings. Out of above, ₹1 crore have been used by the company for investment in effluent treatment plant which is ostensibly for a long-term purpose.</li> <li>• Hence, the matter needs to be reported in accordance with requirements of Clause (ix)(d) of CARO, 2020</li> </ul>
Q62.	<p>The company has dispensed with the practice of taking inventory of their inventories at the year-end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. Explain reporting requirement under CARO, 2020. <b>(ICAI Study Material- Illustration)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>State the matters to be included in auditor's report as per CARO, 2020 regarding - Verification of inventory and working capital limits. <b>(MTP2, May 2022, 3 marks)</b></p> <p><b>Clause (ii)</b> of Para 3 of CARO, 2020, requires the auditor to report</p> <ol style="list-style-type: none"> <li>whether physical verification of inventory has been <b>conducted</b> at <b>reasonable intervals</b> by the <b>management</b> and whether, in the <b>opinion</b> of the <b>auditor</b>, the <b>coverage</b> and <b>procedure</b> of such verification by the management is appropriate; whether any discrepancies of <b>10% or more</b> in the aggregate for each class of inventory were noticed and if so, whether they have been properly <b>dealt</b> with in the books of account;</li> <li>whether during <b>any</b> point of time of the year, the company has been <b>sanctioned</b> working capital limits in excess of ₹ <b>5 crore</b>, in <b>aggregate</b>, from banks or financial institutions on the basis of <b>security</b> of <b>current assets</b>; whether the quarterly <b>returns</b> or statements <b>filed</b> by the company with such banks or financial institutions are in <b>agreement</b> with the <b>books</b> of account of the Company, if not, give details;</li> </ol> <p>In the given case, the above requirement of physical verification of inventory by the management has not been taken place and therefore the auditor should point out the same under CARO, 2020. He may consider the impact on financial statement and report accordingly.</p>
Q63.	<p>Examine the applicability of CARO 2020 : 'Educating Child' is a limited company registered under section 8 of the Companies Act, 2013. <b>(ICAI Study Material- Illustration)</b></p> <p>In the given case, 'Educating Child' is licensed to operate under section 8 of the Companies Act, 2013. Therefore, CARO, 2020 shall <b>not</b> be <b>applicable</b> to 'Educating Child' accordingly.</p>
Q64.	<p>Discuss which class of companies are specifically exempt from the applicability of CARO 2020. <b>(ICAI Study Material - Test Your Knowledge) (MTP1, Nov 2019, 3 Marks)</b></p> <p>CARO 2020 shall apply to <b>every</b> company including a <b>foreign</b> company as defined in section 2(42) of the Companies Act, 2013, <b>except</b>–</p> <ul style="list-style-type: none"> <li>• A <b>banking</b> company</li> <li>• An <b>insurance</b> company</li> <li>• A company licensed to operate under <b>section 8</b> of the Companies Act;</li> <li>• A <b>One Person</b> Company as defined in section 2(62) of the Companies Act;</li> </ul>

	<ul style="list-style-type: none"> <li>• A <b>small company</b> as defined in section 2(85) of the Companies Act; and</li> <li>• a <b>private limited company, not being a subsidiary or holding company of a public company</b>, <ul style="list-style-type: none"> <li>○ having a <b>paid up capital</b> and reserves and surplus not more than <b>₹ 1 crore</b> as on the balance sheet date and</li> <li>○ which does not have total <b>borrowings exceeding ₹ 1 crore</b> from any bank or financial institution at any point of time during the financial year and</li> <li>○ which does not have a total <b>revenue</b> as disclosed in Schedule III to the Companies Act (including revenue from discontinuing operations) <b>exceeding ₹ 10 crore</b> during the financial year as per the financial statements.</li> </ul> </li> </ul>
Q65.	<p>Discuss the reporting requirements under CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>State the matters to be included in the auditor's report as per CARO, 2020, regarding:</p> <ol style="list-style-type: none"> <li>Private Placement of Preferential Issues.</li> <li>Utilisation of IPO and further public offer.</li> </ol> <p><b>(SA, May 2018, 4 Marks) (MTP2, May 2019, 4 Marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>State the auditor's reporting responsibilities under CARO, 2020 when –</p> <ol style="list-style-type: none"> <li>The company has made private placement of shares.</li> <li>The company has raised money by public issue.</li> </ol> <p><b>(SA, Dec 2021, 4 marks)</b></p> <p><b>Private Placement of Preferential Issues [Para 3(x) of CARO 2020]</b></p> <ul style="list-style-type: none"> <li>• whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so,</li> <li>• whether the requirements of <b>section 42</b> and <b>section 62</b> of the Companies Act, 2013 have been <b>complied</b> with and the funds raised have been used for the <b>purposes</b> for which the funds were <b>raised</b>, if <b>not</b>, provide <b>details</b> in respect of <b>amount</b> involved and <b>nature</b> of non-compliance;</li> </ul> <p><b>Utilisation of IPO and further public offer [Para 3(x) of CARO 2020]</b></p> <ul style="list-style-type: none"> <li>• whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were <b>applied</b> for the <b>purposes</b> for which those are <b>raised</b>, if <b>not</b>,</li> <li>• the <b>details</b> together with delays or default and subsequent rectification, if any, as may be applicable, be reported</li> </ul>
Q66.	<p>State the matters to be included in the auditor's report as per CARO, 2020 regarding -</p> <ol style="list-style-type: none"> <li>Default in repayment of loans or borrowing to a financial institution, bank etc.</li> <li>Fraud by the company or on the Company by its officers or employees.</li> </ol> <p><b>(MTP1, May 2018, 4 marks) (MTP1, May 2019, 4 Marks) (MTP2, May 2021, 4 Marks) (MTP2, Nov 2021, 3 Marks)</b></p> <ol style="list-style-type: none"> <li>Default in repayment of loans or borrowing to a financial institution, bank etc. - <b>Refer Qno 73</b></li> <li>Fraud by the company or on the Company by its officers or employees. <b>[Clause (xi) of Para 3 of CARO 2020]</b> <ol style="list-style-type: none"> <li>whether any fraud <b>by</b> the company or any fraud <b>on</b> the company has been <b>noticed</b> or <b>reported</b> during the year, if <b>yes</b>, the <b>nature</b> and the <b>amount</b> involved is to be indicated;</li> <li>whether any report under <b>section 143(12)</b> of the Companies Act has been filed by the auditors in Form <b>ADT-4</b> as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;</li> <li>whether the auditor has considered <b>whistle-blower complaints</b>, if any, received during the year by the company;</li> </ol> </li> </ol>
Q67.	<p>State the matters to be included in the auditor's report as per CARO, 2020 regarding-</p> <ol style="list-style-type: none"> <li>in case the company has accepted deposits</li> <li>Nidhi company</li> </ol>



(MTP2, May 2018, 4 Marks)

Matters to be included in the Auditor's Report under CARO, 2020: The auditor's report on the accounts of a company to which CARO applies shall include a statement on the following matters, namely-

i) **In case the company has accepted deposits**

in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the **directives** issued by the **Reserve Bank of India** and the provisions of **sections 73 to 76** or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been **complied** with, if **not**, the **nature** of such **contraventions** be stated; if an **order** has been passed by **Company Law Board or National Company Law Tribunal or Reserve Bank of India** or any **court** or any other **tribunal**, whether the same has been **complied** with or not;

ii) **Nidhi company**

- whether the **Nidhi Company** has complied with the **Net Owned Funds to Deposits** in the ratio of **1:20** to meet out the liability;
- whether the Nidhi Company is maintaining **10% unencumbered term deposits** as specified in the Nidhi Rules, 2014 to meet out the liability;
- whether there has been any **default** in payment of **interest** on deposits or repayment thereof for any period and if so, the details thereof;

Q68.

Discuss the reporting requirements regarding Property, Plant and Equipment under CARO, 2020.

(MTP2, Nov 2018, 3 Marks) (SA, May 2019, 3 Marks) (RTP, Nov 2021, NA)

OR

Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets.

(RTP, May 2022, NA)

Reporting for PPE and Intangible assets - **Clause (i)** of Para 3 of CARO, 2020, requires the auditor to include a statement in the auditor's report on the following matters, namely -

- whether the company is maintaining **proper records** showing **full particulars**, including **quantitative** details and **situation** of PPE
- whether the company is maintaining **proper records** showing full particulars of **intangible** assets;
- whether these Property, Plant and Equipment have been **physically verified** by the **management** at reasonable intervals; whether any **material discrepancies** were noticed on such verification and if so, whether the same have been properly **dealt** with in the books of account;
- whether the title deeds of **all** the immovable properties (**other than** properties where the company is the lessee and the lease agreements are duly executed in favor of the **lessee**) **disclosed** in the financial statements are held in the name of the company, if not, provide the details thereof in the **format** below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held –indicate range, where appropriate	Reason for not being held in name of company*
					*also indicate if in dispute

- whether the company has **revalued** its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is **based** on the valuation by a **Registered Valuer**; **specify** the amount of change, if **change is 10% or more** in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- whether any **proceedings** have been initiated or are pending against the company for holding any **benami property** under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately **disclosed** the details in its financial statements;

Q69.

State the matters to be included in the auditor's report as per CARO, 2020 regarding-

- Property, Plant and Equipment
- statutory dues

	<p><b>(MTP1, Nov 2018, 5 Marks) (MTP1, May 2020, 4 Marks)</b></p> <p>i) Property, Plant and Equipment - <b>Refer QNo 68</b></p> <p>ii) As per <b>clause (vii)</b> of Para 3 of CARO, 2020, reporting requirements in respect of statutory dues are :</p> <ol style="list-style-type: none"> <li>whether the company is <b>regular</b> in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if <b>not</b>, the extent of the <b>arrears of outstanding</b> statutory dues as on the <b>last day</b> of the <b>financial year</b> concerned for a period of <b>more than six months</b> from the <b>date they became payable</b>, shall be indicated;</li> <li>where statutory dues referred to in sub-clause (a) have <b>not</b> been <b>deposited</b> on <b>account</b> of any <b>dispute</b>, then the <b>amounts</b> involved and the <b>forum</b> where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);</li> </ol>
Q70.	<p>The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2020.</p> <p><b>(SA, Nov 2018, 4 Marks)(MTP1, Nov 2021, 3 Marks) (SA, Nov 2022, 4 marks)</b></p> <p>The auditor is required to report as per <b>clause (x)(b)</b> of paragraph 3 of CARO 2020, whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of <b>section 42</b> and <b>section 62</b> of the Companies Act, 2013 have been <b>complied</b> with and the funds raised have been used for the <b>purposes</b> for which the funds were <b>raised</b>, if <b>not</b>, provide <b>details</b> in respect of <b>amount</b> involved and <b>nature</b> of non compliance;</p> <p>In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilized these funds for repayment of long term loans and advance.</p>
Q71.	<p>M Ltd. has given certain loans to related parties and also has accepted certain deposits. As an auditor, how will you include the above items in paragraph 3 of CARO, 2020? <b>(SA, Nov 2019, 4 Marks) (MTP1, May 2021, 3 Marks)</b></p> <p><b>Loans to related parties:</b></p> <p><b>Para 3(iii)</b> of CARO, 2020 states whether during the year the company has granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,</p> <ol style="list-style-type: none"> <li>whether during the year the company has provided loans or provided advances in the nature of loans, if so, indicate             <ol style="list-style-type: none"> <li>the <b>aggregate</b> amount during the year, and <b>balance outstanding</b> at the balance sheet date with respect to such loans or advances and guarantees or security to <b>subsidiaries, joint ventures and associates</b>;</li> <li>the <b>aggregate</b> amount during the year, and <b>balance outstanding</b> at the balance sheet date with respect to such loans or advances and guarantees or security to <b>parties other than subsidiaries, joint ventures and associates</b>;</li> </ol> </li> <li>whether <b>terms</b> and <b>conditions</b> of the grant of all loans and advances in the nature of loans and guarantees provided are <b>not prejudicial</b> to the company's <b>interest</b>;</li> <li>in respect of loans and advances in the nature of loans, whether the <b>schedule</b> of <b>repayment</b> of principal and payment of interest has been stipulated and whether the repayments or receipts are <b>regular</b>;</li> <li>if the amount is overdue, state the total amount <b>overdue</b> for <b>more than 90 days</b>, and whether <b>reasonable steps</b> have been taken by the company for recovery of the principal and interest;</li> <li>whether any <b>loan</b> or advance in the nature of loan granted which has <b>fallen due</b> during the year, has been <b>renewed</b> or <b>extended</b> or fresh loans granted to <b>settle the overdues of existing loans</b> given to the <b>same parties</b>, if so, specify the <b>aggregate amount</b> of such <b>dues</b> renewed or extended or settled by fresh loans and the <b>percentage</b> of the <b>aggregate to the total loans</b> or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];</li> <li>whether the company has granted any loans or advances in the nature of loans <b>either repayable on demand</b> or <b>without</b> specifying any <b>terms</b> or <b>period</b> of repayment, if so, specify the <b>aggregate amount, percentage</b> thereof to the total loans granted, aggregate amount of loans <b>granted to Promoters, related parties</b> as defined in section 2(76) of the Companies Act, 2013;</li> </ol> <p><b>Deposit Accepted [Para 3(v) of CARO, 2020]</b></p>

	<ul style="list-style-type: none"><li>in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the <b>directives</b> issued by the <b>RBI</b> and the provisions of <b>sections 73 to 76</b> or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been <b>complied</b> with, if <b>not</b>, the <b>nature</b> of such <b>contraventions</b> be stated;</li><li>if an <b>order</b> has been passed by <b>Company Law Board or National Company Law Tribunal or RBI</b> or any <b>court</b> or any other <b>tribunal</b>, whether the same has been <b>complied</b> with or not;</li></ul>												
Q72.	<p>Provision of CARO, 2020 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid up Capital and Reserves &amp; Surplus of ₹ 50 lakhs, Secured loan from bank of ₹ 90 Lakhs and Turnover of ₹ 5 Crore, for the financial year 2023-24. <b>(MTP2, May 2021, 3 Marks)</b></p> <p>CARO specifically exempts a <b>private limited company, not being a subsidiary or holding company of a public company</b>,</p> <ul style="list-style-type: none"><li>having a <b>paid up capital</b> and reserves and surplus not more than <b>₹ 1 crore</b> as on the balance sheet date and</li><li>which does not have total <b>borrowings exceeding ₹ 1 crore</b> from any bank or financial institution at any point of time during the financial year and</li><li>which does not have a total <b>revenue</b> as disclosed in Schedule III to the Companies Act (including revenue from discontinuing operations) <b>exceeding ₹ 10 crore</b> during the financial year as per the financial statements</li></ul> <p>It is clear that ABC Pvt. Ltd. is a subsidiary of XYZ Ltd. and hence <b>not exempt</b> from CARO, 2020 although it is satisfying the conditions that allow exemption to private limited company which is not a subsidiary or holding company of a public company</p>												
Q73.	<p>State the matters to be included in auditor's report as per CARO, 2020 regarding "Default in repayment of loan or borrowing to a financial institution, bank etc." <b>(MTP1, May 2022, 3 marks)</b></p> <p style="text-align: center;"><b>OR</b></p> <p>ABC Ltd. is a public company, which has availed various loans and cash credit facilities from Banks and other financial institutions. The company has defaulted in repayments of such borrowings during the year under audit. What are the reporting requirements in this regard under the Companies (Auditor's Report) Order, 2020 ? <b>(SA, May 2023, 4 marks)</b></p> <p><b>Repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders</b> [Clause (ix) of Para 3 of CARO 2020]</p> <p>a) whether the company has <b>defaulted</b> in <b>repayment of loans</b> or <b>other borrowings</b> or in the <b>payment of interest</b> thereon to any lender, if <b>yes</b>, the <b>period</b> and the <b>amount</b> of default to be reported as per the format below:-</p> <table><tr><th>Nature of borrowing, including debt securities</th><th>Name of lender</th><th>Amount not paid on due date</th><th>Whether principal or interest</th><th>No. of days delay or unpaid</th><th>Remarks, if any</th></tr><tr><td></td><td>lender wise details to be provided in case of defaults to banks, financial institutions and Government.</td><td></td><td></td><td></td><td></td></tr></table> <p>b) whether the company is a declared <b>wilful defaulter</b> by any bank or financial institution or other lender;</p> <p>c) whether <b>term loans</b> were <b>applied</b> for the <b>purpose</b> for which the loans were obtained; if <b>not</b>, the <b>amount</b> of loan so <b>diverted</b> and the <b>purpose</b> for which it is used may be <b>reported</b>;</p> <p>d) whether funds raised on <b>short term basis</b> have been utilized for long term purposes, if yes, the <b>nature</b> and <b>amount</b> to be indicated;</p> <p>e) whether the company has taken any <b>funds</b> from any entity or person on account of or to meet the <b>obligations</b> of its <b>subsidiaries, associates or joint ventures</b>, if so, <b>details</b> thereof with <b>nature</b> of such transactions and the <b>amount</b> in each case;</p> <p>f) whether the company has raised loans during the year on the <b>pledge of securities</b> held in its subsidiaries, joint ventures or associate companies, if so, give <b>details</b> thereof and also <b>report</b> if the company has <b>defaulted</b> in repayment of such loans raised;</p>	Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any		lender wise details to be provided in case of defaults to banks, financial institutions and Government.				
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	lender wise details to be provided in case of defaults to banks, financial institutions and Government.												

Q74.	<p>D Ltd. is a company engaged in publishing business magazines. CA P is the statutory auditor of the company. The company takes property in the barter deal from its real estate customers against publication of their advertisements. The properties obtained during the year through such barter deals have been considered in the books of accounts on the basis of possession letter only and have been included in PPE in the financial statements. Considering this matter of such importance that is fundamental to the users understanding, CA P has decided to communicate the same in his report. CA P seeks your guidance in reporting this matter in his audit report. (SA, May 2022, 4 marks)</p>												
	<p>Para 3 (i)(c) of CARO 2020 requires the auditor to report the following:</p> <ul style="list-style-type: none"><li>whether the title deeds of <b>all</b> the immovable properties (<b>other than</b> properties where the company is the lessee and the lease agreements are duly executed in favour of the <b>lessee</b>) <b>disclosed</b> in the financial statements are held in the <b>name</b> of the company,</li><li>if not, provide the details thereof in the <b>format</b> below</li></ul> <table><tr><th>Description of property</th><th>Gross carrying value</th><th>Held in name of</th><th>Whether promoter, director or their relative or employee</th><th>Period held– indicate range, where appropriate</th><th>Reason for not being held in name of company*</th></tr><tr><td></td><td></td><td></td><td></td><td></td><td>*also indicate if in dispute</td></tr></table>	Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held– indicate range, where appropriate	Reason for not being held in name of company*						*also indicate if in dispute
Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held– indicate range, where appropriate	Reason for not being held in name of company*								
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Q75.	<p>Discuss the reporting requirements as per CARO, 2020, regarding:</p> <p>i) Inventory and</p> <p>ii) Deposits accepted by company or amounts which are deemed to be deposits.</p> <p>(MTP2, Nov 2022, 4 Marks)</p>												
	<p>Matters to be included as per CARO, 2020:</p> <p>i) <b>Inventory [Para 3(ii)]</b></p> <p>a) whether physical verification of inventory has been <b>conducted</b> at <b>reasonable intervals</b> by the management and whether, in the <b>opinion</b> of the <b>auditor</b>, the <b>coverage</b> and <b>procedure</b> of such verification by the management is appropriate; whether any discrepancies of <b>10% or more</b> in the aggregate for each class of inventory were noticed and if so, whether they have been properly <b>dealt</b> with in the books of account;</p> <p>b) whether during <b>any</b> point of time of the year, the company has been <b>sanctioned</b> working capital limits in <b>excess of ₹ 5 crore</b>, in <b>aggregate</b>, from banks or financial institutions on the basis of <b>security of current assets</b>; whether the quarterly <b>returns</b> or statements <b>filed</b> by the company with such banks or financial institutions are in <b>agreement</b> with the <b>books</b> of account of the Company, if not, give details;</p> <p>ii) <b>Deposits accepted by company or amounts which are deemed to be deposits [Para 3(v)]</b></p> <ul style="list-style-type: none"><li>In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the <b>directives</b> issued by the <b>Reserve Bank of India</b> and the provisions of <b>sections 73 to 76</b> or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been <b>complied</b> with, if <b>not</b>, the <b>nature</b> of such <b>contraventions</b> be stated;</li><li>if an order has been passed by <b>Company Law Board or National Company Law Tribunal or Reserve Bank of India</b> or any <b>court</b> or any other <b>tribunal</b>, whether the same has been <b>complied</b> with or not;</li></ul>												
Q76.	<p>Discuss the reporting requirements regarding statutory dues and Internal Audit as per CARO, 2020.</p> <p>(MTP1, Nov 2022, 4 Marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Discuss the reporting requirements as per CARO, 2020, regarding:</p> <p>i) disputed and undisputed statutory dues and</p> <p>ii) internal audit system of the company</p> <p>(MTP1, May 2023, 4 marks)</p>												
	<p>Matters to be included as per CARO, 2020 :</p> <p>i) <b>Statutory dues [Para 3(vii)]</b></p> <p>a) whether the company is <b>regular</b> in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales -tax, service tax, duty of customs, duty</p>												



	<p>of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if <b>not</b>, the <b>extent</b> of the <b>arrears</b> of <b>outstanding</b> statutory dues as on the <b>last day</b> of the <b>financial year</b> concerned for a period of <b>more than six months</b> from the <b>date they became payable</b>, shall be indicated;</p> <p>b) where statutory dues referred to in sub-clause (a) have <b>not</b> been <b>deposited</b> on account of any <b>dispute</b>, then the <b>amounts</b> involved and the <b>forum</b> where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);</p> <p>ii) <b>Internal Audit [Para 3(xiv)]</b></p> <p>a) whether the company has an <b>internal audit system</b> commensurate with the <b>size</b> and <b>nature</b> of its business.</p> <p>b) whether the <b>reports</b> of the <b>Internal Auditors</b> for the period under audit were <b>considered</b> by the statutory auditor;</p>
Q77.	<p>State the matters to be included in the auditor's report as per CARO, 2020 regarding:</p> <p>i) Nidhi Company.</p> <p>ii) Transactions with related parties.</p> <p><b>(RTP, Nov 2023, NA)</b></p> <p>i) <b>Nidhi Company</b></p> <p>As per <b>clause (xii)</b> of CARO, 2020, the following matters are required to be included in the auditor's report relating to Nidhi Company</p> <p>a) whether the <b>Nidhi Company</b> has complied with the <b>Net Owned Funds to Deposits</b> in the ratio of <b>1:20</b> to meet out the liability;</p> <p>b) whether the Nidhi Company is maintaining <b>10% unencumbered term deposits</b> as specified in the Nidhi Rules, 2014 to meet out the liability;</p> <p>c) whether there has been any <b>default</b> in payment of <b>interest</b> on deposits or repayment thereof for any period and if so, the details thereof;</p> <p>ii) <b>Transactions with related parties</b></p> <p>As per <b>clause (xiii)</b> of CARO, 2020, the following matter is required to be included in the auditor's report relating to transactions with the related parties: whether <b>all</b> transactions with the <b>related parties</b> are in compliance with <b>sections 177</b> and <b>188</b> of Companies Act where applicable and the details have been <b>disclosed</b> in the financial statements, etc., as required by the applicable <b>accounting standards</b>;</p>
Q78.	<p>G Pvt. Ltd. had fully paid up Capital and Reserves of ₹ 1.20 crore as at the end of F.Y. 2022-2023. During the F.Y 2023-2024, the company incurred losses to the tune of ₹ 25 lacs. During the year, the company also borrowed ₹ 55 lakh each from a bank and a financial institution independently. It had a turnover of Rs 850 lakh (other than revenue of ₹ 250 lakh from discontinuing operations). Ascertain whether CARO, 2020 is applicable to the company (<b>SA, May 2022, 4 marks</b>)</p> <p><b>Applicability of CARO, 2020 in case of Private Ltd. Company:</b></p> <p>CARO, 2020 shall apply to every company including a foreign company <b>except</b>– a <b>private limited company, not being a subsidiary or holding company of a public company</b>,</p> <ul style="list-style-type: none"> <li>• having a <b>paid-up capital</b> and reserves and surplus not more than <b>₹ 1 crore</b> as on the balance sheet date; and</li> <li>• which does not have total <b>borrowings exceeding ₹ 1 crore</b> from any bank or financial institution at any point of time during the financial year; and</li> <li>• which does not have a total <b>revenue</b> as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) <b>exceeding ₹ 10 crore</b> during the financial year as per the financial statements.</li> </ul> <p>Applying the above to the given case,</p> <ul style="list-style-type: none"> <li>• Paid-up capital and reserves : ₹ 95 Lakh (₹ 120 Lakh - ₹ 25 Lakh)</li> <li>• Borrowings from a Bank and financial institution : ₹ 1.10 Crore (₹ 55 Lakh + ₹ 55 Lakh)</li> <li>• Turnover (including discontinuing operations): ₹ 11 Crore (₹ 850 lakh + ₹ 250 Lakh)</li> </ul> <p>As per Section 2(85) of Companies Act, 2013 read with Companies (Specification of Definitions Details) Rules, 2014, small company means a company, other than a public company:</p> <ul style="list-style-type: none"> <li>• <b>paid-up share capital</b> of which <b>does not exceed ₹ 4 crore</b>; and</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>turnover</b> of which as per its last profit and loss account for the immediately preceding financial year <b>does not exceed ₹ 40 crore.</b></li> </ul> <p><b>Conclusion:</b> CARO is <b>not applicable</b> over the company as it is a small company.</p>
Q79.	<p>AST Pvt. Ltd. has fully paid capital of ₹ 120 lakhs. During the year, the company had borrowed ₹ 20 lakhs each from a bank and a financial institution. It has a turnover of ₹ 525 lakhs during the immediately preceding financial year. Will Companies (Auditor's Report) Order, 2020 be applicable to AST Pvt. Ltd.? <b>(SELF)</b></p> <p><b>Applicability of CARO, 2020:</b> The Companies (Auditor's Report) Order, 2020, <b>exempts a Small Company</b> as defined in Section 2(85) of the Companies Act, 2013. As per Section 2(85) of Companies Act, 2013 read with Rule 2(1)(t) of the Companies (Specification of Definitions Details) Rules, 2014 as amended by Companies (Specification of Definition Details) Amendment Rules, 2022 w.e.f. 15.09.2022, small company means a company, other than a public company:</p> <ul style="list-style-type: none"> <li>• <b>paid-up share capital</b> of which <b>does not exceed ₹ 4 crore</b>; and</li> <li>• <b>turnover</b> of which as per its last profit and loss account for the immediately preceding financial year <b>does not exceed ₹ 40 crore.</b></li> </ul> <p>In the present case, both paid-up capital and turnover of the company is within the threshold limits as specified above, hence AST Pvt. Ltd. will be classified as a <b>small company</b>.</p> <p><b>Conclusion:</b> CARO is <b>not applicable</b> over AST Pvt. Ltd. as it is a small company.</p>

## Part II: Correct/Incorrect Questions

Q1.	<p>There is no need of addressee in the Auditor's report. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>Incorrect.</b> The auditor's report shall be addressed, as appropriate, based on the <b>circumstances</b> of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for <b>whom the report is prepared</b>, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.</p>
Q2.	<p>The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>Incorrect.</b> The auditor shall express an <b>unmodified</b> opinion when the auditor concludes that the financial statements are prepared, in all <b>material</b> respects, in accordance with the applicable financial reporting framework.</p>
Q3.	<p>The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>Incorrect.</b> The auditor shall modify the opinion in the auditor's report when:</p> <ul style="list-style-type: none"> <li>• The auditor concludes that, based on the audit <b>evidence obtained</b>, the <b>financial statements</b> as a whole are <b>not free</b> from <b>material misstatement</b>; or</li> <li>• The auditor is <b>unable</b> to obtain <b>sufficient appropriate audit evidence</b> to conclude that the <b>financial statements</b> as a whole are <b>free</b> from <b>material misstatement</b></li> </ul>
Q4.	<p>The auditor shall express a disclaimer of opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. <b>(ICAI Study Material - Test Your Knowledge)</b></p> <p><b>Incorrect.</b> The auditor shall express an <b>adverse</b> opinion when the auditor, having <b>obtained sufficient appropriate audit evidence</b>, concludes that misstatements, individually or in the aggregate, are <b>both material</b> and <b>pervasive</b> to the financial statements.</p>

Q5.	When the auditor has to express an adverse opinion, he need not communicate with those charged with governance as this may have an impact on payment of his audit fees. (ICAI Study Material - Test Your Knowledge)
	<b>Incorrect.</b> When the auditor expects to <b>modify</b> the opinion in the auditor's report, the auditor shall <b>communicate</b> with <b>those charged with governance</b> the circumstances that led to the expected modification and the wording of the modification.
Q6.	Communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements. (ICAI Study Material - Test Your Knowledge)
	<b>OR</b> The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements. (SA, May 2018, 2 marks) (MTP2, May 2019, 2 marks)
	<b>Incorrect.</b> Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is <b>not a substitute</b> for <b>disclosures</b> in the <b>financial statements</b> that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.
Q7.	Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion. (ICAI Study Material - Test Your Knowledge)
	<b>OR</b> Communicating Key Audit Matters is a substitute for the auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with SA 705. (SA, Jan 2021, 2 marks)
	<b>Incorrect.</b> Communicating key audit matters in the auditor's report is <b>not a substitute</b> for the auditor expressing a <b>modified opinion</b> when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
Q8.	The concept of "joint audit" has legal foothold under the Companies Act, 2013. (ICAI Study Material - Test Your Knowledge)
	<b>Correct.</b> Under provisions of section 139(3), the members of a company may resolve to provide that audit shall be conducted by <b>more than one auditor</b> . Hence, the concept of "joint audit" has a <b>legal foothold</b> also under Companies Act, 2013.
Q9.	The auditor shall express an adverse opinion when: <ul style="list-style-type: none"> <li>a) 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</li> <li>b) 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</li> </ul> (MTP1, May 2018, 2 marks) (MTP1, Nov 2018, 2 marks) (MTP1, May 2019, 2 marks)
	<b>Incorrect.</b> The auditor shall express a <b>qualified</b> opinion when: <ul style="list-style-type: none"> <li>a) The auditor, having obtained <b>sufficient appropriate audit evidence</b>, concludes that misstatements, individually or in the aggregate, are <b>material</b>, but <b>not pervasive</b>, to the financial statements; or</li> <li>b) The auditor is <b>unable to obtain sufficient appropriate audit evidence</b> 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 <b>material but not pervasive</b></li> </ul>
Q10.	Other matter paragraph is paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. (MTP1, May 2018, 2 marks) (MTP1, Nov 2018, 2 marks) (MTP2, Nov 2018, 2 Marks) (MTP1, May 2019, 2 marks)
	<b>Incorrect.</b> <b>Emphasis of Matter paragraph</b> is a paragraph included in the auditor's report that refers to a matter appropriately <b>presented</b> or <b>disclosed</b> in the financial statements that, in the auditor's <b>judgment</b> , is of such importance that it is fundamental to <b>users'</b> understanding of the financial statements
Q11.	The auditor shall express a qualified opinion when: <ul style="list-style-type: none"> <li>a) The auditor concludes that misstatements are material but not pervasive to the financial statements; or</li> <li>b) The auditor is unable to obtain sufficient appropriate audit evidence but the auditor concludes that the possible</li> </ul>

	effects on the financial statements of undetected misstatements, if any, could be material but not pervasive " (MTP2, Nov 2018, 2 Marks)
	<p><b>Correct.</b> The auditor shall express a <b>qualified</b> opinion when:</p> <ol style="list-style-type: none"> <li>The auditor, having obtained <b>sufficient appropriate audit evidence</b>, concludes that misstatements, individually or in the aggregate, are <b>material</b>, but <b>not pervasive</b>, to the financial statements; or</li> <li>The auditor is <b>unable to obtain sufficient appropriate audit evidence</b> 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 <b>material but not pervasive</b></li> </ol>
Q12.	<p>An auditor should issue disclaimer of opinion when there is difference of opinion between him and the management on a particular point. (SA, Nov 2018, 2 marks)</p> <p><b>Incorrect.</b> The auditor shall <b>disclaim</b> an opinion when the auditor is <b>unable</b> to obtain <b>sufficient appropriate audit evidence</b> on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be <b>both material and pervasive</b>. In case of difference of opinion, either the auditor will issue a <b>qualified report or adverse report</b> and not disclaimer of opinion.</p>
Q13.	<p>Joint auditor is always bound by the views of majority of the joint auditors regarding matters to be covered in report. (SA, May 2019, 2 marks)</p> <p><b>Incorrect.</b> Where the joint auditors are in <b>disagreement</b> with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a <b>separate audit report</b>. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s). Therefore, joint auditor is <b>not bound</b> by the views of the majority of the joint auditors regarding the matters to be covered in the audit report.</p>
Q14.	<p>Where the firm is appointed as an auditor of the entity the audit report is signed only in the name of audit firm. (SA, May 2019, 2 marks)</p> <p style="text-align: center;"><b>OR</b></p> <p>Where a firm is appointed as the auditor of a company, the report is signed only in the personal name of the partner signing the report. (SA, Nov 2022, 2 marks)</p> <p><b>Incorrect.</b> Where the firm is appointed as the auditor, the report is signed in the <b>personal name</b> of the <b>auditor and</b> in the <b>name</b> of the <b>audit firm</b>. The partner/proprietor signing the audit report also needs to mention the <b>membership number</b> assigned by ICAI along with <b>registration number</b> for the <b>firm</b></p>
Q15.	<p>If financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion. (MTP1, Nov 2019, 2 marks)</p> <p><b>Incorrect.</b> As per <b>SA 705</b> "Modifications to the Opinion in the Independent Auditor's Report", the auditor shall express an <b>adverse</b> opinion when the auditor, having <b>obtained sufficient appropriate audit evidence</b>, concludes that misstatements, individually or in the aggregate, are <b>both material and pervasive</b> to the financial statements. However, the auditor shall express <b>qualified</b> opinion when he concludes that misstatement, individually or in aggregate are <b>material but not pervasive</b>.</p>
Q16.	<p>Provision of CARO, 2020 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid up Capital and Reserves &amp; Surplus of ₹ 50 lakhs, Secured loan from bank of ₹ 90 Lakhs and Turnover of ₹ 5 Crore, for the financial year 2023-24. (SA, Nov 2019, 2 Marks)</p> <p><b>Incorrect.</b> CARO specifically exempts a <b>private limited company, not being a subsidiary or holding company of a public company</b>,</p> <ul style="list-style-type: none"> <li>having a <b>paid up capital</b> and reserves and surplus not more than <b>₹ 1 crore</b> as on the balance sheet date and</li> <li>which does not have total <b>borrowings exceeding ₹ 1 crore</b> from any bank or financial institution at any point of time during the financial year and</li> <li>which does not have a total <b>revenue</b> as disclosed in Schedule III to the Companies Act (including revenue from discontinuing operations) <b>exceeding ₹ 10 crore</b> during the financial year as per the financial statements</li> </ul> <p>It is clear that ABC Pvt. Ltd. is a subsidiary of XYZ Ltd. and hence <b>not exempt</b> from CARO, 2020 although it is satisfying the conditions that allow exemption to private limited company which is not a subsidiary or holding company of a public</p>



	company
Q17.	<p>An Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent. <b>(RTP, May 2020, NA)</b></p> <p><b>Incorrect.</b> The purpose of an audit is to enhance the degree of confidence of intended <b>users</b> of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a <b>true</b> and <b>fair</b> view of the affairs of the entity. Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are a true and fair representation of the transactions they claim to represent.</p>
Q18.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. <b>(MTP1, May 2020, 2 marks) (MTP2, May 2021, 2 marks)</b></p> <p><b>Incorrect.</b> If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705</p>
Q19.	<p>In considering the qualitative aspects of the entity's accounting practices, the auditor may not become aware of possible bias in management's judgments. <b>(RTP, Nov 2020, NA)</b></p> <p><b>Incorrect.</b> In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated.</p>
Q20.	<p>The auditor has to report under section 143 of companies act, 2013 whether the company has adequate internal controls in place and overall effectiveness of such internal controls. <b>(MTP1, Nov 2020, 2 Marks)</b></p> <p><b>Incorrect.</b> Under provisions of <b>Section 143</b> of the Companies Act, 2013, the auditor has to report whether the company has adequate <b>internal financial controls</b> with reference to financial statements in place and <b>operating effectiveness</b> of such controls. The auditor has to <b>report</b> on adequacy and effectiveness of <b>internal financial controls only and not internal controls</b>.</p>
Q21.	<p>In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. <b>(RTP, May 2021, NA)</b></p> <p><b>Correct.</b> In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated.</p>
Q22.	<p>The inclusion of an Emphasis of Matter paragraph in the Auditor's Report affects the auditor's opinion. <b>(MTP1, May 2021, 2 marks) (RTP, Nov 2023, NA)</b></p> <p><b>Incorrect.</b> When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall Indicate that the auditor's opinion is <b>not modified</b> in respect of the matter emphasized. Such a paragraph shall refer only to information <b>presented</b> or <b>disclosed</b> in the financial statements. The inclusion of an Emphasis of Matter paragraph in the auditor's report <b>does not affect the auditor's opinion</b>.</p>
Q23.	<p>The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of the auditor's report. <b>(SA, July 2021, 2 marks)</b></p> <p><b>Incorrect.</b> The description of the auditor's responsibilities for the audit of the financial statement shall be always shown as below -</p> <ul style="list-style-type: none"> <li>• Within the <b>body</b> of the auditor's report</li> <li>• Within an <b>appendix</b> to the auditor's report, in which case the auditor's report shall include a <b>reference</b> to the <b>location</b> of the appendix or</li> <li>• By a specific <b>reference within</b> the auditor's <b>report</b> to the <b>location</b> of such a description on a <b>website</b> of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so</li> </ul>

Q24.	Auditor has to disclose the impact, if any, of the pending litigations on the financial position of the auditee in his audit report. (SA, Dec 2021, 2 marks)
	<b>Incorrect.</b> Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in the auditor's report. The auditor's report shall also include their <b>views</b> and <b>comments</b> on whether the company has disclosed the impact, if any, of <b>pending litigations</b> on its financial position in its financial statement
Q25.	Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken (SA, Dec 2021, 2 marks)
	<b>Incorrect.</b> The auditor shall report the matter to the <b>Board</b> or the <b>Audit Committee</b> , as the case may be, immediately but not later than <b>2 days of his knowledge of the fraud</b> , seeking their reply or observations <b>within 45 days</b> . Company is bound to disclose <b>remedial action</b> taken in Board's report.
Q26.	Communicating key audit matters in the auditor's report is a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern (RTP, May 2022, NA)
	<b>Incorrect.</b> Communicating key audit matters in the auditor's report is <b>not a substitute</b> for reporting in accordance with <b>SA 570</b> 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
Q27.	According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 5% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets (RTP, May 2022, NA)
	<b>Incorrect.</b> According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if <b>change is 10% or more</b> in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets
Q28.	An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013. (MTP1, May 2022, 2 marks) (RTP, Nov 2022, NA)
	<b>Incorrect.</b> The auditor is <b>not</b> required to report on the matters specified in section 143(1) of the Companies Act, 2013 <b>unless</b> he has any <b>special comments</b> to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in <b>adverse</b>
Q29.	According to CARO 2020, the company auditor is required to state that whether the title deeds of all immovable properties held in the name of the company are disclosed in its financial statements. (SA, May 2022, 2 Marks)
	<b>Incorrect.</b> According to CARO, 2020, the company auditor is required to state whether the title deeds of <b>all</b> the immovable properties ( <b>other than</b> properties where the company is the <b>lessee</b> and the lease agreements are duly executed in favour of the lessee) <b>disclosed</b> in the financial statements are held in the <b>name</b> of the company.
Q30.	Mr. T, the director of A Ltd., has purchased an old car belonging to the company against the cooling equipment belonging to the director, which is given to the company as consideration for the car. The auditor is not required to include this in his CARO report (SA, Nov 2022, 2 marks)
	<b>Incorrect.</b> As per Para 3(xv) of CARO, 2020, the auditor is required to report whether the company has entered into any <b>non-cash transactions</b> with <b>directors</b> or persons connected with him and if so, whether the provisions of <b>section 192</b> of Companies Act have been complied with.
Q31.	Communicating key audit matters in the auditor's report is a separate opinion on individual matters. (SA, May 2023, 2 marks)
	<b>Incorrect.</b> As per <b>SA 701</b> , "Communicating Key Audit Matters in the Independent Auditor's Report", communicating key audit

matters in the auditor's report is **not a separate opinion on individual matters**.

## Part III: Multiple Choice Questions

Q1.	<p>While expressing an unmodified opinion on financial statements, the auditor shall not use which of the following phrases?</p> <p>(a) present fairly in all material respects (b) give a true and fair view (c) with the foregoing explanation (d) All of the above</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (c) with the foregoing explanation</p> <p><b>Explanation:</b> When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion</p>
Q2.	<p>_____ is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the user's understanding of the financial statements.</p> <p>(a) Emphasis of Matter Paragraph (b) Other Matter Paragraph (c) Key Audit Matter (d) Management Responsibility Paragraph.</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (a) Emphasis of Matter Paragraph</p>
Q3.	<p>Statement 1: Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.</p> <p>Statement 2: Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.</p> <p>(a) Only Statement 1 is correct (b) Only Statement 2 is correct (c) Both the statements are correct (d) None of the statement is correct</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (d) None of the statement is correct</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• S1 is incorrect. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;</li> <li>• S2 is incorrect. Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705</li> </ul>
Q4.	<p>Which of the following is not correct?</p> <p>(a) SA 700 - Forming an Opinion and Reporting on the Financial Statements (b) SA 701- Key Audit Matters in the Independent Auditor's Report (c) SA 705- Comparative Information- Corresponding figures and Comparative Financial Statements (d) SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<p><b>Correct answer:</b> (c) SA 705- Comparative Information- Corresponding figures and Comparative Financial Statements</p>

	<b>Explanation:</b> SA 710 - "Comparative Information- Corresponding figures and Comparative financial statements"
Q5.	<p>Responsibilities of Joint Auditors are governed by:</p> <p>(a) SA 200 (b) SA 229 (c) SA 299 (d) SA 230</p> <p><b>(ICAI Study Material - Test Your Knowledge)</b></p>
	<b>Correct answer:</b> (c) SA 299
Q6.	<p>SA 700 requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with SAs more recognizable. Which of the following is that specific heading :</p> <p>(a) Key audit matters (b) Basis of opinion (c) Date (d) All of the above</p> <p><b>(Sample MCQs) (ICAI MCQs)</b></p>
	<b>Correct answer:</b> (d) All of the above
Q7.	<p>The Opinion section of the auditor's report shall:</p> <p>(a) Identify the entity whose financial statements have been audited; (b) State that the financial statements have been audited; (c) Identify the title of each statement comprising the financial statements; (d) All of the above</p> <p><b>(ICAI MCQs)</b></p>
	<b>Correct answer:</b> (d) All of the above
Q8.	<p>The auditor shall express _____ 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.</p> <p>(a) Adverse (b) Qualified (c) Disclaimer (d) None of the above</p> <p><b>(Sample MCQs) (ICAI MCQs)</b></p>
	<b>Correct answer:</b> (a) Adverse
Q9.	<p>Which of the following is not a type of modified opinion:</p> <p>(a) qualified opinion (b) adverse opinion (c) disclaimer of opinion (d) negative opinion</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (d) negative opinion</p> <p><b>Explanation:</b> There are three types of modified opinions, namely qualified opinion, adverse opinion and a disclaimer of opinion</p>
Q10.	<p>CA. Goofy has been appointed as an auditor for audit of a complete set of financial statements of Dippy Ltd., a listed company. The financial statements of the company are prepared by the management in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013. However, the inventories are misstated which is deemed to be material but not pervasive to the financial statements. Based on the audit evidences obtained, CA. Goofy has</p>



	<p>concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570. Further, CA. Goofy is also aware of the fact that a qualified opinion would be appropriate due to a material misstatement of the Financial Statements. State what phrases should the auditor use while drafting such opinion paragraph?</p> <p>(a) In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.</p> <p>(b) In our opinion and to the best of our information and according to the explanations given to us, with the foregoing explanation, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.</p> <p>(c) In our opinion and to the best of our information and according to the explanations given to us, subject to the misstatement regarding inventories, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.</p> <p>(d) In our opinion and to the best of our information and according to the explanations given to us, with the explanation described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.</p> <p><b>(Sample MCQs) (RTP, May 2019, NA)</b></p>
	<p><b>Correct answer:</b> (a) In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework</p> <p><b>Explanation:</b> When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the Opinion section as these are not sufficiently clear or forceful.</p>
Q11.	<p>Minnie Ltd., a listed company, appointed CA. Kranny for auditing complete set of consolidated financial statements of the company. CA. Kranny is unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements. Based on the audit evidence obtained, CA. Kranny concludes that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern in accordance with SA 570. State what type of opinion CA. Kranny must have provided in the given scenario?</p> <p>(a) Unmodified opinion.</p> <p>(b) Qualified opinion.</p> <p>(c) Adverse opinion.</p> <p>(d) Disclaimer of opinion.</p> <p><b>(Sample MCQs)</b></p>
	<p><b>Correct answer:</b> (b) Qualified opinion</p> <p><b>Explanation:</b> The auditor shall express a qualified opinion when 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.</p>
Q12.	<p>Reporting on fraud is made by auditor under which of the following clause of para 3 of CARO, 2020</p> <p>(a) Clause (xi)</p> <p>(b) Clause (xii)</p> <p>(c) Clause (xiii)</p> <p>(d) Clause (xiv)</p> <p><b>(ICAI MCQs)</b></p>
	<p><b>Correct answer:</b> (a) Clause (xi)</p>
Q13.	<p>Reporting on fraud is to be made by an auditor to Central Government when fraud amount is</p> <p>(a) Exceeding ₹10 lakh</p> <p>(b) Exceeding ₹50 lakh</p> <p>(c) Exceeding ₹1 crore</p>

	<p>(d) ₹ 1 crore or above (ICAI MCQs)</p> <p><b>Correct answer:</b> (d) ₹1 crore or above <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Fraud involving an amount of less than ₹ 1 crore - Report to Board/Audit Committee</li> <li>• Fraud involving an amount of ₹ 1 crore or above - Report to Central Government</li> </ul>
Q14.	<p>Reporting on fraud is made by auditor to Central Government in statement in the form</p> <p>(a) ADT – 1 (b) ADT – 2 (c) ADT – 3 (d) ADT - 4 (ICAI MCQs)</p> <p><b>Correct answer:</b> (d) ADT - 4 <b>Explanation:</b></p> <ul style="list-style-type: none"> <li>• Information to the Registrar by Company for appointment of Auditor - Form ADT 1</li> <li>• Application for removal of auditor(s) from his/their office before expiry of term - Form ADT 2</li> <li>• Notice of Resignation by the Auditor - Form ADT 3</li> </ul>
Q15.	<p>M/s XYZ &amp; Associates is appointed as the new auditors of M/s Bright Ltd. On conducting the audit, the firm found that the accountant has entered fake invoices of credit purchases in the books of accounts aggregated of ₹ 55 Lakhs and cleared all the payments to the fake creditor. The auditor M/s PQR &amp; Associates should report such fraud to :</p> <p>(a) Central Government (b) Reserve Bank of India (c) Board of Directors/Audit Committee (d) Comptroller &amp; Auditor General (ICAI MCQs)</p> <p style="text-align: center;"><b>OR</b></p> <p>M/s PQR &amp; Associates is appointed as the new auditors of M/s Prince Ltd. On conducting the audit, the firm found that the accountant has entered fake invoices of credit purchases in the books of accounts aggregated of ₹ 75 Lakhs and cleared all the payments to the fake creditor. The auditor M/s PQR &amp; Associates should report such fraud to :</p> <p>(a) Central Government (b) Reserve Bank of India (c) Board of Directors/Audit Committee (d) Comptroller &amp; Auditor General (MTP1, Nov 2021, 2 marks)</p> <p><b>Correct answer:</b> (c) Board of Directors/Audit Committee <b>Explanation:</b> In case of a fraud involving an amount less than ₹ 1 crore, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.</p>
Q16.	<p>Which of the following is correct :</p> <p>(a) 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 both material and pervasive to the financial statements. (b) The auditor shall express a disclaimer 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. (c) 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. (d) 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 material, but not pervasive, to the financial statements (MTP1, May 2019, 2 marks)</p>

	<p><b>Correct answer:</b> (c) 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.</p>
Q17.	<p>In case of a fraud involving less than ₹ 1 crore, the auditor shall</p> <p>(a) report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.</p> <p>(b) report the matter to the audit committee constituted under section 177 within such time and in such manner as prescribed.</p> <p>(c) report the matter to the Board within such time and in such manner as prescribed.</p> <p>(d) report the matter to the audit committee constituted under section 177 and also to the Board within such time and in such manner as prescribed.</p> <p><b>(MTP1, May 2019, 1 mark)</b></p> <p><b>Correct answer:</b> (a) report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.</p>
Q18.	<p>Which of the following is incorrect :</p> <p>(a) Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;</p> <p>(b) Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);</p> <p>(c) Communicating key audit matters in the auditor's report is not a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern;</p> <p>(d) Communicating key audit matters in the auditor's report is a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);</p> <p><b>(MTP2, May 2019, 2 marks)</b></p> <p><b>Correct answer:</b> (d) Communicating key audit matters in the auditor's report is a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised)</p> <p><b>Explanation:</b> Statement 4 is incorrect. Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.</p>
Q19.	<p>Which of the following is correct :</p> <p>(a) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor need not disclose the substantive reasons for the different opinion.</p> <p>(b) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706.</p> <p>(c) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an emphasis of Matter paragraph in accordance with SA 706.</p> <p>(d) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph or emphasis of matter paragraph in accordance with SA 706.</p> <p><b>(MTP2, May 2019, 2 marks)</b></p> <p><b>Correct answer:</b> (b) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706</p>

Q20.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express:</p> <p>(a) a disclaimer opinion  (b) a qualified opinion  (c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.  (d) unmodified opinion</p> <p><b>(RTP, Nov 2019, NA) (MTP1, May 2020, 2 marks)</b></p>
	<b>Correct answer:</b> (c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
Q21.	<p>An Audit report is :</p> <p>(a) an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent.  (b) an opinion drawn on the entity's books of accounts to make sure that the records are true and fair representation of the transactions they claim to represent.  (c) an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.  (d) an opinion drawn on the entity's books of accounts to make sure that the records are true and correct representation of the transactions they claim to represent</p> <p><b>(MTP1, Nov 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (c) an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.
Q22.	<p>Which of the following is not a Specific Evaluations by the Auditor :</p> <p>(a) The financial statements adequately disclose the significant accounting policies selected and applied;  (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;  (c) The accounting estimates made by management are reasonable;  (d) The sufficient appropriate audit evidence has been obtained;</p> <p><b>(MTP1, Nov 2019, 2 Marks)</b></p>
	<b>Correct answer:</b> (d) The sufficient appropriate audit evidence has been obtained;
Q23.	<p>A company did not disclose accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, the auditor should issue–</p> <p>(a) a qualified opinion  (b) an adverse opinion  (c) a disclaimer of opinion  (d) emphasis of matter paragraph.</p> <p><b>(MTP1, Nov 2019, 1 Mark)</b></p>
	<b>Correct answer:</b> (a) a qualified opinion
Q24.	<p>If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances,</p> <p>(a) the auditor shall express a qualified opinion in accordance with SA 705.  (b) the auditor shall express a disclaimer of opinion in accordance with SA 705.  (c) the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.  (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.</p> <p><b>(MTP1, Nov 2019, 2 Marks)</b></p>
	<b>Correct answer:</b> (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705
Q25.	<p>Which of the following is correct as per section 143(10) of the Companies Act, 2013 :</p>



	<p>(a) IFAC may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p>(b) the International Auditing Standards Board may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p>(c) the MCA may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p>(d) the Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p><b>(MTP1, Nov 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (d) the Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p>
Q26.	<p>Which of the following is not a duty of auditor to report under section 143(1)?</p> <p>(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;</p> <p>(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;</p> <p>(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;</p> <p>(d) whether the report on the accounts of any branch office of the company audited under sub-section(8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;</p> <p><b>(MTP1, Nov 2019, 1 Mark)</b></p>
	<p><b>Correct answer:</b> (d) whether the report on the accounts of any branch office of the company audited under sub-section(8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;</p>
Q27.	<p>Which of the following is not an advantage of Joint Audit :</p> <p>(a) Sharing of expertise.</p> <p>(b) General superiority complexes of some auditors.</p> <p>(c) Lower workload.</p> <p>(d) Displacement of the auditor of the company taken over in a take - over often obviated.</p> <p><b>(MTP1, Nov 2019, 1 mark)</b></p>
	<p><b>Correct answer:</b> (b) General superiority complexes of some auditors.</p> <p><b>Explanation:</b> General superiority complexes of some auditors is a disadvantage of Joint Audit.</p>
Q28.	<p>Which of the following is not correct:</p> <p>(a) SA 700- Forming an Opinion and Reporting on Financial Statements</p> <p>(b) SA 705- Modified Opinion</p> <p>(c) SA 701- Communicating Key Audit Matters</p> <p>(d) SA 706-Comparative Information</p> <p><b>(MTP1, Nov 2020, 2 marks)</b></p>
	<p><b>Correct answer:</b> (d) SA 706-Comparative Information</p> <p><b>Explanation:</b> SA 710 "Comparative Information- Corresponding figures and Comparative financial statements"</p>
Q29.	<p>Which of the following is correct, in case of joint audit, where there is disagreement with regard to the opinion or any matters to be covered by the audit report.</p>

	<p>(a) The auditors shall express their opinion in separate audit report.</p> <p>(b) The audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).</p> <p>(c) Both (a) and (b) are correct</p> <p>(d) The auditor who is having a separate opinion is bound by the opinion of the majority of the auditors and needs to issue a common audit report.</p> <p><b>(MTP1, May 2021, 1 mark)</b></p>
	<p><b>Correct answer:</b> (c) Both (a) and (b) are correct</p> <p><b>Explanation:</b> 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. A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in a separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s)</p>
Q30.	<p>To jointly audit books of accounts of WZ Limited for the financial year 2023-24 two different firms of Chartered Accountants namely MH and Associates and NR and Associates were appointed. MH and Associates and NR and Associates can together be called as:</p> <p>(a) Principal Auditors of WZ Limited.</p> <p>(b) Branch Auditors of WZ Limited.</p> <p>(c) Individual Auditors of WZ Limited</p> <p>(d) Joint Auditors of WZ Limited.</p> <p><b>(RTP, Nov 2021, NA)</b></p>
	<p><b>Correct answer:</b> (d) Joint Auditors of WZ Limited</p>
Q31.	<p>Which of the following is FALSE regarding UDIN? (Unique document identification number)</p> <p>(a) It is to be generated on UDIN portal.</p> <p>(b) Its basic objective is to help ICAI in keeping and maintaining an online registry of different services provided by all of its members.</p> <p>(c) It has to be generated and stated for each audit report signed by a Chartered Accountant.</p> <p>(d) It has to be generated and stated for each certificate signed by a Chartered Accountant.</p> <p><b>(MTP2, Nov 2022, 1 mark)</b></p>
	<p><b>Correct answer:</b> (b) Its basic objective is to help ICAI in keeping and maintaining an online registry of different services provided by all of its members.</p> <p><b>Explanation:</b></p> <ul style="list-style-type: none"> <li>Basic objective of UDIN is : To curb the malpractices of certification by non-CAs by impersonating themselves as CAs, the ICAI has come out with an innovative concept of UDIN i.e. Unique Document Identification Number which has been implemented in a phased manner. It will secure the certificates/reports/ documents attested/certified by practicing CAs. This will also enable the Regulators/Banks/Third parties to check the authenticity of the certificates/reports/documents.</li> <li>Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them</li> <li>An auditor is also 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.</li> </ul>
Q32.	<p>During the course of audit of a listed company, CA P finds that solar power generating plant capitalized in books for ₹ 5.00 crore during the year does not exist. It became known that only bills were arranged and no assets were actually procured. Besides, financial statements also reflect depreciation of ₹ 1.50 core on above. The bills of capitalized asset were approved by procurement head. The matter was reported to audit committee by CA P. However, no response was received. Considering above, choose the most appropriate option: -</p> <p>(a) The matter needs to be reported to MCA in ADT-4. It also requires reporting under CARO,2020.</p> <p>(b) The matter needs to be reported to MCA in ADT-4. It does not require reporting under CARO,2020.</p> <p>(c) The matter need not be reported to MCA. However, it requires reporting under CARO,2020.</p> <p>(d) The matter needs neither reporting to MCA nor under CARO,2020</p> <p><b>(MTP2, Nov 2022, 1 mark)</b></p>

	<b>Correct answer:</b> (a) The matter needs to be reported to MCA in ADT-4. It also requires reporting under CARO,2020.
Q33.	<p>Which of following is not an element of audit report in accordance with SA 700?</p> <p>(a) Title (b) Addressee (c) Audit strategy (d) Auditor's opinion (MTP2, Nov 2023, 1 mark)</p>
	<b>Correct answer:</b> (c) Audit strategy
Q34.	<p>An auditor disclaims opinion when_____?</p> <p>(a) He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be material. (b) He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and adverse. (c) He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and pervasive. (d) He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and perverse. (MTP2, Nov 2023, 1 mark)</p>
	<b>Correct answer:</b> (c) He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and pervasive.
Q35.	<p>UDIN (Unique Document Identification Number) is required to be stated by practising Chartered Accountant on: -</p> <p>(a) Each audit report only (b) Each audit report and each certificate (c) Each audit report issued under Companies Act, 2013 only (d) Each audit report issued under Companies Act, 2013 only and each certificate (MTP2, Nov 2023, 1 mark)</p>
	<b>Correct answer:</b> (b) Each audit report and each certificate
Q36.	<p>For which of following company, provisions of CARO,2020 would be applicable?</p> <p>(a) Boost Up Training (OPC) Private Limited (b) RCI Bank Limited (c) PST Industries Limited (d) Moon Insurance Limited (MTP2, Nov 2023, 1 mark)</p>
	<b>Correct answer:</b> (c) PST Industries Limited
	<b>Explanation:</b> Banking company, insurance company and One Person Company are exempt from the applicability of CARO.
Q37.	<p>While reporting under CARO, 2020, it is duty of statutory auditor of company to report: -</p> <p>(a) Fraud of less than ₹ 1 crore committed by officers or employees of company during the year (b) Fraud of ₹ 1 crore or more committed by officers or employees of company during the year (c) Fraud of ₹ 5 crore or more committed by officers or employees of company during the year (d) Any fraud by the company or on the company noticed or reported during the year (MTP2, Nov 2023, 1 mark)</p>
	<p><b>Correct answer:</b> (d) Any fraud by the company or on the company noticed or reported during the year</p> <p><b>Explanation:</b> Difference between Section 143(12) and CARO reporting</p> <ul style="list-style-type: none"> <li>• If the auditor is not sure whether fraud is being committed or not but due to some transactions, the auditor has the</li> </ul>

	<p>reasons to believe that a fraud is being committed or has been committed by an employee or officer. So, in such a case the auditor needs to report as per section 143(12).</p> <ul style="list-style-type: none"><li>• As per sec 143(12) read with Rule 13, In case of a fraud involving an amount less than ₹ 1 crore, the auditor shall report the matter to Board/audit committee. And, in case of a fraud involving an amount of ₹ 1 crore or above, the auditor shall report the matter to CG.</li><li>• In CARO, the auditor is required to report any fraud by the company or any fraud on the company has been noticed or reported during the year. However, this clause will include only the reported frauds and not suspected fraud.</li></ul>
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