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CA INTER

AUDITING AND ETHICS

Concept Book

JAN 25



PROF. ROHIT SHROFF



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OBJECTIVES OF AUDIT**

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Q1 INTRODUCTION

1. **Medieval Times:** Auditor used to HEAR the accounts read out to them to check that employees were not careless and negligent.
2. **Origin:** Originates from Latin word audire meaning to hear
3. **1860:** First Auditor General of India was appointed in British India. Office of Auditor General was given statutory recognition
4. **1949:** ICAI was established as a statutory body for regulating the profession of Chartered Accountancy

Q2 ANALYSIS OF DEFINITION

As per ICAI

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

ANALYSIS OF DEFINITION

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

Q3**INTERDISCIPLINARY NATURE OF AUDITING- RELATIONSHIP
WITH DIVERSE SUBJECTS**

1. **Financial management:** Auditor is expected to have knowledge about various Financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.
2. **Law:** An auditor should have a good knowledge of business laws affecting the entity.
3. **Accounting:** Auditing reviews the financial statements which are nothing but a result of the overall accounting process.
4. **Production:** Good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.
5. **Behavioral science:** Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.
6. **Economics:** Auditor is expected to be familiar with the overall economic environment of the client.
7. **Data processing:** EDP auditing in itself is developing as a discipline in itself.
8. **Statistics and Mathematics:** Auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.

Q4**OBJECTIVES**

- Obtaining a **reasonable assurance** that FS as a whole are free from material misstatement due to fraud or error
- thereby enabling the auditor to express an opinion on whether the FS are prepared, in all material respects, in accordance with an AFRF;
- **To report** on the FS and communicate as required by the SAs, in accordance with the auditor's findings.

Q5**SCOPE OF AUDIT****What's Covered?**

1. Coverage of all aspects of entity
2. Reliability and sufficiency of financial info
3. **Proper disclosure of financial info**
4. Expression of an opinion on FS

What's not covered?

1. Duties outside scope of competence of auditor
2. Expertise in authentication of documents
3. **An audit is not an official investigation into alleged wrong doing.**
4. Responsibility of preparation and presentation of FS

A. What is included?**1. Coverage of all aspects of entity**

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

2. Reliability and sufficiency of financial information

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

3. Proper disclosure of financial information

- The auditor should also decide whether relevant information is properly disclosed in the FS. He should also keep in mind applicable **statutory requirements** in this regard.
- It is done by ensuring that financial statements properly **summarize transactions and events** recorded therein and by considering the judgments made by management in preparation of financial statements.
- The auditor evaluates **selection** and **consistent application** of accounting policies by management; whether such a selection is **proper** and whether chosen policy has been **applied consistently** on a period-to-period basis.

B. What is not included?

1. Auditor is not expected to **perform duties which fall outside domain of his competence.**
 - For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him. Similarly, it is not expected from an auditor to determine suitability and life of civil structures like buildings.
 - These require different skillsets which may be performed by qualified engineers in their respective fields.

2. An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field.
3. An audit is not an official investigation into alleged wrong doing.
 - He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation
 - Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.
 - The objective of audit is to obtain reasonable assurance on the FS and to express an opinion
 - The scope of audit is general and broad whereas scope of investigation is specific and narrow.

Q6 INHERENT LIMITATION OF AUDIT

1. Nature of Financial reporting:

(A) Judgements:

- Preparation of FS involves making many judgments by management.
- These judgments may involve subjective decisions or a degree of uncertainty.
- Therefore, auditor may not be able to obtain absolute assurance that FS are free from MMS due to frauds or errors.

(B) Devising Internal controls

- Such controls may not have operated to produce reliable financial information due to their own limitations.
- Overriding of internal controls devised by the company due to collusion between two persons.

2. Nature of audit procedures:

- There are practical and legal limitations on ability of auditor to obtain audit evidence.
- For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.
- Management may not provide complete information as requested by auditor.
- There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required

information, he can only report. It is an example of **legal limitation** on auditor's ability to obtain audit evidence.

- The management may consist of **dishonest people** and may be, itself, involved in fraud
- It is quite possible that entity may have entered into some **transactions with related parties**. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

3. Not in nature of investigations

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

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

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

5. Future events

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

Q7 ENGAGEMENT

Arrangement to do something



Takes the shape of invitation card



Marriage



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

Takes the shape of an engagement letter

SA 210: AGREING TO THE TERMS OF AUDIT ENGAGEMENTS



Q8 DOG Loves HIM

- D** → Detect fraud or error or both
- O** → An audit reviews existence and operations of various controls operating in any entity. Hence, it is useful at pointing out deficiencies.
- G** → Helpful to government authorities
- L** → Relied upon by lenders
- H** → Audited accounts provide high quality information.
- I** → Interest is safeguarded by an audit
- M** → Moral check on Employees

Q9 AUDIT MANDATORY

STATUTORY  (C²A PEBI)

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

VOLUNTARY

- Incoming partner
- Death of a partner

Q10 WHO APPOINTS THE AUDITOR



Q11 TO WHOM REPORT IS SUBMITTED

Incase of Co – Shareholders
Incase of firm – Partners

Q12 ASSURANCE ENGAGEMENT

- "Assurance engagement" means an engagement in which
- a **practitioner expresses** a conclusion
- designed to **enhance the degree of confidence** of the intended users other than the responsible party
- about the outcome of the evaluation or measurement of a subject matter against criteria.
- It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

Q13 ELEMENTS OF ASSURANCE ENGAGEMENT

(1) 3 Party relationship:

- **Practitioner:** The term is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information

- **Responsible party:** responsible for preparation of subject matter

- **Intended users:** These persons may use the report in making decisions

(2) Subject Matter: It refers to the information to be examined by the practitioner

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

- (4) **SAAE:** “Sufficient” relates to quantity of evidence obtained by auditor. “Appropriate” relates to quality of evidence.

- (5) **Written Report:** A written assurance report is the outcome of an assurance engagement.

Q14 AUDITOR & ITS QUALITIES



- **T** → The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education
- **I** → He must have the highest degree of integrity backed by adequate independence.
- **K** → He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert
- **A** → He must know thoroughly all accounting principles and techniques.
- **T** → Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability are some of qualities which an auditor.

Q15 AUDIT VS REVIEW VS ASSURANCE VS RELATED SERVICE

(1) ASSURANCE SERVICE

- (a) Related to **Historical Financial Statements:**

- (i) **HIGH** but not Absolute assurance → **AUDIT** → **SA** (Standard on Audit)

- (ii) **MODERATE** but not High assurance → **REVIEW** → **SRE** (standard on review engagement)

- (b) **Not** Related to Historical FS :

- (i) **MODERATE** but → not High assurance → **ASSURANCE** → **SAE** (Standard on assurance engagement)

- (2) **NON-ASSURANCE SERVICE** → **NO** assurance → **RELATED SERVICE** → **SRS** (Standard on related services)

(A) AUDIT VS REVIEW

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

(B) REASONABLE ASSURANCE VS LIMITED ASSURANCE

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

(C) EXAMINATION OF PROSPECTIVE FINANCIAL INFO:

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

Q16 WHY ARE STANDARDS NEEDED

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



2

AUDIT STRATEGY, AUDIT PLANNING
AND AUDIT PROGRAMMECONTENTS

Q1	Why planning an audit is necessary?
Q2	Nature of audit planning – a continuous and iterative process
Q3	Planning process-elements of planning
Q4	Factors to be taken into consideration by auditor for establishing audit strategy
Q5	Relationship between audit strategy and audit plan
Q6	Overall audit strategy and the audit plan- the auditor's responsibility
Q7	Changes to planning decisions during the course of audit
Q8	Planning supervision and review of work of engagement team members
Q9	Documentation
Q10	Audit programme
Q11	Audit programme- designed to provide audit evidence
Q12	Advantages and disadvantages of an audit programme
Q13	Extract of sample audit programme pertaining to sales of an entity

Q1

WHY PLANNING AN AUDIT IS NECESSARY? - ITS BENEFITS



(CID TIE)

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

Therefore, planning an audit ensures that audit risk is reduced to an acceptable low level. When audit work is adequately and properly planned, it reduces the risk of inappropriate opinion by the auditor.

Q2

NATURE OF AUDIT PLANNING – A CONTINUOUS AND ITERATIVE PROCESS

- 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, 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: -



(ROMEO)

- R** → The analytical procedures to be applied as risk assessment procedures.
- O** → Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework. SA 315
- M** → The determination of materiality.
- E** → The involvement of experts.
- O** → The performance of other risk assessment procedures.

NOTE 1 : Involvement of key engagement team members in planning audit

- The engagement partner and other key members of the engagement team shall be involved in planning the audit including planning and participating in the discussion among engagement team members.
- The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process.

NOTE 2 : Discussion of elements of planning with entity's management

- The auditor may decide to discuss elements of planning with the entity's management 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 not to compromise the effectiveness of the audit.

Q3

PLANNING PROCESS-ELEMENTS OF PLANNING

Phase 1 : Preliminary engagement activities include the following: -

Step 1 : Performing procedures regarding the Continuance of Client Relationships and Audit Engagements

Matters such as integrity of principal owners and key management, competence of engagement team to perform the audit engagement and implications of matters that have arisen during current and previous audit engagement may need to be considered.

Step 2 : Evaluating compliance with ethical requirements including independence

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:

1. Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence	2. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and	3. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.
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Step 3 : Establishing an understanding of terms of engagement

It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. It ensures that there is no confusion with the client regarding terms of the engagement

Phase 2 : STRATEGY

Step 1 : Establishing the overall audit strategy-Assistance for the auditor

- The process of establishing the overall audit strategy assists the auditor to determine
 - (i) 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
 - (ii) The amount of resources 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
 - (iii) When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
 - (iv) How such resources are managed, directed and supervised, 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

Phase 3 : DEVELOPMENT OF AUDIT PLAN

- 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.
- SA-300 states that auditor shall develop an audit plan that shall include description of-
 - (i) The nature, timing and extent of planned risk assessment procedures
 - (ii) The nature, timing and extent of planned further audit procedures at assertion level
 - (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

Q4

FACTORS TO BE TAKEN INTO CONSIDERATION BY AUDITOR
FOR ESTABLISHING AUDIT STRATEGY

(a) Identify the characteristics of the engagement that define its scope

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



(FINE)

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

(b) Ascertain the reporting time table objectives of the engagement to plan the timing of the audit and the nature of the communications required.

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

- (i) The entity's timetable for reporting
- (ii) Organization of meetings to discuss of nature, timing and extent of audit work with management
- (iii) Discussion with management regarding
 - the expected type and timing of reports to be issued including the auditor's report
 - Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.

(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts

- The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant.
- Few examples are listed as under:
 - Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
 - Significant industry developments such as changes in industry regulations and new reporting requirements.

- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

(d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant

Considering results of preliminary engagement activities and knowledge gained from similar engagements goes a long way in establishing sound audit strategy. Examples are listed as under:

- (i) Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them.
- (ii) The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.

- (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement
 - Selection of engagement team and assignment of audit work to team members is a significant factor in establishing overall audit strategy.
 - Experienced team members may be assigned in areas where there is higher risk of material misstatement.
 - Similarly, engagement budgeting and devotion of more time to areas of higher risk of material misstatement are to be kept in mind.

Q5

RELATIONSHIP BETWEEN AUDIT STRATEGY AND AUDIT PLAN

- (1) Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.
- (2) Audit strategy determines scope, timing and direction of audit.
- (3) Audit plan describes how strategy is going to be implemented.
- (4) The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
- (5) 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.

(6) 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.

Q6 OVERALL AUDIT STRATEGY AND THE AUDIT PLAN- THE AUDITOR'S RESPONSIBILITY

- The overall audit strategy and the audit plan remain the auditor's responsibility.
- It is the auditor who is responsible for establishing overall audit strategy and developing audit plan.
- However, auditor may discuss elements of planning with entity's management without compromising effectiveness of audit.

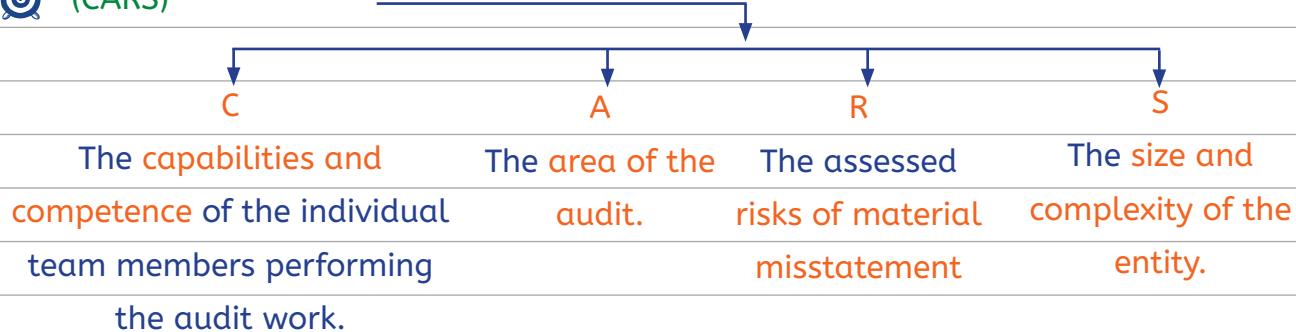
Q7 CHANGES TO PLANNING DECISIONS DURING THE COURSE OF AUDIT

- 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 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.

Q8 PLANNING SUPERVISION AND REVIEW OF WORK OF ENGAGEMENT TEAM MEMBERS

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. 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:

(CARS)



Q9

DOCUMENTATION

(1) The documentation of the **overall audit strategy** is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

(2) The documentation of **the audit plan** is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

(3) A record of the **significant changes to the overall audit strategy and the audit plan**, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit.

It also reflects the appropriate response to the significant changes occurring during the audit.

Q10

AUDIT PROGRAMME

- An audit programme consists of a **series of verification procedures** to be applied to the **financial statements** and accounts of a given entity for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on financial statements.
- In other words, 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.

Note 1 : Features of Audit Programme**1. One Programme not applicable to All**

- Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls 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 not practicable.

2. The Assistant to keep an open mind

- As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern.
- The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him.
- He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit.

3. Periodic review of the audit programme

- There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge 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 obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

4. Constructing an audit programme

- The audit **planning ideally commences** at the conclusion of the previous year's audit, and along with the related programme, it should be **reconsidered for modification** as the audit progresses.
- 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.
- However, the auditor may decide **not to rely on internal controls** when there are other more **efficient ways of obtaining sufficient appropriate audit evidence**.
- The auditor should also consider **the timing of the procedures**, the coordination of any assistance expected from the client, the **availability of assistants**, and the **involvement of other auditors or experts**.
- Further, the auditor normally has **flexibility** in deciding when to perform audit procedures.
- 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.

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

- (1) Stay within the scope and limitation of the assignment.
- (2) Prepare a written audit programme.
- (3) Determine the evidence reasonably available and identify the best evidence.
- (4) Apply only those steps which are useful in accomplishing the **verification purpose**.
- (5) Include the audit objectives for each area.
- (6) Consider all possibilities of error.
- (7) Co-ordinate the procedures to be applied to related items.

Q11 AUDIT PROGRAMME- DESIGNED TO PROVIDE AUDIT EVIDENCE

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both **information** contained in the accounting records underlying the financial statements and **other information**.

- Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.
- 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.
- An auditor picks up evidence from a variety of fields and it is generally of the following broad types:
 - (a) Documentary examination
 - (b) Physical examination
 - (c) Statements and explanation of management, officials and employees
 - (d) Statements and explanations of third parties
 - (e) Arithmetical calculations by the auditor
 - (f) State of internal controls and internal checks
 - (g) Inter-relationship of the various accounting data
 - (h) Subsidiary and memorandum records
 - (i) Minutes
 - (j) Subsequent action by the client and by others.

Example:

1. For cash in hand, the best evidence is 'count'.
2. For investment pledged with a bank, the banker's certificate.
3. 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.

- 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.

Q12

ADVANTAGES AND DISADVANTAGES OF AN AUDIT PROGRAMME

The advantages of an audit programme are:

- (a) It provides the assistant carrying out the audit **with total and clear set of instructions** of the work generally to be done.
- (b) It is essential, particularly for major audits, to provide **a total perspective of the work to be performed**.
- (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 pre-determined 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 professional auditor.

Some disadvantages are also there in the use of audit programmes but most of these can be removed by following some concrete steps.

The disadvantages are:

- (a) The work may become **mechanical** and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (b) The programme often tends to become **rigid and inflexible** 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.
- (c) Inefficient assistants may take shelter behind the programme i.e., defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (d) A **hard and fast audit programme** may kill the initiative of efficient and enterprising assistants.

NOTE 1:

All these disadvantages may be eliminated by **imaginative supervision** of the work carried on by the assistants; the auditor must have a **receptive attitude** as regards the assistants; the assistants should be encouraged to observe matters **objectively** and bring significant matters to the notice of supervisor/principal.

Q13 EXTRACT OF SAMPLE AUDIT PROGRAMME PERTAINING TO SALES OF AN ENTITY

Name of concern	
Financial year	2021 – 22
Prepared by	P (with date)
Reviewed by	Q (with date)
Approved by	R (with date)

Serial Number	Nature of Procedure	Extent of Check	Basis of Sample	Done by
(a)	Vouch few sales invoice from copies available in record of the concern.			
(b)	Trace these invoices into the account books of the concern.			
(c)	Verify few invoice with e-way bills generated on the e-way bill portal.			
(d)	Trace few sales invoices into the stock records to ensure that sold quantities have been reduced from stocks.			
(e)	Trace also few sales invoices into account of buyers			



3

RISK ASSESSMENT &
INTERNAL CONTROL

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1

AUDIT RISK

Q1 INTRODUCTION

- Audit risk means the risk that the auditor gives an **inappropriate audit** opinion when the financial statements are materially misstated.
- It means that an auditor expresses an **unmodified opinion** when financial statements are materially misstated.
- Audit risk is a function of the **risks of material misstatement** and **detection risk**.

Risks of material misstatement:

(1) SA 200 states that risk of material statement is the risk that the financial statements are materially misstated **prior to audit**. It simply means that **there is a probability of frauds or errors in financial statements before audit**.

(2) The risks of material misstatement may exist at two levels:

↓

(i) **Risks of material misstatement** (ii) **Risks of material misstatement at the assertion**
at the overall financial level are assessed in order to determine the statement level refer to risks nature, timing, and extent of further audit of material misstatement procedures necessary to obtain sufficient that relate **pervasively** to the appropriate audit evidence. This evidence financial statements as a whole enables the auditor to express an opinion on and potentially affect many the financial statements at an acceptably low assertions. level of audit risk.

(3) **Components of risk of material misstatement:**

The risk of material misstatement at assertion level comprises of two components i.e., inherent risk and control risk.

(a) **Inherent risk:** Inherent risk is 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** as described in SA-200.

(b) **Control risk:** In accordance with SA-200, 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 not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

(4) **Detection risk:** SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Detection risk comprises sampling and non-sampling risk:

↓

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. It simply means that the sample was not representative of the population from which it was chosen.

Non-sampling risk is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

Note 1: The auditor can only influence detection risk. Inherent risk and control risk belong to the entity and are influenced by the entity. Therefore, auditor must reduce detection risk in order to keep audit risk at low level. **Detection risk may be reduced by increasing area of checking, testing larger samples and by including competent and experienced persons in the engagement team.**

Note 2: Audit risk-What is not included?

Audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Note 3: Assessment of risks- A matter of professional Judgment

The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

2

IDENTIFYING & ASSESSING THE RISK
OF MATERIAL MISSTATEMENT

Q1 IDENTIFYING & ASSESSING THE RISK OF MATERIAL

- SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"
- The objective of the auditor is to identify and assess the risks of material misstatement whether due to fraud or error, at the **financial statement and assertion levels**, through
- understanding the entity and its environment
- including the entity's internal control,
- thereby providing a basis for designing and implementing responses to the responses to the assessed **risks of material misstatement**.
- This will help the auditor to reduce the risk of material misstatement to an acceptably low level.

Q2 THE OBJECTIVE OF THE AUDITOR AS STATED IN SA 315 IS TO
IDENTIFY AND ASSESS THE RISKS OF MATERIAL MISSTATEMENT

(i) Auditor shall **identify and assess** the risks of material misstatement at

- (a) The **financial statement** level
- (b) The **assertion level** for classes of transactions, account balances, and disclosures. To provide a basis for designing and performing further audit procedures

(ii) For the purpose of identifying and assessing the risks of material misstatement the auditor shall:

- (a) **Identify risks** throughout the process of obtaining an **understanding of the entity and its environment** including relevant **controls** that
- (b) **Assess** the identified risks, and evaluate whether they relate more **pervasively** to the **financial statements** as a whole and potentially affect many **assertions**
- (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
- (d) 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.

3

UNDERSTANDING THE ENTITY
AND ITS ENVIRONMENT

Q1 UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT (ROMAN)

SA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment states that the auditor shall obtain an understanding of the following:

R → Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments.

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.

Examples of other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation etc.

O → The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

M → The measurement and review of the entity's financial performance:

Management and others will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the financial statements.

Examples for measuring and reviewing financial performance which may be used by an auditor may include:

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.

- Budgets, forecasts, variance analyses, and departmental or other level performance reports.
- Credit rating agency reports.

A → The entity's selection and application of accounting policies, 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.

N → The nature of the entity, including:

- (i) its operations;
- (ii) its ownership and governance structures;
- (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
- (iv) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

Examples of matters that the auditor may consider while obtaining understanding of nature of entity include:

- Business operations such as nature of revenue sources, products or services, conduct of operations, location of production facilities, key customers and suppliers of goods and services
- Investment and investment activities such as capital investment activities and planned or recently executed acquisitions
- Financing and financing activities such as major subsidiaries, debt structure etc.
- Financial reporting such as accounting principles and revenue recognition practices.

Q2 UNDERSTANDING THE ENTITY-A CONTINUOUS PROCESS

- Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process.
- The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

G (RAM DAS)

- R** → Assessing **risks** of material misstatement of the financial statements

- A** → Considering the **appropriateness** of the selection and application of accounting policies
- M** → Determining **materiality** in accordance with SA 320

- D** → **Developing** expectations for use when performing analytical procedures

- A** → Evaluating the sufficiency and appropriateness of audit evidence obtained such as the appropriateness of **assumptions** and of management's oral and written representations.

- S** → Identifying areas where **special** audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions.



4

INTERNAL CONTROL

Q1 MEANING OF INTERNAL CONTROL

- As per SA-315, “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment”,
- the internal control may be defined as
- “the process **designed, implemented and maintained**
- by those charged with governance, management and other personnel
- to provide reasonable assurance about the achievement of an entity’s objectives with regard
- to reliability of financial reporting,
- effectiveness and efficiency of operations,
- safeguarding of assets,
- and compliance with applicable laws and regulations.

Q2 BENEFITS OF UNDERSTANDING OF INTERNAL CONTROL

An understanding of internal control assists the auditor in:

- Identifying **types of potential misstatements**;
- Identifying factors that affect the **risks of material misstatement**, and
- Designing the **nature, timing, and extent** of further audit procedures.

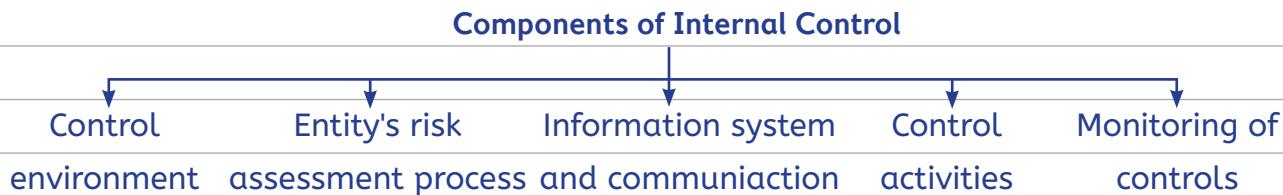
Q3 LIMITATIONS OF INTERNAL CONTROL

- 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.
- Realities that **human judgment** in decision-making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control.

- (iii) 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. 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.
- (iv) **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.
- (v) This oversight may compensate for the generally more limited opportunities for segregation of duties. On the other hand, the ownermanager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

Q4 COMPONENTS OF INTERNAL CONTROL

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:



Q4A CONTROL ENVIRONMENT

1. The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:
 - (i) Management has created and maintained a **culture of honesty and ethical behaviour** and
 - (ii) The strengths in the control environment elements collectively provide an appropriate **foundation** for the other components of internal control.
2. **What is included in Control Environment?**

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.
- (iii) the control environment sets the tone of an organization, influencing the control consciousness of its people.

3. **Elements of the Control Environment:** Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

[MOTI CA HAI]

M

→ **Management's philosophy and operating style**

Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions towards financial reporting- what approach is taken by management in selecting accounting policies, approach in developing accounting estimates etc.

O

→ **Organisational structure**

Establishing a relevant organisational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.

T

→ **Participation by those charged with governance**

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.

I

→ **Communication and enforcement of integrity and ethical values**

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behaviour are the product of the entity's ethical and behavioural standards, how they are communicated, and how they are reinforced in practice.

The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts.

C

→ **Commitment to competence**

Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

A → Assignment of authority and responsibility

Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.

H → Human resource policies and practices:

Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions. Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity.

(4) Existence of a satisfactory control environment-not an absolute deterrent to fraud

- The existence of a **satisfactory control environment** can be a **positive factor** when the auditor **assesses the risks of material misstatement**.
- However, although it may help **reduce the risk of fraud**, a **satisfactory control environment is not an absolute deterrent to fraud**.
- Conversely, **deficiencies in the control environment** may **undermine the effectiveness of controls**, in particular in relation to fraud.
- 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.
- The control environment in itself does not **prevent, or detect and correct, a material misstatement**
- It may, however, influence the auditor's evaluation of the effectiveness of other controls (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.

Q4B THE 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
- (d) **Deciding about actions** to address those risks

Q4C

THE INFORMATION SYSTEM, INCLUDING THE RELATED BUSINESS PROCESSES, RELEVANT TO FINANCIAL REPORTING AND COMMUNICATION

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:

- (a) The classes of transactions in the entity's operations that are significant to the financial statements
- (b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements
- (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions
- (d) How the information system captures events and conditions that are significant to the financial statements
- (e) The financial reporting process used to prepare the entity's financial statements.
- (f) Controls surrounding journal entries.

An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data. Many information systems make extensive use of information technology (IT). Information system should provide qualitative financial information.

Q4D

CONTROL ACTIVITIES

- An audit 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.
- Control activities are the policies and procedures that help ensure that management directives are carried out.
- Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

Control activities relevant to audit generally include

- (i) policies and procedures relating to performance reviews (reviews of actual performance with budgets),
- (ii) information processing (for example controls over checking arithmetical accuracy of records, program change controls etc),

- (iii) **physical controls** (like controls over physical security of assets) and
- (iv) **segregation of duties** (controls over ensuring that different people are assigned the responsibilities of authorising transactions, recording transactions and maintaining custody of assets)

Q4F MONITORING OF CONTROLS

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.
- It helps in assessing the effectiveness of controls on a **timely basis**.
- It involves assessing the effectiveness of controls on a timely basis and taking necessary **remedial actions**.
- It includes considering whether controls are operating as intended and that they are modified as appropriate for change in conditions.
- Management accomplishes monitoring of controls through **ongoing activities**, **separate evaluations**, or a combination of the two.
- Ongoing monitoring activities are often **built into the normal recurring activities** of an entity and include regular management and **supervisory activities**.
- Management's monitoring activities may include using information from communications from external parties such as **customer complaints** and **regulator comments** that may indicate problems or highlight areas in need of improvement.

Q5 ARE ALL CONTROLS RELEVANT TO THE AUDIT?

- There is a **direct relationship** between an entity's **objectives** and the **control** it **implements** to provide reasonable assurance about their achievement.
- however, not all of these objectives and controls are **relevant to the auditor's risk assessment**.
- 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:

 (MS₂ DANCeS)

 → **Materiality**

 → **The size of the entity.**

- D** → The diversity and complexity of the entity's operations.
- A** → Applicable legal and regulatory requirements.
- N** → The nature of the entity's business, including its organisation and ownership characteristics.
- S** → Whether, and how, a **specific control**, individually or in combination with others, prevents, or detects and corrects, material misstatement.
- S₁** → The significance of the related risk.
- C₁** → The circumstances and the applicable **component of internal control**.
- C₂** → The nature and complexity of the systems that are part of the entity's internal control, including the use of **service organisations**.

Q6 CONTROLS OVER THE COMPLETENESS AND ACCURACY OF INFORMATION

- Controls over the completeness and accuracy of information produced by the entity **may be relevant to** the audit if the auditor intends to make **use of the information** in designing and performing **further** procedures.
- For example, in auditing **revenue** by applying standard prices to records of **sales volume**, the auditor considers the accuracy of the price information and the completeness and accuracy of the sales volume data.
- Controls relating to **operations** and **compliance objectives** may also be relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures.

Q7 INTERNAL CONTROL OVER SAFEGUARDING OF ASSETS

- Internal control over safeguarding of assets against unauthorised acquisition, use, or **disposition** may include controls relating to both **financial reporting** and **operations** objectives.
- The auditor's consideration of such controls is generally limited to those **relevant to** the **reliability of financial reporting**.
- 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**
- Conversely, 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**.

Q8 NATURE AND EXTENT OF THE UNDERSTANDING OF RELEVANT CONTROLS

- Evaluating the **design** of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.
- There is little point in assessing the **implementation** of a control that is **not effective**, and so the **design** of a control is considered first.
- An **improperly designed control** may represent a **significant deficiency** in internal control.
- Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-
 - ▶ **Inquiring** of entity personnel.
 - ▶ **Observing** the application of specific controls.
 - ▶ **Inspecting** documents and reports.
 - ▶ Tracing transactions through the **information system** relevant to financial reporting.
- **Inquiry alone**, however, is not sufficient for such purposes.
- Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness, unless there is **some automation** that provides for the consistent operation of the controls.
- For example, obtaining audit evidence about the implementation of a **manual control at a point in time** does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit.
- However, because of the inherent consistency of IT processing, performing audit procedures to determine whether an **automated control** has been implemented may serve as a **test of that control's operating effectiveness**, depending on the auditor's assessment and testing of controls such as those over program changes.

5

RISKS THAT REQUIRE SPECIAL
AUDIT CONSIDERATION

Q1 RISKS THAT REQUIRE SPECIAL AUDIT CONSIDERATION

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (F) → Whether the risk is a risk of fraud
- (E) → Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention
- (C) → The complexity of transactions
- (R) → Whether the risk involves significant transactions with related parties
- (S) → The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty and
- (O) → Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Q2 IDENTIFYING SIGNIFICANT RISKS

Risks of Material Misstatement – Greater for Significant Non-Routine Transactions

- Greater management intervention to specify the accounting treatment.
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

ROMMS - Risks of material misstatement- Greater for Significant Judgmental Matters

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

6

EVALUATION & TESTING OF
INTERNAL CONTROL SYSTEM

Q1 BENEFITS OF EVALUATION OF INTERNAL CONTROL TO THE AUDITOR

The review of internal controls will enable the auditor to know:

- (i) whether **errors and frauds** are likely to be located in the ordinary course of operations of the business
- (ii) whether an **adequate internal control system** is in use and operating as planned by the management
- (iii) whether an effective **internal auditing department** is operating
- (iv) whether the controls adequately **safeguard the assets**
- (v) how far and how adequately the **management** is discharging its function in so far as correct recording of transactions is concerned
- (vi) how reliable the **reports, records and the certificates** to the management can be
- (vii) the **extent and the depth of the examination** that he needs to carry out in the different areas of accounting
- (viii) what would be appropriate **audit technique and the audit procedure** in the given circumstances
- (ix) what are the areas where **control is weak** and where it is **excessive and**
- (x) whether some **worthwhile suggestions** can be given to improve the control system.

Q2 EVALUATION OF INTERNAL CONTROL- METHODS

Methods of evaluation of internal control



Q2A THE NARRATIVE RECORD

- This is a complete and **exhaustive description** of the system as found in operation by the auditor.
- **Actual testing** and observation are necessary **before such a record can be developed.**
- It may be recommended in cases where **no formal control system** is in operation and would be more suited to **small business**.
- The basic disadvantages of narrative records are:
 - (i) To **comprehend the system** in operation is quite difficult.
 - (ii) To identify **weaknesses or gaps** in the system.
 - (iii) To incorporate **changes** arising on account of reshuffling of manpower, etc.

Q2B CHECK LIST

- This is a series of instructions and/or questions which a member of the **auditing staff must** follow and/or answer.
- When he completes instruction, he **initials** the space against the instruction.
- Answers to the check list instructions are usually Yes, No or Not Applicable.

Example:

A few examples of check list instructions are given hereunder:

- (1) Are tenders called before placing orders?
- (2) Are the purchases made on the basis of a written order?
- (3) Is the purchase order form standardised?
- (4) Are purchase order forms pre-numbered?

Q2C INTERNAL CONTROL QUESTIONNAIRE

- This is a comprehensive series of questions concerning internal control.
- This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.
- In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness.
- Provision is made for an explanation or further details of 'No' answers.
- In respect of questions not relevant to the business, 'Not Applicable' reply is given.
- The questionnaire is usually **issued to the client and the client** is requested to get it filled by the concerned executives and employees.

Examples of Extracts of Internal Control Questionnaire in respect of purchases,
creditors, inventories and fixed assets:

A. Purchases	B. Creditors	C. Inventories	D. Fixed Assets
<p>(1) Are purchases centralised in the Purchase Department?</p> <p>(2) (a) Are purchases made only from approved suppliers?</p> <p>(b) Is a list of approved suppliers maintained for this purpose?</p> <p>(c) Does the master list contain more than one source of supply for all important materials?</p> <p>(3) Are the purchase orders based on valid purchase requisitions duly signed by authorised persons in this behalf?</p> <p>(4) Are purchases based on competitive quotations from two or more suppliers?</p> <p>(5) Are purchase orders pre-numbered?</p> <p>(6) Are purchase orders signed only by employees authorized in this behalf?</p> <p>(7) Are all materials received only in the Receiving Department?</p> <p>(8) Are persons connected with receipt of materials and the keeping of receiving records denied authority to issue purchase orders or to approve invoices?</p> <p>(9) Are materials inspected and counted, weighed or measured in the Receiving Department?</p> <p>(10) Are receipt of materials evidenced by pre-numbered Goods Received Note?</p>	<p>(1) (a) Are suppliers' invoices routed direct to the Accounts Department?</p> <p>(b) Are they entered in a Bill register before submitting them to other departments for check and/or approval?</p> <p>(c) Are advance and partial payments entered on the invoices before they are submitted to other departments?</p> <p>(2) Does the system ensure that all invoices are duly processed?</p> <p>(3) In respect of raw material and supplies, are reconciliations made of quantities and/or values received as shown by purchase invoices with receipt into stock records?</p> <p>(4) Does the Accounts Department match the invoices of supplies with Goods Received Notes and purchase orders?</p> <p>(5) Do all invoices bear evidence of being checked for prices, freight, terms etc.?</p> <p>(6) Are all advance payments duly authorized by persons competent to authorize such payments?</p> <p>(7) Are duplicate invoices marked immediately on receipt to avoid payment against them?</p> <p>(8) Are all supplier's statements compared with ledger accounts?</p> <p>(9) Is there any follow-up action to investigate difference, if any, between the suppliers' statements and the ledger accounts?</p> <p>(10) Is a list of unpaid creditors prepared and reconciled periodically?</p>	<p>(1) Are stocks stored in assigned areas?</p> <p>(2) Are stocks insured comprehensively against different risks? If some risk is not insured, whether it is due to specific decision taken by a senior official?</p> <p>(3) Is a record maintained for the insurance policies?</p> <p>(4) Is the record reviewed periodically?</p> <p>(5) Is there an official who decides on the value for which stocks are to be insured?</p> <p>(6) Is the adequacy of insurance cover reviewed periodically?</p> <p>(7) Are perpetual stock records kept for raw materials, work-in-progress, finished goods and stores?</p> <p>(8) Are stock records periodically reconciled with accounting records?</p> <p>(9) Where there is a system of perpetual inventory count:</p> <p>(a) Is there a periodical report of shortages/excess?</p> <p>(b) If so, are these differences investigated?</p> <p>(c) Are these differences adjusted in the stock records and in the financial accounts?</p> <p>(d) Is written approval obtained from a responsible official to adjust these differences?</p> <p>(10) Are there norms for stock levels to be held?</p>	<p>(1) Are budgets for capital expenditure approved?</p> <p>(2) Is the authority to incur capital expenditure restricted to specified officials?</p> <p>(3) Are purchases of capital expenditure subject to same controls as applicable to purchases of raw materials, stores etc.?</p> <p>(4) Is there proper check to see that amounts expended do not exceed the amount authorized?</p> <p>(5) Are fixed assets verified periodically?</p> <p>(6) Is there a written procedure for such verification?</p> <p>(7) Are reports prepared on such verification?</p> <p>(8) Do such reports indicate damaged/obsolete items of fixed assets?</p> <p>(9) Are discrepancies disclosed by such reports investigated?</p> <p>(10) Are the records and financial accounts corrected with appropriate authority?</p>

Q2D FLOW CHART

- It is a **graphic presentation** of each part of the company's system of internal control.
- A flow chart is considered to be the **most concise way of recording** the auditor's review of the system.
- It minimises the **amount of narrative explanation** and thereby achieves a consideration or presentation not possible in any other form.
- It gives **bird's eye view of the system** and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

Q3 TESTING OF INTERNAL CONTROL

(1) Test of controls are performed to obtain audit evidence about the effectiveness of the:

- (i) **Design of the accounting and internal control system**
- (ii) **Operation of the internal control throughout the period**

(2) Test of controls may include:

Inspection of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly, for example, verifying that a transaction has been authorised.

- (i) **Inquiries about, and observation** of internal controls which leave no audit trail, for example, determining who actually performs each function and not merely who is supposed to perform it.
- (ii) **Re-performance** involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, for example, reconciliation of bank accounts, to ensure they were correctly performed by the entity.
- (iii) **Testing of internal control** operating on specific computerised applications or over the overall **information technology function**, for example, access or program change controls.

(3)

- While obtaining audit evidence about the effective operation of internal controls, the auditor considers.
- **how they were applied,**
- the **consistency** with which they were applied during the period
- and **by whom they were applied.**

(4) • Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk.

- The evaluation of deviations may result in the auditor concluding that the assessed level of control risk needs to be revised.
- In such cases, the auditor would modify the nature, timing and extent of planned substantive procedures.



7

RISK ASSESSMENT
PROCEDURES

Q1 MEANING

- 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 ROMMS, whether due to fraud or error,
- at the FS and assertion level are defined as RAP.

Q2 WHAT IS INCLUDED IN RISK ASSESSMENT PROCEDURES?

(a) Inquiries of Management and Others Within the Entity:

- (i) Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control.
- (ii) Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- (iii) Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations.
- (iv) Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies.
- (v) Inquiries directed to the risk management function may provide information about operational and regulatory risks that may affect financial reporting.
- (vi) Inquiries directed to information systems personnel may provide information or other information system-related risks.

(b) Analytical Procedures:

- (i) Analytical procedures performed as RAP may identify aspects of the entity of which the auditor was unaware and may assist in assessing the ROMMS in order to provide a basis for designing and implementing responses to the assessed risks.

(c) Observation and Inspection:

Examples of such audit procedures include observation or inspection of the following:

- (i) The entity's operations.
- (ii) Documents (such as business plans and strategies), records, and internal control manuals.
- (iii) Reports 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)
- (iv) The entity's premises and plant facilities.

8

MATERIALITY

Q1 WHAT IS MEANT BY MATERIALITY?

- SA 320 Materiality in Planning and Performing an Audit states that misstatements, including omissions,
- are considered to be material if they, individually or in the aggregate,
- could reasonably be expected to influence the economic decisions of users

Q2 MATERIALITY IN PLANNING AND PERFORMING AN AUDIT- AUDITOR'S RESPONSIBILITY

(A) Introduction:

- SA 320 deals with auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.

(B) FRF:

- 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:
 - (a) Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users;
 - (b) Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
 - (c) Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.
- Such a discussion, if present in the applicable financial reporting framework, provides a frame of reference to the auditor in determining materiality for the audit.
- If the applicable financial reporting framework does not include a discussion of the

concept of materiality, the characteristics referred to above provide the auditor with such a frame of reference.

(C) If there is any **statutory requirement** of disclosure, it is to be considered **material irrespective** of the value of amount. Examples are given below: -

(a) As per Division I of schedule III of Companies Act, 2013, any item of income or expenditure which exceeds **one percent of the revenue from operations or ` 1,00,000, whichever is higher**, needs to be disclosed separately.

(b) A company should disclose in notes to accounts, shares in the company held by each **shareholder holding more than 5 per cent shares** specifying the number of shares held as per requirements of Division I of Schedule III of Companies Act, 2013.

Q3 DETERMINATION OF MATERIALITY- A MATTER OF PROFESSIONAL JUDGMENT

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:**

(a) 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**;

(b) Understand that financial statements are **prepared, presented and audited** to levels of materiality;

(c) Recognize the **uncertainties inherent** in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(d) Make **reasonable economic decisions** on the basis of the information in the financial statements.

Q4 PERFORMANCE MATERIALITY

- Performance materiality means the amount or amounts set by the auditor **at less than materiality** for the financial statements as a whole to reduce to an appropriately low level the probability that the **aggregate of uncorrected and undetected misstatements** exceeds materiality for the financial statements as a whole.
- Performance materiality is **set at a value lower than overall materiality**. It lowers the risk that auditor will not be able to identify misstatements **that are material when added together**.

Q5

USE OF BENCHMARKS IN DETERMINING MATERIALITY FOR THE FINANCIAL STATEMENTS AS A WHOLE

(A) INTRODUCTION:

- 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.

(B) FACTORS TO BE CONSIDERED: [FOCUS ON VIOLEN]

- Factors that may affect the identification of an appropriate benchmark include the following:
Whether there are items on which the **attention of the users** of the particular entity's financial statements tends to be **focused**. For example, for the purpose of evaluating financial performance users may tend to focus on **profit, revenue or net assets**.
 - **V** → The relative **volatility** of the benchmark.
 - **I** → and the **industry and economic environment** in which the entity operates,
 - **O** → the entity's **ownership structure** and the way it is financed. For 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;
 - **L** → where the entity is at in its **life cycle**,
 - **E** → The **elements** of the financial statements like assets, liabilities, equity, revenue, expenses.
 - **N** → The **nature** of the entity,
- 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**.
- **Profit before tax** from continuing operations is often used for **profit-oriented entities**. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as **gross profit or total revenues**.

(C) RELEVANT FINANCIAL DATA

In relation to the chosen benchmark, relevant financial data ordinarily includes: -

- **Prior periods' financial results and financial positions**,
- **The period to-date financial results and financial position**, and
- **Budgets or forecasts for the current period**,
- **Adjusted for significant changes** in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

Q6

MATERIALITY LEVEL OR LEVELS FOR PARTICULAR CLASSES OF TRANSACTIONS,
ACCOUNT BALANCES OR DISCLOSURES.

Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

1. Whether law, regulations or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items like in case of related party transactions, and the remuneration of management and those charged with governance.
2. The key disclosures in relation to the industry in which the entity operates. For example, research and development costs for a pharmaceutical company.
3. Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements like in case of newly acquired business.

Q7

REVISION IN MATERIALITY LEVEL AS THE AUDIT PROGRESSES

1. 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
 - (i) a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business),
 - (ii) new information, or
 - (iii) a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.
2. 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.
3. 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 necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

Q8 DOCUMENTING THE MATERIALITY

The audit documentation shall include the following amounts and the factors considered in their determination:

(a) Materiality for the financial statements as a whole	(b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures	(c) Performance materiality and	(d) Any revision of (a)-(c) as the audit progressed
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Q9 MATERIALITY AND AUDIT RISK

1. 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.
2. In conducting an audit of financial statements, the overall objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.
3. 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.
4. Materiality and Audit Risk are considered throughout the audit, in particular, when:
 - (a) Identifying and assessing the risks of material misstatement;
 - (b) Determining the nature, timing and extent of further audit procedures; and
 - (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

9

THE AUDITOR'S RESPONSES
TO ASSESSED RISKS

Q1 OBJECTIVE

The objective of the auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

SA 330 states that:

- (a) The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the **financial statement level**.
- (b) The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the **assertion level**.

Q2 IN DESIGNING THE FURTHER AUDIT PROCEDURES TO BE PERFORMED, THE AUDITOR SHALL

- (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:
 - (i) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the **inherent risk**); and
 - (ii) Whether the risk assessment takes into account the relevant controls (i.e., the **control risk**), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively.
- (b) Obtain more **persuasive audit evidence** the higher the auditor's assessment of risk.

Q3 THE AUDITOR SHALL DESIGN AND PERFORM TESTS OF CONTROLS TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE AS TO THE OPERATING EFFECTIVENESS OF RELEVANT CONTROLS WHEN

- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor **intends to rely on the operating effectiveness** of controls in determining the nature, timing and extent of substantive procedures); or
- (b) **Substantive procedures alone cannot provide sufficient appropriate audit evidence** at the assertion level.

Q4 NATURE OF TEST OF CONTROLS

In designing and performing test of controls, the auditor shall:

- 1. Perform other audit procedures in **combination with inquiry** to obtain audit evidence about the operating effectiveness of the controls, including:
 - (i) **How the controls were applied** at relevant times during the period under audit.
 - (ii) **The consistency** with which they were applied.
 - (iii) **By whom** or by what means they were applied.
- 2. Determine whether the controls to be tested depend upon other controls (**indirect controls**), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.
- 3. **Inquiry alone** is not sufficient to test the operating effectiveness of controls. Accordingly, other **audit procedures** are performed in **combination with inquiry**.
- 4. In this regard, 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.
- 5. The **nature** of the particular **control** influences the **type of procedure** required to obtain audit evidence about whether the control was operating effectively.
- 6. If operating effectiveness is evidenced by **documentation**, the auditor may decide to **inspect it to obtain** audit evidence about operating effectiveness.
- 7. 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.

Q5

MATTERS THE AUDITOR MAY CONSIDER IN DETERMINING THE EXTENT OF TEST OF CONTROLS INCLUDE THE FOLLOWING:

1. The **frequency** of the performance of the control by the entity during the period.
2. The **length of time** during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The **expected rate of deviation** from a control.
4. The **relevance and reliability** of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The **extent to which audit evidence is obtained from tests of other controls** related to the assertion.

Q6

TIMING OF TEST OF CONTROLS

The auditor shall test controls for the **particular time**, or **throughout the period**,

only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's **physical inventory** counting at the period end.

(a) Audit evidence pertaining to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's **physical inventory** counting at the period end.

(b) If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate

Q7

USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS

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:

1. The effectiveness of other **elements** of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
2. The risks arising from the **characteristics** of the control, including whether it is **manual or automated**
3. The effectiveness of **general IT-controls**
4. 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 previous audits, and whether there have been personnel changes that significantly affect the application of the control

5. Whether the **lack of a change** in a particular control poses a risk due to changing circumstances and
6. The risks of material misstatement and the **extent of reliance** on the control

Q8

SPECIFIC INQUIRIES BY AUDITOR WHEN DEVIATIONS FROM CONTROLS ARE DETECTED

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

The test of controls that have been performed provide an appropriate basis for reliance on the controls Additional test of controls are necessary or The potential risks of misstatement need to be addressed using substantive procedures

Note: 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.

This requirement reflects the facts that:

(i) the auditor's assessment of risk is **judgmental** and so may not identify all risks of material misstatement and (ii) there are **inherent limitations** to **internal control**, including management override.

Q9

TESTS OF DETAILS

Tests of details are further classified into tests of transactions i.e., **vouching** and tests of balances i.e., **verification**.

(i) a purchase transaction may be verified by examining the related purchase invoice, goods received note, inward gate entry register. (ii) Tests of balances consist of verification of assets as well as liabilities. Verification of an item of fixed asset, for example, would help in establishing existence of that asset as on date of balance sheet.

Q10

SUBSTANTIVE ANALYTICAL PROCEDURES

Refer SA 520

Q11 NATURE AND EXTENT OF SUBSTANTIVE PROCEDURES

Depending on the circumstances, the auditor may determine that:

1. Performing **only substantive analytical procedures** will be sufficient 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.
2. **Only tests of details** are appropriate.
3. A **combination** of substantive analytical procedures and tests of details are most responsive to the assessed risks.

10

WHAT IS AN AUTOMATED
ENVIRONMENT?

Q1 MEANING

An automated environment basically refers to a business environment where the **processes**, **operations**, **accounting** and even **decisions** are carried out by using computer systems – also known as **Information Systems (IS)** or **Information Technology (IT)** systems.

Q2 KEY FEATURES OF AN AUTOMATED ENVIRONMENT

- Enables **faster business** operation
- **Accuracy** in data processing and computation
- Ability to process **large volume** of transactions
- **Integration** amongst business operations
- **Better security** and controls
- Less prone to **human errors**
- Provides **latest information**
- **Connectivity** and networking capability

Q3 UNDERSTANDING AND DOCUMENTING AUTOMATED ENVIRONMENT

- Information systems being used (one or more application systems and what they are)
- Their purpose (financial and non-financial)
- Location of IT systems – local vs global
- Architecture (desktop based, client-server, web application, cloud based)
- Version (functions and risks could vary in different versions of same application).
- Interfaces within systems (in case multiple systems exist).
- In-house vs Packaged.
- Outsourced activities (IT maintenance and support).
- Key persons (CIO, CISO, Administrators).

Note: The understanding of a company's IT environment that is obtained should be documented.

Q4 RISKS ARISING FROM USE OF IT SYSTEMS

- Inaccurate processing of data, processing inaccurate data, or both.
- Unauthorized access to data.
- Direct data changes (backend changes).
- Excessive access / Privileged access (super users).
- Lack of adequate segregation of duties.
- Unauthorized changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- Loss of data.

Q5 IMPACT OF IT RELATED RISKS

The above risks have to be mitigated. If not mitigated, such risks, could have an impact on audit in different ways discussed as under:



(a) Impact on substantive checking	(b) Impact on controls	(c) Impact on reporting
<ul style="list-style-type: none"> • Inability to address above discussed risks may lead to non-reliance of data obtained from systems. • In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy. • It could lead to increased substantive checking i.e., detailed checking 	<ul style="list-style-type: none"> It can lead to non-reliance on automated controls, system calculations and built into applications. It may result in additional audit work 	<ul style="list-style-type: none"> Due to regulatory requirements in respect of internal financial controls in case of companies, it may lead to modification of auditor's report in some instances.

Q6 TYPES OF CONTROLS IN AN AUTOMATED ENVIRONMENT**(A) General IT controls:**

General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. General IT-controls that maintain the integrity of information and security of data commonly include controls over the following:

(a) Controls over Data centre and network operations:	(b) Program Change: 1. The objective of program change controls over access	(c) Access Security	(d) Application system acquisition, development, and maintenance
The objective of controls	controls is to ensure security is to ensure		
over Data centre and	that modified systems that access to		
network operations is to	continue to meet programs and data		
ensure that production	financial reporting is authenticated and		
systems are processed	objectives.	authorized to meet	
to meet financial	2. It includes activities financial reporting		
reporting objectives.	such as change objectives. It includes		
These include activities	management process, activities such as		
such as	recording, managing	1. security	
1. overall management	and tracking change organization &		
of computer operation	requests, making and management,		
activities,	testing changes etc	2. security policies &	
2. preparing, scheduling		procedures,	
and executing of batch		3. application security,	
jobs,		initiation, analysis &	
3. monitoring, storage		4. data security,	
and retention of		5. operating system	
backups. Matters such as		security,	
BCP (Business continuity		activities, project	
plan) and DRP (Disaster		initiation, analysis &	
recovery plan) which		design, construction,	
deal with recovery from		testing & quality	
failures are also taken		assurance etc.	
care of by such type of		6. network security,	
controls.		7. physical security etc	

(B) Application Controls:

1. Application controls include both **automated or manual controls** that operate at a business process level.
2. Automated Application controls are **embedded into IT applications**.
3. Examples of automated applications include edit checks and validation of input data, sequence number checks, user limit checks, reasonableness checks, mandatory data fields.

(C) IT dependent Controls:

1. 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.
2. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the **reliability of source data**.
3. Due to the inherent dependency on IT, the effectiveness and reliability of automated application controls and IT dependent controls require the **General IT controls to be effective**. **Note:** General IT Controls vs. Application Controls

1. These two categories of control over IT systems are interrelated.
2. 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.

Q7**TESTING METHODS IN AN AUTOMATED ENVIRONMENT**

1. There are basically **four types** of audit tests that should be used. These are inquiry, observation, inspection and reperformance.
2. **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.
3. **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.
4. Generally, applying **inquiry in combination with inspection** gives the most effective and efficient audit evidence.
5. However, which audit test to use, when and in what combination is a matter of **professional judgement** 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.
6. When testing in an automated environment, some of the more common methods are as follows:
 - Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
 - Observe how a **user processes transactions** under different scenarios.
 - **Inspect the configuration** defined in an application

Q8

CHARACTERISTICS OF MANUAL AND AUTOMATED ELEMENTS OF INTERNAL CONTROL RELEVANT TO THE AUDITOR'S RISK ASSESSMENT

The characteristics of manual or automated elements are relevant to the auditor's risk assessment and further audit procedures based thereon.

(a) Controls in a **manual system** may include such procedures as **approvals** and **reviews** of transactions, and **reconciliations** and **follow-up** of reconciling items. Alternatively, an entity may use **automated procedures** to initiate, record, process, and report transactions, in which case records in **electronic format** replace paper documents.

(b) Controls in **IT** systems consist of a combination of **automated controls** (for example, controls embedded in computer programs) and **manual controls**. Further, manual controls may be independent of **IT**, may use information produced by **IT**.

Q9

MANUAL ELEMENTS VS AUTOMATED ELEMENTS IN ENTITY'S INTERNAL CONTROL

(a) Manual elements in internal control may be more **suitable** where **judgment** and **discretion** are required such as for the following circumstances:

1. Large, unusual or non-recurring transactions.
2. Circumstances where errors are difficult to define, anticipate or predict.
3. In **changing circumstances** that require a control response outside the scope of an existing automated control.
4. In **monitoring** the effectiveness of automated controls.

(b) **Manual elements** in internal control may be **less reliable** than automated elements because they can be more easily **bypassed**, **ignored**, or **overridden** and they are also more prone to simple errors and mistakes.

Manual control elements may be **less suitable** for the following circumstances:

1. **High volume or recurring transactions**, or in situations where **errors** that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
2. Control activities where the **specific ways** to perform the control can be adequately designed and automated.

Q10 DATA ANALYTICS FOR AUDIT

1. The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics.
2. The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.
3. 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 following:
 - C1 → Check completeness of data and population that is used in either test of controls or substantive audit tests.
 - S → Selection of audit samples – random sampling, systematic sampling.
 - R → Re-computation of balances – reconstruction of trial balance from transaction data.
 - M → Reperformance of mathematical calculations – depreciation, bank interest calculation.
 - J → Analysis of journal entries
 - F → Fraud investigation.
 - C2 → Evaluating impact of control deficiencies.

Q11 DIGITAL AUDIT

1. Entities are embracing digitization as part of their operations to keep pace with changing times.
2. New technologies are helping companies revamp their operations and rethink the way business is conducted.
3. Companies are restructuring their business models driven by technology. Automation is key to digitization.
4. In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.
5. Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way.
6. By using such tools, auditors can conduct audit in a better way and devote more attention to areas requiring greater focus.
7. Digital audit is helping auditors to better identify risks making use of technology.

Q12 INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

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

The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company. The term “internal financial controls” is used at some places in Companies Act, 2013 casting responsibilities as under:

Relevant provision of Companies Act, 2013	Nature of Responsibility
Section 134 (5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are adequate and were operating effectively.
Section 143(3)(i) of the Act	<p>The auditor's report shall state whether the company has adequate Internal financial controls system in place and also on the operating effectiveness of such controls.</p> <p>This requirement shall not apply to a private company which –</p> <p>(i) is One Person Company or a small company; or</p> <p>(ii) has turnover less than `50 crore as per latest audited Financial Statements; and which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial Year for less than `25 crore.</p>
Section 177(4)(vii) of the Act	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems
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.

Q13 DOCUMENTING THE RISKS

The auditor shall document:

(a) The discussion among (b) Key elements of the (c) The identified (c) The risks
the engagement team and understanding obtained regarding and assessed identified,
the significant decisions each of the aspects of the entity risks of material and related
reached and its environment and of each of misstatement controls about
the internal control components, at the financial which the
the sources of information from statement level auditor has
which the understanding was and at the obtained an
obtained; and the risk assessment assertion level understanding
procedures performed and

Q14 ASSESS AND REPORT AUDIT FINDINGS

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 management and those charged with governance.

Some points to consider are as follows:

1. Are there any weaknesses in IT controls?
2. What is the impact of these weaknesses on overall audit?
3. Report deficiencies to management – Internal controls memo or Management letter.
4. Communicate in writing any significant deficiencies to those Charged with governance.

4

AUDIT EVIDENCE

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SA 530

AUDIT SAMPLING

Q1 MEANING

Audit Sampling means

- Application of audit procedure
- To less than 100% of the items within a population
- Of audit relevance such that all sampling units have a chance of selection

Q2 CHARACTERISTICS POPULATION

COMPLETENESS

APPROPRIATENESS

RELIABLE

Q3 SAMPLING UNIT

The individual items that make up the population are known as sampling units.

Q4 SAMPLING SELECTION METHOD

Random Sampling:

(i) Simple Random Sampling:

- Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected.
- Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum).
- 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.

(ii) Stratified Sampling

- This method involves dividing the whole population to be tested in few separate groups called "strata" & taking a sample from each of them.
- Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum

Example: Debtors : 10L-100L

100L-200L

200L-300L

- **Systematic Sampling**

- ▶ Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected
- ▶ Selected Sampling Interval = Sample Units/Sample Size
- ▶ **Example:** $SI = 1,00,000/1,000 = 100$ th Item

- **Haphazard Selection**

- ▶ Haphazard selection, in which the auditor selects the sample without following a structured technique.
- ▶ Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability
- ▶ For example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page
- **Monetary unit Sampling**

It is a type of **value-weighted selection** in which sample size, selection and evaluation results in a conclusion in **monetary amounts**

Example: Amounts above Rs.10,000

- **Block selection**

- ▶ This method involves selection of a block(s) 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.

Note 1: STRATIFICATION

- Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations
- The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
- 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.
- Similarly, a population may be stratified according to a particular characteristic that indicates a higher ROMMS, for example, when testing the RDD in the valuation of accounts receivable, balances may be stratified by age.

Note 2: VALUE WEIGHTED SELECTION

- When performing tests of details, it may be efficient to identify the sampling unit as the individual monetary units that make up the population.
- Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.
- One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.
- This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection

Q5

SAMPLING RISK

- In case of test of controls that controls are more effective than they actually are
- In case of test of details that a material misstatement doesn't exist when in fact it does.
- The auditor is primarily concerned with this type of error because it affects audit effectiveness & is more likely to lead to an inappropriate audit opinion
- In case of test of controls that controls are less effective than they actually are
- In case of test of details that a material misstatement exist when in fact it doesn't.
- This error affects audit efficiency as it would lead to additional work to establish that initial conclusions were incorrect

Q6 Non Sampling Risk

- The risk that the auditor reaches an erroneous conclusion for any reason **not related to sampling risk**
- Sources of Non sampling risk are:
 - ▶ Human Mistakes
 - ▶ Misinterpreting sample results
 - ▶ Applying audit procedures not appropriate to objectives of audit
 - ▶ Relying on erroneous information

Note: Non sampling risk can never be mathematically measured

Q7 TOLERABLE LEVEL

Level up to which auditor can accept misstatement/deviation

TOLERABLE MISSTATEMENT

- A **monetary amount** set by auditor
- In respect of which the auditor seeks to obtain
- Appropriate level of assurance that
- The monetary amount set by the auditor is not exceeded by the actual MS in the popln

TOLERABLE RATE OF DEVIATION

- A **rate of deviation** set by auditor
- In respect of which the auditor seeks to obtain
- Appropriate level of assurance that
- The rate of deviation set by the auditor is not exceeded by the actual deviation in the popln

Q8 FACTORS THAT SHOULD BE CONSIDERED FOR EXTENT OF CHECKING (SIA DT)

- S** → **Size** of the organization under audit
- I** → **State of internal Control**
- A** → **Adequacy & reliability** of books & records
- D** → **Degree** of the desired confidence
- 1** → **Tolerable error range**

A. EXAMPLES OF FACTORS INFLUENCING SAMPLE SIZE FOR TOC

1. The **more assurance** the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the ROMMS will be, and the **larger** the sample size will need to be.

2. If there is an **increase in the tolerable** rate of deviation. Then sample size will **decrease**, as lower the tolerable rate of deviation, larger the sample size needs to be.
3. When there is an **increase in the expected rate of deviation** of the population to be tested then sample size will increase, as **higher** the expected rate of deviation, larger the sample size needs to be
4. An **increase in the auditor's desired level of assurance** that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will **increase** the sample size
5. In **case of large populations**, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining SAAE. Therefore, there will be **negligible effect on sample size** due to increase in the number of sampling units in the population.

B. EXAMPLES OF FACTORS INFLUENCING SAMPLE SIZE FOR TOD

1. The **higher** the auditor's assessment of the **ROMMS**, the larger the sample size needs to be
2. The more the auditor is relying on other **substantive procedures** (tests of details or substantive analytical procedures) to reduce to an acceptable level the detection risk regarding a particular population, the less assurance the auditor will require from sampling and, therefore, the smaller the sample size can be.
3. An **increase in the auditor's desired level of assurance** that tolerable misstatement is not exceeded by actual misstatement in the population will **increase** the sample size
4. An **increase in tolerable misstatement** will **decrease** the sample size as lower the tolerable misstatement, the larger the sample size needs to be.
5. The **greater the amount of misstatement** the auditor expects to find in the population, the **larger** the sample size
6. When **stratification** of the population is appropriate then **sample size will decrease**
7. There will be **negligible effect** on sample size due to **number of sampling units in the population**

Q9 SAMPLE DESIGN, SAMPLE SIZE AND SAMPLE SELECTION OF ITEMS FOR TESTING

Designing An audit Sample

- When designing an audit sample, the auditor shall consider **the purpose of the audit procedures** and the **characteristics of the population** from which the sample will be drawn.

- The auditor shall determine a sample size sufficient to **reduce sampling risk** to an acceptably low level.
- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

Sample Size

- Auditor shall determine sample size which is sufficient to **reduce sampling risk** to an acceptably low level.
- 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.**

Selection of Items for testing

The auditor shall select the items for testing in such a way that each sampling unit has a chance of selection. Thus method of sampling adopted by the auditor should be unbiased.

Q10 STATISTICAL & NON STATISTICAL SAMPLING

STATISTICAL

Meaning: This method of auditing is more scientific than testing based on auditor's own judgment because it involves use of **mathematical laws of probability** in determining the appropriate sample size

NON STATISTICAL

Meaning: Under this method the sample size is determined on the basis of **personal experience & knowledge** of the auditor

ADVANTAGES OF STATISTICAL (BMC PAO)

- B** → It may provide a **better description of a large mass**
- M** → The method provides a means of estimating the **minimum sample size** associated with **a specified risk and precision**.
- C** → It provides a means for deriving a "**calculated risk**" (sampling error) i.e. the probable difference in result due to the use of a sample
- P** → Sample size does not **increase in proportion to size of population**
- A** → **Widely accepted way of sampling**
- O** → The sample selection is **more objective** and thereby more defensible

Q11 NATURE AND CAUSES OF DEVIATIONS AND MISSTATEMENTS

1. Analyzing Deviation	Observe	→	Extend audit
	Common		procedures to all
	Features		those items
2. Misstatement/Deviation	Anomaly	→	Obtain high degree of certainty that such MS is not representative of population

Q12 PROJECT MISSTATEMENTS

- 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.
- When a misstatement has been established as an **anomaly**, it may be **excluded** when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still **needs to be considered** in addition to the projection of the non-anomalous misstatements.
- For **tests of details**, the auditor shall project misstatements found in the sample to the population whereas
- for **tests of controls**, **no explicit projection** of deviations is necessary since the sample deviation rate is also the **projected deviation rate** for the population as a whole.

Q13 EVALUATING RESULTS OF AUDIT SAMPLING

The auditor shall evaluate

- The results of the sample , and
- Whether the use of audit sampling has provided reasonable basis for conclusion

Q14 AUDIT PROCEDURE

- The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
- If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a **replacement item**. (An example of when it is necessary to perform the procedure on a replacement item is when a cancelled cheque is selected while

testing for evidence of payment authorization. If the auditor is satisfied that the cheque has been properly cancelled such that it does not constitute a deviation, an appropriately chosen replacement is examined.)

3. If the auditor is **unable to apply the designed audit procedures**, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a **deviation** from the prescribed control, in the case of **TOC**, or a **misstatement**, in the case of **TOD**.
4. An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item has been lost.
5. An example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request.

Q15 SAMPLING VS TRADITIONAL METHOD

- 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**.
- 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.
- By adopting the sampling technique, the auditor only checks a part 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
- Sampling is used as a part of **Tests of controls**.
- Auditor will check few internal controls and their **operating effectiveness**.
- Based on the conclusion derived, he can **then design the sample size for tests of details** (i.e checking of transactions and balances)

SA 505 EXTERNAL CONFIRMATION

Confirmation Request

AUDITOR

3rd PARTY

Direct written response

Q1 MEANING

- Audit evidence obtained as a direct written response
- to the auditor for a third party (confirming party)
- in paper form or by electronic or other medium.

Q2 BASIC CONCEPTS

NEGATIVE & POSITIVE CONFIRMATION

1. **POSITIVE CONFIRMATION:** A request that the confirming party responds directly to the auditor indicating whether the confirming party **agrees** or **disagrees** with the info in the request

2. **NEGATIVE CONFIRMATION** A request that the confirming party responds directly to the auditor only if confirming party **disagrees** with the info in the request.

1. A positive external confirmation request asks the confirming party to **reply to the auditor in all cases**,

2. either by indicating the confirming party's **agreement with the given information**, or

3. by asking the confirming party to **provide information**

4. A response to a positive confirmation request **ordinarily is expected to provide reliable audit evidence.**

• Negative confirmations provide less persuasive audit evidence than positive confirmations.

• Accordingly, the auditor 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 all of the following are present:

5. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct.

6. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information.

7. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

- S - The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
- A - The auditor has assessed the ROMMS as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- L - A very low exception rate is expected;

- A - The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests

NOTE: FOR NEGATIVE CONFIRMATION:

- The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.
- Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.
- Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise

3. NON-RESPONSE:

A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered

4. EXCEPTION:

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

Q3 MANAGEMENTS REFUSAL TO ALLOW THE AUDITOR TO SEND CONFIRMATIONS  (PIE)

- P** → Perform alternative audit procedures designed to obtain relevant & reliable audit evidence.
- I** → Inquire as to management's reason for refusal & seek audit evidence as to their validity & reasonableness.
- E** → Evaluate the implications of management's refusal on auditors assessment of ROMMS including the risk of fraud
- If the auditor concludes that management's refusal to allow the auditor to send a confirmation request in unreasonable
- or the auditor is unable to obtain relevant & reliable audit evidence from alternative procedures,
- the auditor shall communicate with TCWG,
- the auditor shall also determine the implications for the audit & auditors opinion in accordance with SA 705.

Note 1: ALTERNATIVE AUDIT PROCEDURE

- For accounts receivable balances – examining
- specific subsequent cash receipts,
- shipping documentation, and
- sales near the period-end.
- For accounts payable balances – examining
- subsequent cash disbursements or
- correspondence from third parties, and
- other records, such as goods received notes.

Note 2: REASONABLENESS OF REASONS

- A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation.
- 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.
- The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Q4

FACTORS TO BE CONSIDERED WHEN DESIGNING A CONFIRMATION REQUEST

(ALARM²)

- (A) → The **assertions** regarding which external confirmation is being prepared.
- (L) → The **layout and presentation** of the confirmation request.
- (A) → **Ability & willingness** of the intended confirming party to confirm.
- (R) → Identified risk of material misstatement, including fraud risk factors, if any.
- M1-The mode of communication, whether it is in paper form, or by electronic or other medium.
- M2-Management's authorisation for the 3rd parties to respond to the auditor. It may be noted that confirming parties **may not be willing** to respond to a confirmation request not having management's authorisation.
- (S) → Prior experience on the audit or **similar engagements**.

Q5

CONTROLS OVER EXTERNAL CONFIRMATION PROCEDURE

Step 1: Determine the information to be confirmed/requested:

They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".

Step 2: Select appropriate confirmation party:

Responses are more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed

Step 3: Design confirmation requests (ref: ALARM)

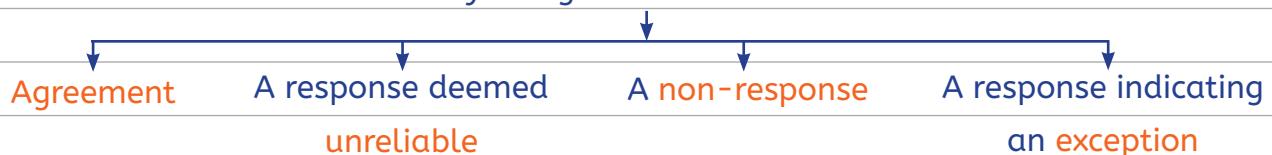
Step 4: Sending requests/follow up requests.

The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time

Q6

EVALUATING THE EVIDENCE OBTAINED

When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:



SA 501

AUDIT EVIDENCE - SPECIFIC
CONSIDERATIONS FOR
SELECTED ITEMS

Q1

INVENTORIES

Case 1:

Attendance at
physical inventory
count

Case 2:

If physical inventory
counting is conducted
at a date other than
the date of the FS

Case 3:

Attendance at
Physical Inventory
Counting Is
Impracticable

Case 4:

Inventory under the
Custody and Control
of a Third Party

Case 1: Attendance at physical inventory count

(a) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

- Observe the performance of management's count procedures
- Inspect the inventory
- Perform test counts

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Case 2: If physical inventory counting is conducted at a date other than the date of the FS

- In addition to above
- Perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

Relevant matters for consideration when designing audit procedures include:

1. Whether the perpetual inventory records are properly adjusted.
2. Reliability of the entity's perpetual inventory records.
3. Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Note : Matters relevant in planning attendance at physical inventory counting

1. Nature of inventory.
2. Stages of completion of work in progress.
3. The ROMMS related to inventory.
4. The nature of the internal control related to inventory.
5. Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
6. The timing of physical inventory counting.
7. Whether the entity maintains a perpetual inventory system.
8. The locations at which inventory is held, including the materiality of the inventory and the ROMMS
9. Whether the assistance of an auditor's expert is needed

Case 3: Attendance at Physical Inventory Counting Is Impracticable

- The auditor shall perform **alternative audit procedure** to obtain SAAE regarding the existence & condition of inventory.
- For example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide SAAE about the existence and condition of inventory.
- If it is not possible to do so, the auditor shall **modify** the Report in accordance with **SA 705**

Case 4: Inventory under the Custody and Control of a Third Party

The auditor shall obtain SAAE by performing one or both of the following:

- (a) Request confirmation from the 3rd party as to the **quantities & condition** of inventory held on behalf of the entry.
- (b) Perform **inspection** or other audit procedures appropriate in circumstances. Examples of other audit procedures include :
 - Attending or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable
 - Obtaining another auditor's report, or a **service auditor's report**, on the adequacy of third party's internal control for ensuring that inventory is properly counted and adequately safeguarded
 - Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts
 - Requesting confirmation from other parties when inventory has been **pledged as collateral**

Q2 LITIGATIONS AND CLAIM



- I** → Inquiry of management & where applicable, others within the entity, including in house legal counsel.
- M** → Reviewing minutes of meeting of those charges with governance & correspondence between entity & external legal counsel.
- L** → Reviewing legal expense account.
- If the auditor assess a ROMMS regarding litigation/ claims that have been identified or when audit procedures performed indicate that other material litigation/ claim may exist,
- the auditor shall in addition to the procedures required by other SA's seek direct communication with the entity's external legal counsel.

SCENE 1:

If:

- (a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- (b) the auditor is unable to obtain SAAE by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

SCENE 2:

- (a) the auditor may seek direct communication with the entity's external legal counsel through a letter of general inquiry.
- (b) If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry, the auditor may seek direct communication through a letter of specific inquiry. For this purpose, a letter of specific inquiry includes:
 1. A list of litigation and claims.
 2. Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
 3. A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

Note: In certain circumstances, the auditor also may judge it necessary to meet 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:

- The auditor determines that the matter is a **significant risk**.
- The **matter is complex**.
- There is disagreement 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.

Q3**UNDERSTANDING OF THE METHODS**

- (a) Obtain an understanding of the **methods** used by management in determining segment information, and **(Note 1)**
- Evaluating whether such methods are likely to result in disclosure in accordance with **AFRF**
- Where appropriate, **testing** the application of such methods
- (b) Performing **analytical procedures or other audit procedures** appropriate in the circumstances

NOTE 1:

- Depending on the circumstances, 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 AFRF include:
 - Sales, transfers and charges between segments, and elimination of inter-segment amounts.
 - Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
 - The allocation of assets and costs among segments.
 - Consistency with prior periods, and the adequacy of disclosures

SA 510

INITIAL AUDIT ENGAGEMENT

Q1 WHAT IS AN INITIAL AUDIT ENGAGEMENT?

Initial audit engagement are the one in which either

The financial statements for
the prior period were
not audited

The financial statements for
the prior period **were**
Audited by a predecessor auditor

Q2 AUDIT PROCEDURE FOR OBTAINING SAAE REGARDING OB

The auditor shall obtain SAAE by  (BAP)

- B → Closing balance of the preceding periods have been correctly brought forward to current period
- A → Determining whether the opening balances reflect the application of appropriate accounting policies
- P → Performing one or more of the following:
 - (i) Where the prior year FS were audited, perusing the copies of the audited FS including the other relevant documents relating to the prior period FS; Ordinarily, the current auditor can place reliance on the closing balances contained in the FS for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.
 - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements



The auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statement



If the auditor concludes that such material misstatements exist in the current period's financial statements



The auditor shall communicate the misstatements with the appropriate level of management and TCWG

Q3 NTE OF PROCEDURE ON OPENING BALANCE

The NTE of audit procedures necessary to obtain SAAE regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's FS.
- The significance of the opening balances relative to the current period's FS.
- Whether the prior period's FS were audited and, if so, whether the predecessor auditor's opinion was modified

Q4 AUDIT PROCEDURE FOR CURRENT ASSETS & LIAB

- For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures.
- For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.
- In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period.
- Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- (i) Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- (ii) Performing audit procedures on the valuation of the opening inventory items.
- (iii) Performing audit procedures on gross profit and cut-off.

Q5**AUDIT PROCEDURE FOR NON CURRENT ASSETS & LIAB**

- For non-current assets and liabilities, such as property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances.
- In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments.
- In other cases, the auditor may need to carry out additional audit procedures.

Q6**REPORTING****Case 1:**

- If the auditor concludes that
- the OB 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

Case 2:

- If the auditor concludes that/:
- The current periods accounting policies are not consistently applied in relation to opening balances in accordance with the AFRF; or
- A change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the AFRF, the auditor shall express a Q/A opinion

Case 3:

- If the auditor is unable to obtain SAAE regarding the opening balances,
- the auditor shall express a qualified opinion or a disclaimer of opinion

Q7 OBJECTIVES

As per SA 510, "Initial Engagement- Opening balances" the objective of the auditor with respect to the opening balances is to obtain SAAE about whether:

- (a) Opening balances contain misstatements that materially affect the current period's FS; and
- (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's FS, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the AFRF.



SA 520

ANALYTICAL PROCEDURES

ANALYTICAL PROCEDURE SA 520

Substantive (Risk assessment in SA 315)

Q1 MEANING

- Evaluation of **Financial Info**
- Through analysis of **plausible relationship**
- Among both **financial & non financial data**

Analytical Procedures may be segregated into the following major types:

- as 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.

Q2 TIMING OF ANALYTICAL PROCEDURES



ANALYTICAL PROCEDURES AT PLANNING PHASE:

- In the planning stage, AP assist the auditor in understanding the client's business and in identifying areas of **potential risk**.
- This information will assist the auditor in determining the **NTE** of his other audit procedures.
- AP in planning the audit use both **financial data and non-financial information**, such as number of employees, square feet of selling space, volume of goods produced and similar information.

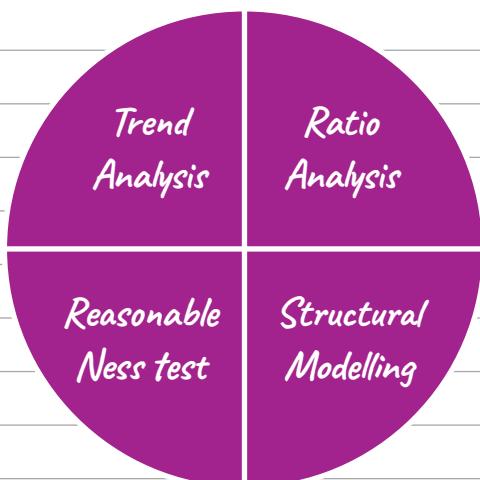
Q3 FACTORS TO BE CONSIDERED FOR SAP



(PADNIS)

- P** → **Predictability:** SAP are more appropriate when an account balance or relationships between items of data are predictable (e.g., GP ratio).
- A** → **Availability of data:** The availability of reliable and relevant data will facilitate effective analytical procedures.
- D** → **Disaggregation:** The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements.
- N** → **Nature of Assertion:** SAP may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations).
- I** → **Inherent risk:**
 - When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the ROMMS in order to determine if a substantive analytical procedure can be used to obtain audit evidence.
 - When inherent risk is **higher**, we may design TOD to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from SAP is unlikely to be sufficient.
- S** → **Source:**
 - Some classes of transactions tend to be more predictable because they consist of numerous, similar transaction.
 - Whereas the transactions recorded by **non-routine** and estimation significant classes of transactions are often subject to management judgement and therefore more difficult to predict.

Q4 TECHNIQUES FOR SAP



1. Loan : 10cr
Int: 2L
2. Fixed Assets: 100cr
Depⁿ: 70cr
3. Real estate:
Brokeage : 1%
: 7%

Q5 ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS



- (R) → Evaluate reliability of data (Note 1)
- (E) → Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement. (Note 2)
- (D) → Determine the amount of any difference of recorded amounts from expected value that is acceptable without further investigation (Note 3)
- (S) → Determine suitability of a particular SAP for a given assertion taking account of the assessed ROMMS and TOD, if any, for these assertions (Note 4)

NOTE 1: EXTENT OF RELIANCE ON ANALYTICAL PROCEDURE:

- (N) → Nature & relevance of info. For ex, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- (S) → Source of information available. For ex, information may be more reliable when it is obtained from independent sources outside the entity;
- (C1) → Comparability of the information available. . For ex, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- (C2) → Controls over the preparations of the information that are designed to ensure its completeness, accuracy and validity. Eg, controls over the preparation, review and maintenance of budgets.

NOTE 2: EVALUATION OF WHETHER THE EXPECTATION IS SUFFICIENTLY PRECISE

- (P) → The accuracy with which the expected results of substantive analytical procedures can be predicted.
- (A) → The availability of the information, both financial and non-financial.
- (D) → The degree to which information can be disaggregated.

NOTE 3: AMOUNT OF DIFFERENCE OF RECORDED AMOUNTS FROM EXPECTED VALUES THAT IS ACCEPTABLE

The auditor's determination of the amount of difference from the expectation that can be accepted without further investigation is influenced by

- materiality and
- the consistency with the desired level of assurance

NOTE 4: SUITABILITY OF PARTICULAR ANALYTICAL PROCEDURES FOR GIVEN ASSERTIONS

1. SAP are generally more applicable to **large volumes of transactions** that tend to be predictable over time.
2. The application of planned AP is based on the expectation that **relationships among data exist and continue** in the absence of known conditions to the contrary.
3. However, the suitability of a particular AP will depend upon the auditor's assessment of **how effective** it will be in detecting a misstatement.
4. In some cases, even an **unsophisticated predictive model** may be effective as an AP.
Examples: Wages, gross profit ratio, etc

Q6 INVESTIGATING RESULTS OF ANALYTICAL PROCEDURE

- (i) Inquiring of management & obtaining appropriate AE for the same
- (ii) Performing other audit procedures as necessary in the circumstances:
The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Q7 OBJECTIVES

- To obtain **relevant and reliable AE** when using SAP ; and
- To design and perform AP near the end of the audit that assist the auditor when forming an overall conclusion

Q8 PURPOSE OF ANALYTICAL PROCEDURES

- Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.
- On verifying the balances of sundry account receivables by obtaining the **confirmation of their statements of account**, it will be possible for the auditor to find out whether the **discrepancy** in the balance of an account receivable is due to the **failure to debit his account** with the cost of goods supplied to him or is the result of **non-adjustment** of a remittance received from him.
- Also whether in the case of **account payable**, the **discrepancy** is due to failure to afford him **credit for one or more consignments** of goods supplied by him or failure to **debit him with an amount of remittance**.

- In case of **inventories** of raw materials and stores at the end of the year any excesses or shortages therein shall be **detected**. The investigation of their causes might disclose that the shortages were the result of a **misappropriation of inventory** or that the excess were due to requisitions having been entered before the inventories were issued.
- By reconciling the amounts of **interest** and **dividends** collected with the amounts which had **accrued due** and that which are **outstanding for payment**, the mistake, if any, in the **adjustment of such an income** would be detected.
- The overall tests can be extended for making **inter-firm** and **intra-firm** comparison of **trading results**.



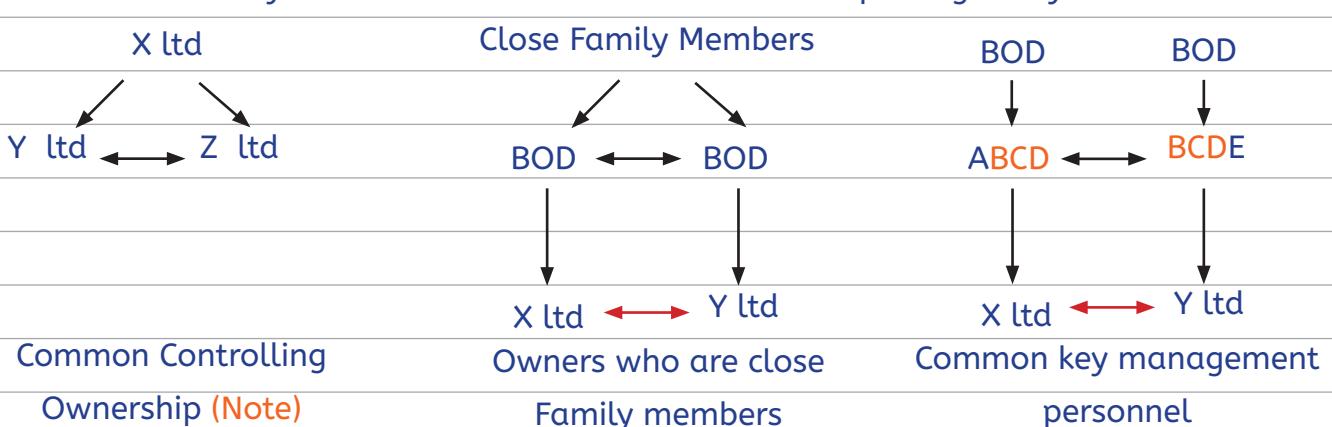
SA 550

RELATED PARTIES

Q1 MEANING

- (i) A related party as defined in the AFRF.
- (ii) Where the AFRF establishes minimal or no related party requirements

1.	PERSON	X LTD	PERSON	PERSON
	Y LTD	Y LTD	X LTD	X LTD
	a person	+ or entity has	+ directly	+ through one or more
		control or significant	or indirectly	intermediaries over
		influence		the reporting entity
2.	Y LTD		Y LTD	Y LTD
			X LTD	X LTD
			Z LTD	Z LTD
	Another entity	+ over which reporting entity has control or significant influence	+ directly or indirectly	+ directly or indirectly
				Through one or more intermediaries



Note: However, entities that are under common control by a state (i.e National, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

Gujarat Govt



Note 1: Meaning of control and significant influence in reference to related party

Many financial reporting frameworks discuss the concepts of control and significant influence. They generally explain that:

- Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and
- Significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.

The existence of the following relationships may indicate the presence of control or significant influence:

- Direct or indirect equity holdings or other financial interests in the entity.
- The entity's holdings of direct or indirect equity or other financial interests in other entities.
- Being part of those charged with governance or key management (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
- Being a close family member of any person referred to in subparagraph (iii).
- Having a significant business relationship with any person referred to in subparagraph (iii).

Note 2: Meaning of Related Parties with Dominant Influence

Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behaviour is relevant when identifying and assessing the risks of material misstatement due to fraud.

Note 3: Meaning of Special-Purpose Entities as Related Parties

In some circumstances, a special-purpose entity may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special purpose entity's equity.

Q2 RISK ASSOCIATED WITH RELATED PARTY RELATIONSHIPS & TRANSACTIONS:(CIM)

- (i) A related party may operate through extensive and **complex relationships** and structures, with a corresponding increase in the complexity of RPT
- (ii) **Information systems may be ineffective** at identifying or summarizing transactions and outstanding balances between an entity and its parties
- (iii) RPT may not be conducted under **normal market terms** and conditions.

Q3 UNDERSTANDING THE ENTITY'S RELATED PARTY RELATIONSHIPS AND TRANSACTIONS

- (1) The **identity of the entity's related parties**, including changes from the prior period
- (2) The **nature of the relationships** between the entity and these related parties
- (2) Whether the entity entered into **any transactions** with these related parties during the period, and if so, the **type and purpose of the transactions**.

5. Evaluating accounting system and

3. Related internal controls:

Identify, account for, and disclose related party relationships and transactions in accordance with the AFRF

Authorize and approve

- significant transactions and arrangements with related parties
- and outside the normal course of business.

Q4 CONSIDERATIONS FOR SMALL ENTITIES

- Control environment in **smaller entities** is likely to be different from larger entities.
- In particular TCWG **may not include an outside member**, and the role of governance may be undertaken **directly by the owner-manager** where no other owner exists.
- Control activities in smaller entities are **likely to be less formal** and smaller entities may have no documented processes for dealing with related party relationships and transactions.
- An **owner-manager** may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions.
- For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, **through inquiry of management combined with other procedures**, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

Q5 DOCUMENTS TO IDENTIFY RELATED PARTY

During the audit, the auditor may inspect records or documents that may provide information about RPR & RPT, for example:



(SIR CIA ROL)

- S** → Shareholder registers to identify the entity's principal shareholders.
- I** → Entity income tax returns.
- R** → Information supplied by the entity to regulatory authorities.
- C** → Statements of conflicts of interest from management and those charged with governance.
- I** → Records of the entity's investments and those of its pension plans.
- A** → Contracts and agreements with key management or those charged with governance.
- R** → Significant contracts re-negotiated by the entity during the period.
- O** → Significant contracts and agreements not in the entity's ordinary course of business.
- L** → Life insurance policies acquired by the entity.

SA 500

AUDIT EVIDENCE

Q1 MEANING OF AUDIT EVIDENCE AS PER SA 500

Audit evidence is **Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based**

It includes both information contained in the accounting records underlying the financial statements and other information

(1) **Information contained in the accounting records**

Accounting records include

- the records of initial accounting entries and supporting records, such as cheques and records of electronic fund transfers;
- invoices;
- contracts
- the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and
- records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

(2) **Other information 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

- minutes of the meetings,
- written confirmations from trade receivables and trade payables,
- manuals containing details of internal control etc.

Q2 TYPE OF EVIDENCE

(a) Depending upon nature:

(b) Depending upon source:

1. Visual: For example, observing physical verification of inventory conducted by the client's staff.	1. Internal Evidence: Evidence which originates within the organisation being audited is internal evidence.
2. Oral: For example, discussion with the management and various officers of the client.	Example: Sales invoice, Copies of sales challan and forwarding notes, goods received note, inspection report, copies of cash memo, debit and credit notes, etc.
3. Documentary: For example, fixed deposit certificate, loan agreement, sales bill etc.	2. External evidence: The evidence that originates outside the client's organization

challan and forwarding notes, goods received note, inspection report, copies of cash memo, debit and credit notes, etc.

External evidence: The evidence that originates outside the client's organization is external evidence.

Example: Purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.



and forwarding note, debit notes
notes coming from parties,
confirmations, etc.

Note 1:

1. The external evidence is generally considered to be more reliable as they come from third parties who are not normally interested in manipulation of the accounting information of others.
2. However, if the auditor has any reason to doubt the independence of any third party who has provided any material evidence e.g. an invoice of an associated concern, he should exercise greater vigilance in that matter.
3. As an ordinary rule, the auditor should try to match internal and external evidence as far as practicable.
4. Where external evidence is not readily available to match, the auditor should see as to what extent the various internal evidences corroborate one another.

Q3

RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE

The quality of all audit evidence is affected by the relevance and Reliabilty of the information upon which it is based.

RELEVANCE AND RELIABILITY OF RELEVANA AUDIT EVIDENCE

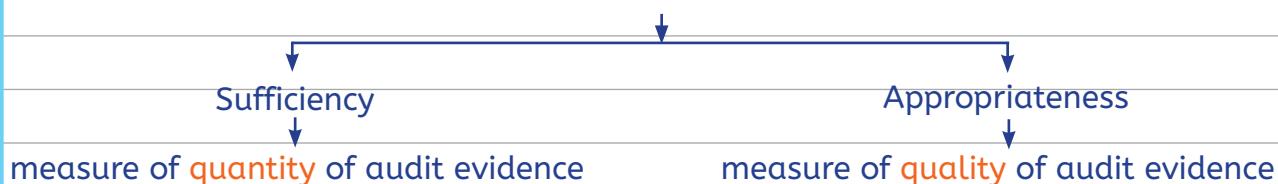
- (1) **Relevanace:** Relevance deals with the logical connection.
- (2) **Reliable:** The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant.

Note 1: The following generalisations about the reliability of audit evidence may be useful:

- (i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (ii) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- (iii) Audit evidence obtained directly 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).
- (iv) Audit evidence in documentary form, 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).
- (v) Audit evidence obtained as original documents is more reliable than audit evidence obtained as photocopies.

Q4

SUFFICIENCY AND APPROPRIATENESS ARE INTERRELATED



Note 1: Auditor's judgement as to **sufficiency** may be affected by the factors such as:

Factors affecting auditor's judgement as to sufficiency of audit evidence



(a) 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.

(b) 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.

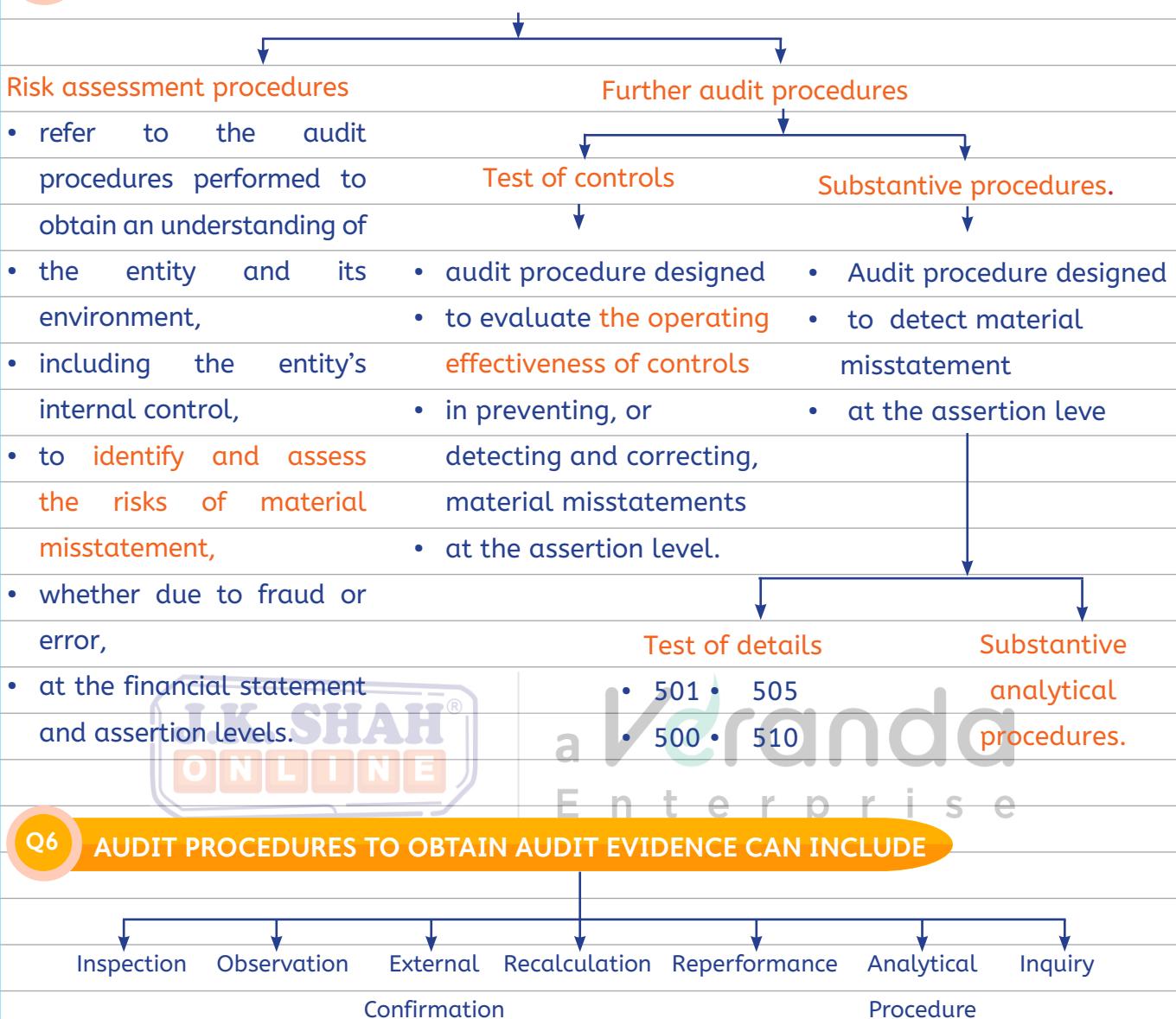
- **Control risk** – The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.

- 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.

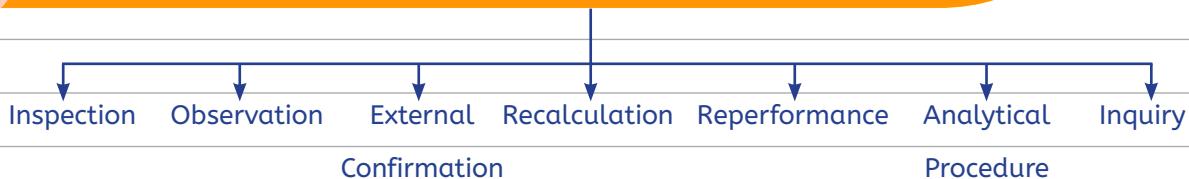
(c) Size & characteristics of a population:

- 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.

Q5 AUDIT PROCEDURES FOR OBTAINING AUDIT EVIDENCE



Q6 AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE CAN INCLUDE



(i) Inspection

- 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.
- Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.
- An 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 a stock or bond.
- Inspection of such documents may not necessarily provide audit evidence about ownership or value.

- In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.
- Inspection of individual inventory items may accompany the observation of inventory counting.

(ii) Observation

- Observation consists of looking at a process or procedure being performed by others.
- Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

(iii) External Confirmation

- An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

(iv) Recalculation

- Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

(v) Reperformance

- Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control

(vi) Analytical Procedures

- Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.
- Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information.

(vii) Inquiry

1. Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.
2. Inquiry is used extensively throughout the audit in addition to other audit procedures.
3. Inquiries may range from formal written inquiries to informal oral inquiries.
4. Evaluating responses to inquiries is an integral part of the inquiry process.

5. Responses to inquiries may provide the auditor with **information not previously possessed** or with corroborative audit evidence.
6. Alternatively, responses might provide information that **differs significantly from other information** that the auditor has obtained,
7. In some cases, **responses to inquiries** provide a basis for the auditor to **modify or perform additional** audit procedures.

Note 1:

1. 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.
2. In respect of **some matters**, the auditor may consider it necessary to **obtain written representations from management**
3. 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.

Q7

ASSERTIONS

- 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.

ASSERTIONS

Classes of transactions and events	Account balances	Presentation and Disclosure
• Occurrence	• Existence	• Occurrence and rights and obligations
• Completeness	• Rights and obligations	• Completeness
• Accuracy	• Completeness	• Classification and understandability
• Cut - Off	• Valuation and allocation	• Accuracy and valuation
• Classification		

(a) **Assertions about classes of transactions and events for the period under audit:**

(i) **Occurrence** – transactions and events that have been recorded have occurred and pertain to the entity.

- (ii) **Completeness** – all transactions and events that should have been recorded have been recorded.
- (iii) **Accuracy** – amounts and other data relating to recorded transactions and events have been recorded appropriately.
- (iv) **Cut-off** – transactions and events have been recorded in the correct accounting period.
- (v) **Classification** – transactions and events have been recorded in the proper accounts.

- (b) **Assertions about account balances at the period end:**
 - (i) **Existence** – assets, liabilities, and equity interests exist.
 - (ii) **Rights and obligations** – the entity **holds** or controls the **rights** to assets, and liabilities are the **obligations** of the entity.
 - (iii) **Completeness** – all assets, liabilities and equity interests that should have been recorded have been recorded.
 - (iv) **Valuation and allocation** – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

- (c) **Assertions about presentation and disclosure:**
 - (i) **Occurrence and rights and obligations** – disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - (ii) **Completeness** – all disclosures that should have been included in the financial statements have been included.
 - (iii) **Classification and understandability** – financial information is appropriately presented and described, and disclosures are clearly expressed.
 - (iv) **Accuracy and valuation** – financial and other **information** are disclosed fairly and at appropriate amounts.

Note 1 : Explicit assertions

Explicit assertions are made when otherwise the reader will be left with an incomplete picture; it may even be misleading.

- An example of the former category may be found in the following items appearing in the liability side of the balance sheet:

Secured Loans ₹ 4,00,000

The description does not give us a complete picture. We do not know:

- (i) the name of the lender, if it is relevant;
- (ii) the nature of security provided; and

(iii) the rate at which interest is payable.

A specific mention is required about these things for a proper appreciation of the item and the financial position.

10% Bank of India loan (P & M hypothecated) 4,00,000

Note 2: Negative assertions

- 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 **no contingent liability** it would be an **expressed negative assertion**;

- On the other hand, if in the balance sheet there is **no item as "building"**, it would be an **implied negative assertion** that the entity did not own any building on the balance sheet date.

Q8 AUDIT TRAIL

- An audit trail is a **documented flow** of a transaction.
- It is used to **investigate how** a source document was translated into an account entry and from there it was inserted into financial statement of an entity.
- It is used as audit evidence to establish **authentication and integrity** of a transaction.
- Audit trails help in **maintaining record of system** and user activity.
- Like, in case of banks, there is an **audit trail** keeping track of **log-on activity** detailing record of log-on attempts and device used.
- It is a **step-by-step record** by which **accounting, trade details, or other financial data** can be traced to their source.
- Audit trails are used to verify and track many **types of transactions** including accounting and financial transactions.
- Audit trails (or audit logs) act as **record-keepers** that document evidence of **certain events**, procedures or operations, because their purpose is to **reduce fraud, material errors, and unauthorized use**.
- Audit trails help to enhance **internal controls** and data security.
- Audit trails can help in **fixing responsibility**, rebuilding events and in thorough analysis of problem areas.
- These can also be used to **rebuild events** upon occurring of some problem.

- Audit trail analysis can specify reason of the problem.
- It can also help in ensuring operation of system as intended.
- In this way, audit trails can help entities in their regular system operations.
- However, audit trails **involve costs**.
- The cost is not only in terms of system expenditure but also **in terms of time involved** in analysing data made available by audit trails.
- However, use of automated tools can be made to **analyse large volume of data** thrown up by audit trails
- Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not.
- It aids in verification whether a transaction was indeed performed by a person authorised to do it.
- Since audit trails also **enhance data security**, these can be used by auditor while performing audit procedures thus **increasing reliability of audit evidence**.

Q9

USING WORK OF MANAGEMENT EXPERTS WORK

ONLINE

NOTE 1: RELYING ON WORK OF MANAGEMENT'S EXPERT:

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**.

- 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;
- (a) Evaluate the competence, capabilities and objectivity of that expert;
- (b) Obtain an understanding of the work of that expert; and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

NOTE 2: THE NATURE OF TIMING (PK T IC N2A RE)

- P** → The auditor's **previous experience of** the work of that expert.
- K** → The auditor's **knowledge and experience of** the management's expert's field of expertise.

- (T) → Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- (I) → The extent to which management can exercise control or influence over the work of the management's expert.
- (C) → The nature and extent of any controls within the entity over the management's expert's work.
- (N1) → The nature and complexity of the matter to which the management's expert relates.
- (N2) → The nature, scope and objectives of the management's expert's work.
- (A) → The availability of alternative sources of audit evidence.
- (R) → The risks of material misstatement in the matter.
- (E) → Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.

Q10 INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE

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

Q11 EVALUATION OF AUDIT EVIDENCE

- SA 500 "Audit Evidence" is applicable to all the audit evidence obtained during the course of the audit 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.
- Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
- The auditor has to conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.

SA 610

USING THE WORK OF
INTERNAL AUDITORS

Q1 DEFINITION OF INTERNAL AUDIT FUNCTION

- The objectives and scope of internal audit functions
- typically include assurance and consulting activities designed
- to evaluate and improve the effectiveness of

Activities Relating to Governance Activities Relating to Risk Management Activities Relating to Internal Control

(1) Activities Relating to Governance

The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

(2) Activities Relating to Risk Management

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

(3) Activities Relating to Internal Control

- **Evaluation of internal control.** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control.

- **Examination of financial and operating information.** 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.
- **Review of operating activities.** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
- **Review of compliance with laws and regulations.** 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.

Q2 WAYS IN WHICH THE EXTERNAL AUDITOR MAY MAKE USE OF THE FUNCTION FOR PURPOSES OF THE AUDIT

- (i) To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud.
- (ii) Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.
- (iii) Unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor (referred to as "direct assistance")

Q3 SCOPE OF SA 610

Standard on Auditing (SA) 610 deals with the external auditor's responsibilities if using the work of internal auditors.

This includes

- (a) using the work of the internal audit function in obtaining audit evidence and
- (b) using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

Q4 EXTERNAL AUDITOR'S RESPONSIBILITY FOR THE AUDIT

- The external auditor has **sole responsibility** for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the **internal audit function** or internal auditors to **provide direct assistance** on the engagement.
- Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors **are independent of the entity** as is required of the external auditor in an audit of financial statements in accordance with SA 200.
- This SA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors.

Q5 OBJECTIVES OF THE EXTERNAL AUDITOR, WHERE THE ENTITY HAS AN INTERNAL AUDIT FUNCTION

- The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination

(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) If using internal auditors to provide direct assistance, to appropriately supervise and review their work.

Q6 EVALUATING THE INTERNAL AUDIT FUNCTION

- The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

Note 1:

(A) The extent to which the internal audit function's **organizational status** and relevant policies and procedures support the **objectivity** of the internal auditors;

Note 2:

(B) The level of **competence** of the internal audit function; and

Note 4:

(C) Whether the internal audit function applies a **systematic and disciplined approach**, including **quality control**.

Note 1: A Objectivity and its evaluation

Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.

Factors that may affect the external auditor's evaluation in relation to Objectivity include the following:

1. Whether the **organizational status of** the internal audit function, including the function's authority and accountability, supports the ability of **the function to be free from bias, conflict of interest or undue influence of others to override professional judgments**
2. Whether **those charged with governance oversee employment decisions related to** the internal audit function.
3. Whether there are **any constraints or restrictions placed on** the internal audit function by management or those charged with governance, for example, in communicating the internal audit function's findings to the external auditor.
4. Whether the internal audit function is **free of any conflicting responsibilities**, for example, having managerial or operational duties or responsibilities that are outside of the internal audit function.

Note 2: Competence and its evaluation

Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.

Factors that may affect the external auditor's determination in relation to competence include the following:

1. Whether the internal audit function is **adequately and appropriately resourced** relative to the size of the entity and the nature of its operations.
2. Whether there are **established policies for hiring, training and assigning internal auditors to internal audit engagements**.
3. Whether the internal auditors have **adequate technical training and proficiency in auditing**.
4. Whether the internal auditors possess the required **knowledge relating to the entity's financial reporting and the applicable financial reporting framework**.

Note 3: Objectivity and competence may be viewed as a continuum.

1. Objectivity and competence may be viewed as a continuum.
2. The more the internal audit function's organizational status and relevant policies and procedures adequately support the **objectivity** of the internal auditors and the higher the level of **competence of the function**, the more likely the external auditor may make use of the work of the **function and in more areas**.
3. However, an organizational status and relevant policies and procedures that provide strong support for the **objectivity** of the internal auditors cannot **compensate for the lack of sufficient competence** of the internal audit function.
4. Equally, a high level of **competence of the internal audit function** cannot **compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors**.

Note 4: Application of a Systematic and Disciplined Approach

The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.

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

1. The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
2. Whether the internal audit function has **appropriate quality control policies and procedures**.

Q7**CIRCUMSTANCES WHEN WORK OF THE INTERNAL AUDIT FUNCTION CANNOT BE USED**

The external auditor shall not use the work of the internal audit function if the external auditor determines that:

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

Q8

EXAMPLES OF WORK OF THE INTERNAL AUDIT FUNCTION THAT CAN BE USED BY THE EXTERNAL AUDITOR INCLUDE THE FOLLOWING

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

Q9

CIRCUMSTANCES IN WHICH THE EXTERNAL AUDITOR SHALL PLAN TO USE LESS OF THE WORK OF THE INTERNAL AUDIT FUNCTION AND PERFORM MORE OF THE WORK DIRECTLY

The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly if:

 (JOLA)

- J → The more **judgment** is involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;
- A → The higher the **assessed risk of material misstatement** at the assertion level, with special consideration given to risks identified as significant;
- O → The less the internal audit function's organizational status and relevant policies and procedures adequately support the **objectivity** of the internal auditors; and
- L → The lower the **level of competence** of the internal audit function.

Q10

USING THE WORK OF THE INTERNAL AUDIT FUNCTION

If the external auditor plans to use the work of the internal audit function, the external auditor shall

- (A) **discuss the planned use of its work with** the function as a basis for coordinating their respective activities.
- (B) **read the reports of the internal** audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the **nature and extent of audit procedures** it performed and the related findings.
- (C) **perform sufficient audit procedures on the body** of work of the internal audit function as a whole that the external auditor plans to use to determine its **adequacy** for purposes of the audit.

Discussion and Coordination with the Internal Audit Function

In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:

1. The **timing** of such work.
2. The **nature** of the work performed.
3. The **extent** of audit coverage.
4. **Materiality** for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality.
5. **Proposed methods of item selection and sample sizes.**
6. **Documentation** of the work performed.
7. **Review and reporting procedures.**

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

1. Discussions take place at appropriate intervals throughout the period.
2. The **external auditor informs the internal audit function of significant matters that may affect the function.**
3. The **external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters** that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Q11

DETERMINING WHETHER, IN WHICH AREAS, AND TO WHAT EXTENT INTERNAL AUDITORS CAN BE USED TO PROVIDE DIRECT ASSISTANCE

Direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

1. The external auditor **may be prohibited by law or regulation** from obtaining direct assistance from internal auditors.
2. If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of **threats to objectivity and the level of competence of the internal auditors** who will be providing such assistance. The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall

include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

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

- (a) There are significant threats to the objectivity of the internal auditor; or
- (b) The internal auditor lacks sufficient competence to perform the proposed work.

The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- (a) Involve making significant judgments in the audit;
- (b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
- (c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- (d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

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

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

Q12 BASICS OF INTERNAL FINANCIAL CONTROL AND REPORTING REQUIREMENTS

You have already read about basics of Internal Financial Control and regulatory/reporting requirements in Chapter 3 in detail. Now, we shall understand distinction between Internal Financial Control and Internal Control over financial reporting.

Distinction between Internal Financial Control and Internal Control over financial reporting:

The term Internal Financial Controls (IFC) 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 and prevention and detection of frauds.

On the other hand, Internal controls over financial reporting is required where auditors are required to express an opinion on the effectiveness of an 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.

Therefore, "internal financial control" is a wider term where as "internal controls over financial reporting" is a narrower term restricted to entity's internal controls over financial reporting only.



6**AUDIT DOCUMENTATION****CONTENTS**

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Q3	Nature of Audit Documentation
Q4	Purpose of Audit Documentation
Q5	The Form, Content & Extent Of Audit Documentation
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Q7	Audit File
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Q9	Ownership & Retention Of Audit Documentation
Q10	Assembly & Retention of The Final Audit File
Q11	Completion Memorandum

Q1 MEANING

- The **record** of audit procedures performed,
- Relevant **audit evidence** obtained,
- And **conclusions** the auditor reached

STATE EXAMPLES OF AUDIT DOCUMENTATION:

1. Audit programme.
2. Engagement letter.
3. External confirmations
4. Copies of written representations given by management & TCWG
5. Audit Checklist
6. Significant matters Communicated to the client.
7. copies of correspondence with experts & another auditor
8. Analysis of significant ratios& trends.

Q2 OBJECTIVE OF THE AUDITOR

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

Q3 NATURE OF AUDIT DOCUMENTATION

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**.

Q4 PURPOSE OF AUDIT DOCUMENTATION



- F** → Retaining a record of matters of continuing significance to **Future audit**.
- A** → Enabling the engagement team to be **accountable** for its work.
- D** → Direct & Supervise audit work
- P** → Assisting the engagement team to **plan & perform** the audit.

- I** → Enabling the conduct of quality control reviews & **inspections**
- E** → Enabling the conduct of **external Inspection** in accordance with applicable legal requirements

Q5 THE FORM, CONTENT & EXTENT OF AUDIT DOCUMENTATION



(I Need DRS)

- I** → document how the auditor addressed the **inconsistency** to resolve the doubts as identified during the course of audit
- N** → the **nature, timing and extent** of the audit procedures performed to comply with the **SA**s and applicable legal and regulatory requirements. In documenting this, the auditor shall record:
 1. Identifying **characteristics** of the specific items or matters tested
 2. **Who performed** the audit work and the **date** such work was completed
 3. **Who reviewed** the audit work performed and the **date and extent** of such review
- D** → document **discussions** of significant matters with the **management**, those charged with **governance**, and **others**, including the nature of the significant matters discussed and **when** and with **whom** the discussions took place.
- R** → the **result** of the audit procedures performed, and the audit evidence obtained
- S** → **significant matters** arising during the audit, the conclusions reached thereon, and **significant professional judgements** made in reaching those conclusions.

Note 1: SIGNIFICANT MATTERS

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.

- (1) Results of audit procedures indicating (a) that the financial statements could be **materially misstated**, or (b) a need to revise the auditor's previous assessment of the **risks of material misstatement** and the auditor's responses to those risks.
- (2) Circumstances that cause the auditor **significant difficulty** in applying necessary audit procedures.
- (3) 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.
- (4) An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of **professional judgement** **exercised** in performing the work and evaluating the results.

Note 2:

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

1. 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.
2. The basis for the auditor's conclusion on the **reasonableness of areas of subjective judgements** (for example, the reasonableness of significant accounting estimates).
3. 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.

Q6 FACTORS AFFECTING THE FORM, CONTENT & EXTENT OF AUDIT DOCUMENTATION

(Neha & Neetu MISS)

- (N) → Nature of Audit procedures to be performed
- (N) → Nature and extent of exceptions identified
- (M) → The audit **methodology** and tools
- (I) → The identified risk of MMS
- (S) → The size & complexity of the entity.
- (S) → The significance of audit evidence obtained.

Q7 AUDIT FILE

One or more folders or other storage media



In physical or electronic form, containing the record that comprise



The audit documentation for a specific engagement

Q8 WORKING PAPER FILES

PERMANENT AUDIT FILE

It contains matters which don't change very often.

EXAMPLES: (SLAM)

S → significant audit observation of earlier years.

L → legal documents ,agreement & Minutes relevant to the audit.

A → Analysis of significant ratios & trends

M → MOA & AOA

CURRENT AUDIT FILE

It contains matters relating to audit of single period.

EXAMPLES: (LIEN)

L → Letter of representation or confirmation received from the client.

I → Important Matter in Minute of BM & GM.

E → Evidence of the planning process of audit & audit programme.

N → Nature, timing & extent of auditing procedures.

Q9 OWNERSHIP & RETENTION OF AUDIT DOCUMENTATION

- As per SQC- 1 audit documentation is the property of the auditor.
- 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 engagement, the independence of the auditor or his personnel. (i.e our papers should not be subject to undue scrutiny)

Q10 ASSEMBLY & RETENTION OF THE FINAL AUDIT FILE

- As per SQC- 1 complete assembly of the final audit file within 60 days after 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
- As per SQC- 1 he should retain documentation for at least 7 years from date of auditor's report, or if later, the date of group auditor's report
- 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 relevant members of the engagement team before the date of the auditor's report.

Q11 COMPLETION MEMORANDUM

- (i) The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary
- (ii) It describes:
 - The significant matters identified during the audit
 - How they were addressed
- (iii) Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist 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.

7

COMPLETION AND REVIEW

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Q4	Communication and correction of misstatements
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Q6	Written representation from management regarding effects of uncorrected statements
Q7	Documentation regarding misstatements identified during audit

SA 560

SUBSEQUENT EVENTS

Q1 DEFINITION

Events occurring between the date of the FS and the date of the auditor's report.

Facts that become known to the auditor after the date of the auditor's report are known as subsequent events.

Q2 OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 560

The objectives of the auditor are to:

(a) Obtain SAAE about whether events occurring between the date of the FS and the date of the auditor's report that require adjustment of, or disclosure in, the FS are appropriately reflected in those FS and

(b) Respond appropriately to facts that become known to the auditor after the date of the auditor's report.

Q3 AUDIT PROCEDURES RELATING TO EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITOR'S REPORT

The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

- (1) Inquiring of management and, where appropriate, TCWG as to whether any subsequent events have occurred which might affect the FS.
- (2) Reading the entity's latest subsequent interim FS, if any.
- (3) Reading minutes, if any, of the meetings, of the entity's owners, management and TCWG, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (4) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

The auditor shall request management and, where appropriate, TCWG to provide a

written representation in accordance with **SA 580, "Written Representations"** that all events occurring subsequent to the date of the FS and for which the AFRF requires adjustment or disclosure have been adjusted or disclosed.

Q4

MEANING OF "DATE THE FINANCIAL STATEMENTS ARE ISSUED"

- It reflects the date that the auditor's report and audited FS are made available to third parties.
- The date the FS are issued generally depends on the **regulatory environment** of the entity.
- In some circumstances, the date the FS are issued may be the date that they are filed with a regulatory authority.
- Since audited FS cannot be **issued** without an **auditor's report**, the date that the audited FS 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.

Q5

FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FS ARE ISSUED

(A) Introduction:

- The auditor has no obligation to perform any audit procedures regarding the FS after the date of the auditor's report.
- However, when, after the date of the auditor's report but before the date the FS 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:



(DIA)

- D** → **Discuss the matter with management** and, where appropriate, TCWG
- A** → **Determine whether the FS need amendment** and, if so,
- I** → **Inquire** how management intends to address the matter in the FS

(B) If management amends the financial statements, the auditor shall:

- (1) **Carry out the audit procedures necessary** in the circumstances on the amendment.
- (2) **Extend the audit procedures**, already referred, to the date of the new auditor's report and
- (3) **Provide a new auditor's report** on the amended FS.

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

(a) The auditor shall either: Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to the amendment of the FS described in the relevant note to the FS or

(b) Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the FS.

(c) Law Prohibits amendments. In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor's report.

(d) If management refuses. However, when management does not amend the FS in circumstances where the auditor believes they need to be amended, then:

(i) If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report or

(ii) If the auditor's report has already been provided to the entity, the auditor shall notify management and, unless all of TCWG are involved in managing the entity, TCWG, not to issue the financial statements to third parties before the necessary amendments have been made.

If the FS are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report.

Q6

FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED

(A) Introduction:

After the FS have been issued, the auditor has no obligation to perform any audit procedures regarding such FS. However, when, after the FS have been 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:

(a) Discuss the matter with management and, where appropriate, TCWG

(b) Determine whether the FS need amendment and, if so,

(c) Inquire how management intends to address the matter in the FS.

(B) If the management amends the FS, the auditor shall:

(a) Carry out the audit procedures necessary in the circumstances on the amendment.

(b) Review the steps taken by management to ensure that anyone in receipt of the previously issued FS together with the auditor's report thereon is informed of the situation.

(c) (i) Extend the audit procedures, already referred, to the date of the new auditor's report, and the date the new auditor's report no earlier than the date of approval of the amended FS and
(ii) Provide a new auditor's report on the amended FS.

(d) When the circumstances are such that law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the FS to the effects of the subsequent events or events causing that amendments and those responsible for approving the FS are not prohibited from restricting their approval to that amendment, amend the auditor's report, or provide a new auditor's report as already discussed.

(e) The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the FS that more extensively discusses the reason for the amendment of the previously issued FS and to the earlier report provided by the auditor.

(f) If management does not take the necessary steps to ensure that anyone in receipt of the previously issued FS is informed of the situation and does not amend the FS in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, TCWG, that the auditor will seek to prevent future reliance on the auditor's report.

(g) If, despite such notification, management or TCWG do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

SA 570

GOING CONCERN

Q1 RESPONSIBILITY OF MGT & AUDITOR

MGT

AUDITOR

Responsibility for assessment of the entity's ability to continue as a going concern:

(1) The preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

(2) 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.

(3) The following factors are relevant to that judgment:

(a) 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.

(b) 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.

(c) 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.

Responsibilities of the auditor:

(1) 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.

(2) Whether a material uncertainty exists about the entity's ability to continue as a going concern.

(3) These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

(4) 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.

(5) The auditor cannot predict such future events or conditions.

(6) 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.

Q2 OBJECTIVES

To obtain SAAE regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the FS;

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.

Q3 RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES

- 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:
 - (a) Assessment is 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
 - (b) 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

Note: The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Q4

EVENTS OR CONDITIONS THAT MAY CAST SIGNIFICANT DOUBT ON THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN

The following 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

(A) Financial events or conditions:  (FOTO CAN WAN)

- (F) → Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets
- (O) → Substantial operating losses
- (T) → Inability to comply with the terms of loan agreements
- (O) → Inability to obtain financing for essential new product development or other essential investments
- (C) → Inability to pay creditors on due dates
- (A) → Adverse key financial ratios
- (N) → Net liability or net current liability position
- (W) → Indications of withdrawal of financial support by creditors
- (A) → Arrears or discontinuance of dividends
- (N) → Negative operating cash flows indicated by historical or prospective financial statements

(B) Operating events or conditions  (MK SaL2E)

- (M) → Management intentions to liquidate the entity or to cease operations
- (K) → Loss of key management without replacement
- (L1) → Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- (L2) → Labour difficulties
- (S) → Shortages of important supplies
- (E) → Emergence of a highly successful competitor

(C) Other events or conditions  (No PUC)

- (N) → Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions
- (P) → Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
- (C) → Changes in law or regulation or government policy expected to adversely affect the entity
- (U) → Uninsured or underinsured catastrophes when they occur

Q5 EVALUATING MANAGEMENT'S ASSESSMENT

- (1) The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.
- (2) It is not the auditor's responsibility to rectify the lack of analysis by management.
- (3) In other circumstances, evaluating management's assessment of the entity's ability to continue as a going concern, may include an evaluation of the **process** management followed to make its assessment, the **assumptions** on which the assessment is based and **management's plans for future action** and whether management's plans are **feasible in the circumstances**.
- (4) In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the **same period** as that used by management to make its assessment as required by the **applicable financial reporting framework**, or by **law** or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern **covers less than twelve months** from the date of the financial statements, the auditor shall request management to extend its assessment period to **at least twelve months from that date**.

Q6 ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED

If events or conditions have been identified that may cast **significant** doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not 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 through **performing additional audit procedures**.

Note 1: Including consideration of mitigating factors.

These procedures shall include:

- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is **likely to improve the situation** and whether management's plans are **feasible in the circumstances**.
- (c) Where the **entity has prepared a cash flow forecast**, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:

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

Note 2: Examples of audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern.



(CID BRIDES)

- C** → Analysing and discussing cash flow, profit and other relevant forecasts with management
- I** → Analysing and discussing the entity's latest available interim financial statements
- D** → Reading the terms of debentures and loan agreements and determining whether any have been breached
- B** → Confirming the existence, terms and adequacy of borrowing facilities.
- R** → Obtaining and reviewing reports of regulatory actions.
- I** → Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications
- D** → Determining the adequacy of support for any planned disposals of assets.
- E** → Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds
- S** → Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern

Q7

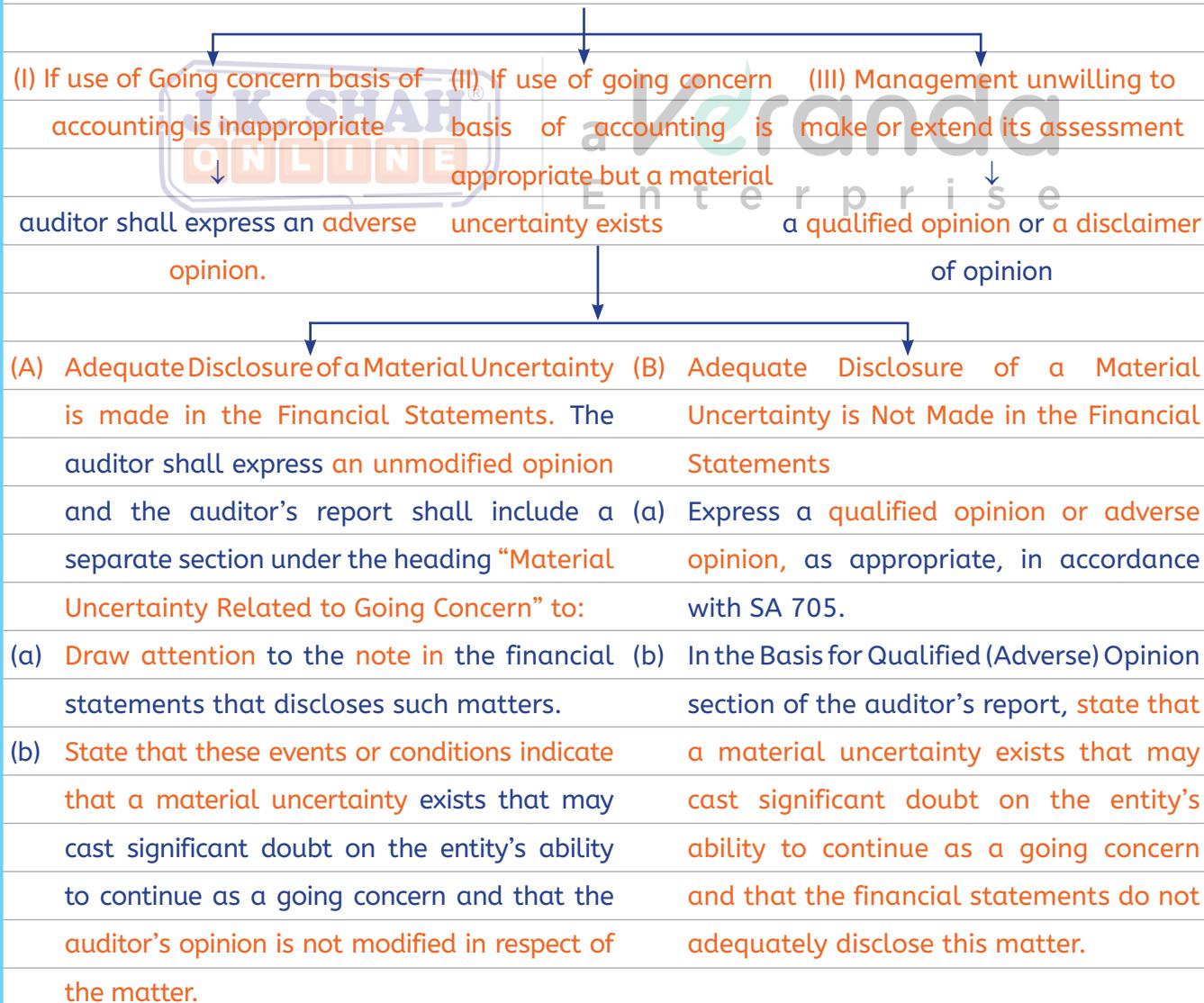
ADEQUACY OF DISCLOSURES WHEN EVENTS OR CONDITIONS HAVE BEEN IDENTIFIED AND A MATERIAL UNCERTAINTY EXISTS

If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

- (a) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and
- (b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Q8

IMPLICATIONS FOR THE AUDITOR'S REPORT



SA 580

WRITTEN REPRESENTATIONS

Q1 DEFINITION

- A written representation is a **written statement** by management provided to the auditor
- to **confirm certain matters**
- or to **support other audit evidence**.
- Written representations in this context **do not** include financial statements, the assertions therein, or supporting books and records.

Q2 WRITTEN REPRESENTATIONS AS AUDIT EVIDENCE

- (1) As per SA 500 'Audit evidence' the auditor shall obtain **sufficient and appropriate evidence**.
- (2) **Sufficiency** refer to the **quantum & appropriateness** refers to the **quality** of the evidence.
- (3) Although WR provide necessary AE, they do not provide **SAAE** on their own about any of the matters with which deal.
- (4) It can be considered just as on **additional evidence**. Thus, other evidences w.r.t specific item shall be obtained by the auditor.
- (5) As written evidence cannot be considered as a **substitute** for other audit evidences, the auditor shall also seek **corroborative evidence** from other sources whether internal or external to entity.

Q3 OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 580

The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance 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;
- (b) To **support other audit evidence relevant**

(c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

Q4

FROM WHOM WRITTEN REPRESENTATIONS ARE REQUESTED BY AUDITOR?

The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

Q5

WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES

Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas:

(a) Preparation of the financial statements

(i) The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation.

(ii) In some cases, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested.

Such individuals may include:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

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

(iv) To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations, confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations.

(b) Information provided and completeness of transactions The auditor shall request management to provide a written representation that:

- It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
- All transactions have been recorded and are reflected in the financial statements.

Q6 WHY WRITTEN REPRESENTATIONS ABOUT MANAGEMENT RESPONSIBILITIES ARE NECESSARY?

- Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities.
- The auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.
- The written representations requiring fulfilment of management responsibilities in relation to above draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them.
- The auditor may also ask management 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
 - Changes in circumstances make it appropriate to do so.

Q7 OTHER WRITTEN REPRESENTATIONS

- 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.

- Such written representations may supplement, but do not form part of, the written representation relating to management's responsibilities regarding preparation of financial statements.
- They may include representations about the following:
 - (i) Whether the selection and application of accounting policies are appropriate; and
 - (ii) Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework:
 - (a) Plans or intentions that may affect the carrying value or classification of assets and liabilities;
 - (b) Liabilities, both actual and contingent;
 - (c) Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
 - (d) Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

Q8 ADDITIONAL WRITTEN REPRESENTATIONS ABOUT INFORMATION PROVIDED TO THE AUDITOR

The auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

Q9 WRITTEN REPRESENTATIONS ABOUT SPECIFIC ASSERTIONS

When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:

- (i) The entity's past history in carrying out its stated intentions.
- (ii) The entity's reasons for choosing a particular course of action.
- (iii) The entity's ability to pursue a specific course of action.
- (iv) The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.
- (v) The auditor may consider it necessary to request management to provide written representations about **specific assertions** in the financial statements, in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion.

For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Q10 DATE OF AND PERIOD(S) COVERED BY WRITTEN REPRESENTATIONS

- (i) The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.
- (ii) The written representations shall be for all financial statements and period(s) referred to in the auditor's report.
- (iii) Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations.
- (iv) Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.
- (v) Situations may arise where current management were not present during all periods referred to in the auditor's report.

Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period.

This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole.

Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Q11 FORM OF WRITTEN REPRESENTATIONS

- (i) The written representations shall be in the form of a representation letter addressed to the auditor.
- (ii) If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required regarding management responsibilities, the relevant matters covered by such statements need not be included in the representation letter.

Q12 DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATIONS

(i) If the auditor has concerns about the

- (E) → ethical values
- (C) → competence,
- (I) → integrity,
- (D) → or diligence of management,

- or about its commitment to or enforcement of these,
- the auditor shall determine the effect that such **concerns may have on the reliability of representations and audit evidence in general**.

(ii) If written representations **are inconsistent with other audit evidence**, the auditor shall perform audit procedures to **attempt to resolve the matter**.

- If the matter remains **unresolved**, the auditor shall reconsider the assessment of the
- competence,
- integrity,
- ethical values
- or diligence of management,
- or of its commitment to or enforcement of these, and shall determine the effect that this may have on the **reliability of representations and audit evidence in general**.

(iii) If the auditor concludes that the written representations are not reliable, the auditor shall **take appropriate actions**, including determining the **possible effect** on the opinion in the auditor's report in accordance with **SA 705**, having regard to the requirement of **disclaimer of opinion**.

Q13 REQUESTED WRITTEN REPRESENTATIONS NOT PROVIDED

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



(DAR)

- (D) → **Discuss** the matter with management;
- (A) → **Take appropriate actions**, including determining the possible effect on the opinion in the auditor's report in accordance with **SA 705** having regard to the requirement of **disclaimer of opinion**.
- (R) → **Re-evaluate the integrity** of management and evaluate the effect that this may have on the **reliability of representations and audit evidence in general**; and

Q14**DISCLAIMER OF OPINION IN CASE OF NON-RELIABILITY OF WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES OR FAILURE TO PROVIDE SUCH WRITTEN REPRESENTATIONS**

The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:

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(a) The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations about management fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions are not reliable; or

(b) Management does not provide the written representations relating to fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions.

SA 260

COMMUNICATION WITH
CHARGED WITH GOVERNANCE

Q1 WHO ARE “THOSE CHARGED WITH GOVERNANCE”?

- (1) The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.
- (2) Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example, in some entities, a supervisory board exists that is separate from executive board. In other entities, both supervisory and executive functions are performed by a single board.
- (3) In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors.
- (4) In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- (5) In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.
- (6) In some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some not-for-profit organizations.
- (7) In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate.

Q2 OBJECTIVES OF AUDITOR AS PER SA 260

- To communicate clearly with TCWG the responsibilities of the auditor in relation to the FS audit, and an overview of the planned scope and timing of the audit.
- To obtain from TCWG information relevant to the audit;

- To provide TCWG with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
- To promote effective two-way communication between the auditor and TCWG

Q3

COMMUNICATION FROM AUDITOR IS IMPORTANT WITH THOSE CHARGED WITH GOVERNANCE. AN EFFECTIVE TWO-WAY COMMUNICATION IS IMPORTANT IN ASSISTING

- (a) The auditor and TCWG in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- (b) The auditor in obtaining from TCWG information 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
- (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the ROMMS of the FS.

Q4

DETERMINING APPROPRIATE PERSONS WITH WHOM TO COMMUNICATE

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate.

Q5

MATTERS TO BE COMMUNICATED BY AUDITOR

Following matters are required to be communicated by auditor with those charged with governance:

- (1) The auditor's responsibilities in relation to the financial statement audit.
 - (a) The auditor is responsible for forming and expressing an opinion on the FS that have been prepared by management with the oversight of TCWG
 - (b) The audit of the financial statements does not relieve management or TCWG of their responsibilities.
- (2) Planned scope and timing of the audit
 - The auditor shall communicate with TCWG an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.
- (3) Significant findings from the audit. The auditor shall communicate with TCWG:
 - (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and FS disclosures.

- (b) Significant difficulties, if any, encountered during the audit;
- (c) Unless all of TCWG are involved in managing the entity;
- (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
- (ii) Written representations the auditor is requesting
- (d) Circumstances that affect the form and content of the auditor's report, if any and
- (e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

Q6

COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES

In the case of listed entities, the auditor shall communicate with TCWG:

- (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and
- (b) (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity.
(ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

Q7

THE COMMUNICATION PROCESS

- (1) The auditor shall communicate with TCWG the form, timing and expected general content of communications.
- (2) The auditor shall communicate in writing with TCWG regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate.
- (3) Written communications need not include all matters that arose during the course of the audit.
- (4) The auditor shall communicate in writing with those charged with governance regarding auditor independence when required in case of listed entities.
- (5) The auditor shall communicate with those charged with governance on a timely basis

Note:

- (1) The auditor shall evaluate whether the **two-way communication** between the auditor and those charged with governance has been adequate for the purpose of the audit.
- (2) If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the **risks of material misstatement** and **ability to obtain sufficient appropriate audit evidence**, and shall take appropriate action.

Q8 DOCUMENTATION

- (1) Where matters required by SA 260 to be communicated are communicated **orally**, the auditor shall include them in the audit documentation, and **when and to whom** they were communicated.
- (2) Where matters have been communicated in **writing**, the auditor shall **retain a copy of the communication** as part of the audit documentation.

SA 265

COMMUNICATION DEFICIENCIES IN INTERNAL CONTROL TO TCWG & MANAGEMENT

Q1 OBJECTIVE OF AUDITOR IN ACCORDANCE WITH SA 265

The objective of the auditor is to communicate appropriately to TCWG and management **deficiencies in internal control** that the auditor has identified during the audit and that, in the auditor's professional judgment, are of **sufficient importance** to merit their respective attentions.

Q2 MEANING OF "DEFICIENCY IN INTERNAL CONTROL" AND "SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL"

(a) **Deficiency in internal control** –
This exists when:

- A control is **designed, implemented** or **operated** in such a way that it is **unable to prevent, or detect and correct**, misstatements in the FS on a timely basis or
- A control necessary to **prevent, or detect and correct**, misstatements in the FS on a timely basis **is missing**.

(b) **Significant deficiency in internal control** – A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of **sufficient importance** to merit the attention of TCWG.

Example (a): Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency: (VISE AF)

- (C) → The **volume of activity** that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- (C) → 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).

C → The **susceptibility to** loss or fraud of the related asset or liability.

C → The subjectivity and complexity of determining estimated amounts, such as fair value accounting **estimates**.

C → The financial statement **amounts exposed** to the deficiencies.

C → The likelihood of the deficiencies leading to material misstatements in the financial statements in the **future**.

Example (b)

Examples of indicators of significant deficiencies in internal control:

- (1) Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
- (2) Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
- (3) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- (4) Absence of a risk assessment process.
- (5) Evidence of an ineffective entity risk assessment process.
- (6) Evidence of an ineffective response to identified significant risks .
- (7) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- (8) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- (9) Evidence of management's inability to oversee the preparation of the financial statements.

Q3

COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE

- The auditor shall communicate in **writing** significant deficiencies in internal control identified during the audit to **those charged with governance** on a **timely basis**.
- The auditor shall also communicate to **management** at an appropriate level of responsibility on a **timely basis**:

(a) In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to TCWG unless it would be inappropriate to communicate directly to management in the circumstances; and

(b) Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

Note 1:

The auditor shall include in the written communication of significant deficiencies in internal control:

- (a) A description of the deficiencies and an explanation of their potential effects; and
- (b) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In particular, the auditor shall explain that:

- (i) The purpose of the audit was for the auditor to express an opinion on the FS;
- (ii) The audit included consideration of internal control relevant to the preparation of the FS in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
- (iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

SA 450

EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

Q1 OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 450

- (a) The effect of identified misstatements on the audit and
- (b) The effect of uncorrected misstatements, if any, on the financial statements.

Note: The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.

Q2 CONSIDERATION OF IDENTIFIED MISSTATEMENTS AS THE AUDIT PROGRESSES

The auditor shall determine whether the overall audit strategy and audit plan need to be revised if:

- (1) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or
- (2) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.
- (3) The auditor may request management to examine a class of transactions, account balance or disclosure in order for management to understand the cause of a misstatement identified by the auditor and to make appropriate adjustments to the financial statements.
- (4) If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

Q3 EVALUATING THE EFFECT OF UNCORRECTED MISSTATEMENTS

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

- (1) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the FS as a whole, and the particular circumstances of their occurrence and

(2) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the FS as a whole.

Q4 COMMUNICATION AND CORRECTION OF MISSTATEMENTS

- (1) The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation.
- (2) The auditor shall request management to correct those misstatements.
- (3) Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.
- (4) The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the ROMMS of future FS because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.
- (5) If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the FS as a whole are free from material misstatement.

Q5 COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

- (1) The auditor shall communicate with TCWG regarding uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.
- (2) The auditor's communication shall identify material uncorrected misstatements individually.
- (3) The auditor shall request that uncorrected misstatements be corrected.
- (4) The auditor shall also communicate with TCWG the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole

Q6

WRITTEN REPRESENTATION FROM MANAGEMENT REGARDING EFFECTS OF
UNCORRECTED STATEMENTS

- (1) The auditor shall request a WR from management and, where appropriate, TCWG
- (2) whether they believe the effects of uncorrected misstatements are **immaterial**, individually and in aggregate.
- (3) **A summary** of such items shall be included.

Q7

DOCUMENTATION REGARDING MISSTATEMENTS IDENTIFIED DURING AUDIT

- (1) The amount below which misstatements would be regarded as **clearly trivial**;
- (2) All misstatements accumulated during the audit and whether they have been **corrected**; and
- (3) The auditor's conclusion as to whether uncorrected misstatements are **material**, individually or in aggregate, and the basis for that conclusion.

8

AUDIT REPORT

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SA 700

FORMING AN OPINION & REPORTING ON FS

Q1 OBJECTIVES

Form an opinion on FS based on an evaluation of the conclusions drawn from the audit evidence obtained and Express clearly the opinion through a written report that also describes the basics for the opinion

Q2 QUALITATIVE ASPECTS

1. The auditor shall evaluate whether the FS are prepared, in all material respects, in accordance with the requirements of the AFRF.
2. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments.
4. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the FS as a whole to be materially misstated.

- The selective correction of misstatements brought to management's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
- Possible management bias in the making of accounting estimates.

Q3 SPECIFIC EVALUATION BY THE AUDITOR

1. The FS adequately disclose the significant accounting policies selected and applied;
2. The accounting policies selected and applied are consistent with the AFRF and are appropriate;
3. The accounting estimates made by management are reasonable;

4. The **information** presented in the FS is relevant, reliable, comparable, and understandable;
5. The FS provide adequate **disclosures** to enable the intended users to understand the effect of material transactions and events on the information conveyed in the FS; and
6. The **terminology** used in the FS, including the title of each FS, is appropriate.

Q4 GENERAL AND FAIR PRESENTATION FRAMEWORK

Q5 BASIC ELEMENTS OF AUDIT REPORT

- **Title**
- An **addressee**, as required by the circumstances of the engagement.
- **Auditor's Opinion:**
The Opinion section of the auditor's report shall also:
 - Identify the **entity** whose financial statements have been audited;
 - State that the financial statements have been **audited**;
 - Identify the **title** of each statement comprising the financial statements;
 - Refer to the **notes**, including the summary of significant accounting policies; and
 - Specify the **date** of, or period covered by, each financial statement comprising the financial statements
- **Basis for Opinion:** The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:
 - States that the audit was conducted in accordance with **Standards on Auditing**;
 - Refers to the section of the auditor's report that describes the **auditor's responsibilities** under the SAs;
 - Includes a statement that the auditor is **independent** of the entity in accordance with the relevant **ethical requirements** relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
 - States whether the auditor believes that the audit evidence the auditor has obtained is **sufficient and appropriate** to provide a basis for the auditor's opinion.

- **Going Concern:** Where applicable, the auditor shall report in accordance with SA 570 (Revised)
- **Key Audit Matters:** For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate KAM in the auditor's report in accordance with SA 701
- **Management Responsibilities:** The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."
 - (a) **Preparing the financial statements** in accordance with the **AFRF**, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
 - (b) Assessing the entity's ability to continue as a **going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.

Oversight of the financial reporting process: This section of the auditor's report shall also identify those responsible for the **oversight of the financial reporting process**, when those responsible for such oversight are different from Management. In this case, the heading of this section shall also refer to "**Those Charged with Governance**"

- **AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS:**
 - (I) This section of the auditor's report shall:
 - (a) State that the **objectives** of the auditor are to:
 - (i) **Obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 - (ii) **Issue an auditor's report** that includes the auditor's opinion.
 - (b) State that **reasonable assurance** is a **high level of assurance**, but is **not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
 - (c) State that **misstatements can arise** from fraud or error, and either:
 - (i) Describe that they are considered **material** if, **individually or in the aggregate**, they could reasonably be expected to **influence the economic decisions** of users taken on the basis of these financial statements; or
 - (ii) Provide a **definition or description of materiality** in accordance with the **AFRF**.

(ii) Auditor's responsibility section to further

State that auditor exercises professional judgement and maintains professional skepticism	Describe an audit by stating that auditors responsibilities are	Describe auditor's responsibility in group audit		
To identify and assess the risks of material misstatement	To obtain an understanding of the internal control system	To evaluate the appropriateness of accounting policies	To conclude the appropriateness of management's use of going concern	To evaluate the overall presentation, structure and content of financial statements

(iii) THE AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS SECTION OF THE AUDITOR'S REPORT ALSO SHALL

- (a) State that the auditor communicates with TCWG regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit
- (b) For audits of FS of listed entities, state that the auditor provides TCWG with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and
- (c) For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure.
- NOTE: Location of the description of the auditor's responsibilities for the audit of the financial statements
 - Within the body of the auditor's report
 - Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or
 - By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

- **Other Reporting Responsibilities:** If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are **in addition to the auditor's responsibilities under the SAs**, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled **"Report on Other Legal and Regulatory Requirements"** or otherwise as appropriate to the content of the section unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.
- **Signature of the auditor:**
 - The report is signed by the auditor (i.e. the engagement partner) in his **personal name**.
 - Where the firm is appointed as the auditor, the report is signed in the **personal name of the auditor** and in the **name of the audit firm**.
 - The partner/proprietor signing the audit report also needs to mention the **membership number** assigned by the Institute of Chartered Accountants of India
- **Place of auditors report:** The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.
- **Date of auditors report:** The auditor's report shall be dated **no earlier than** the date on which the auditor has obtained **sufficient appropriate audit evidence** on which to base the auditor's opinion on the financial statements
- **UDIN**
 - an auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report

PARTICLUAR	UNQUALIFIED OPINION	QUALIFIED OPINION	ADVERSE OPINION	DICLAIMER OPINION
Opinion Para 1st line	We have audited	We have audited	We have audited	We were engaged to audit
2nd Line	Which comprises the balance sheet at March 31st20XX, and the P&L A/c, (and statement of Cash flows) for the year ended, and notes to the FS, including a summary of significant accounting policies.			
3rd Line	In our opinion and to the best of our information and according to the explanations given to us,			
4th Line	Gives true and fair view of the financial position	Except for the effects/possible effects of the matter described in the basis for Qualified opinion para the FS are true & fair	Because of the significance of the matters described in the basis of adverse opinion para the FS are not true & fair	Because of the significance of the matters described in the basis of disclaimer of opinion para the auditor does not express an opinion on FS

Basis of opinion para Last line	We believe we that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our <u>opinion</u>	We believe we that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our <u>qualified opinion</u>	We believe we that the audit evidence we have obtained is sufficient and appropriate to provide a basis for <u>adverse opinion</u>	Because of the matters described in the basis of disclaimer of opinion para, we <u>were not able to obtain SAAE</u> to provide a basis for our opinion
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SA 701

COMMUNICATING KEY
AUDIT MATTERS

Q1 MEANING

- Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.
- Key audit matters are selected from matters communicated with those charged with governance

Q2 APPLICABILITY

- Listed entities
- Circumstances where auditor otherwise decides to communicate key Audit matters in the auditors report
- Required by law or regulation

However, Auditor cannot communicate key audit matters when the auditor disclaims/ adverse an opinion on the financial statements, unless such reporting is required by law or regulation.

Q3 COMMUNICATING KEY AUDIT MATTERS IN THE AUDITOR'S REPORT IS NOT

- A substitute for disclosures in the financial statements that the AFRF requires management to make, or that are otherwise necessary to achieve fair presentation
- 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)
- A substitute for reporting in accordance with SA 570 (Revised) 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
- A separate opinion on individual matters

Q4 PURPOSE OF COMMUNICATING KEY MATTER PARA

- To enhance the **communicative value** of the Auditors report by providing **greater transparency** about the audit that was performed.
- To assist intended users in understanding the entity and areas of significant **management judgement** in the audited FS
- to assist intended users in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the FS of the current period

Q5 DETERMINING KEY AUDIT MATTERS

- Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 (For examples Refer SA 315)
- **Significant auditor judgments** relating to areas in the financial statements that involved **significant management judgment**, including **accounting estimates** that have been identified
- The **effect on the audit of significant events or transactions** that occurred during the period.

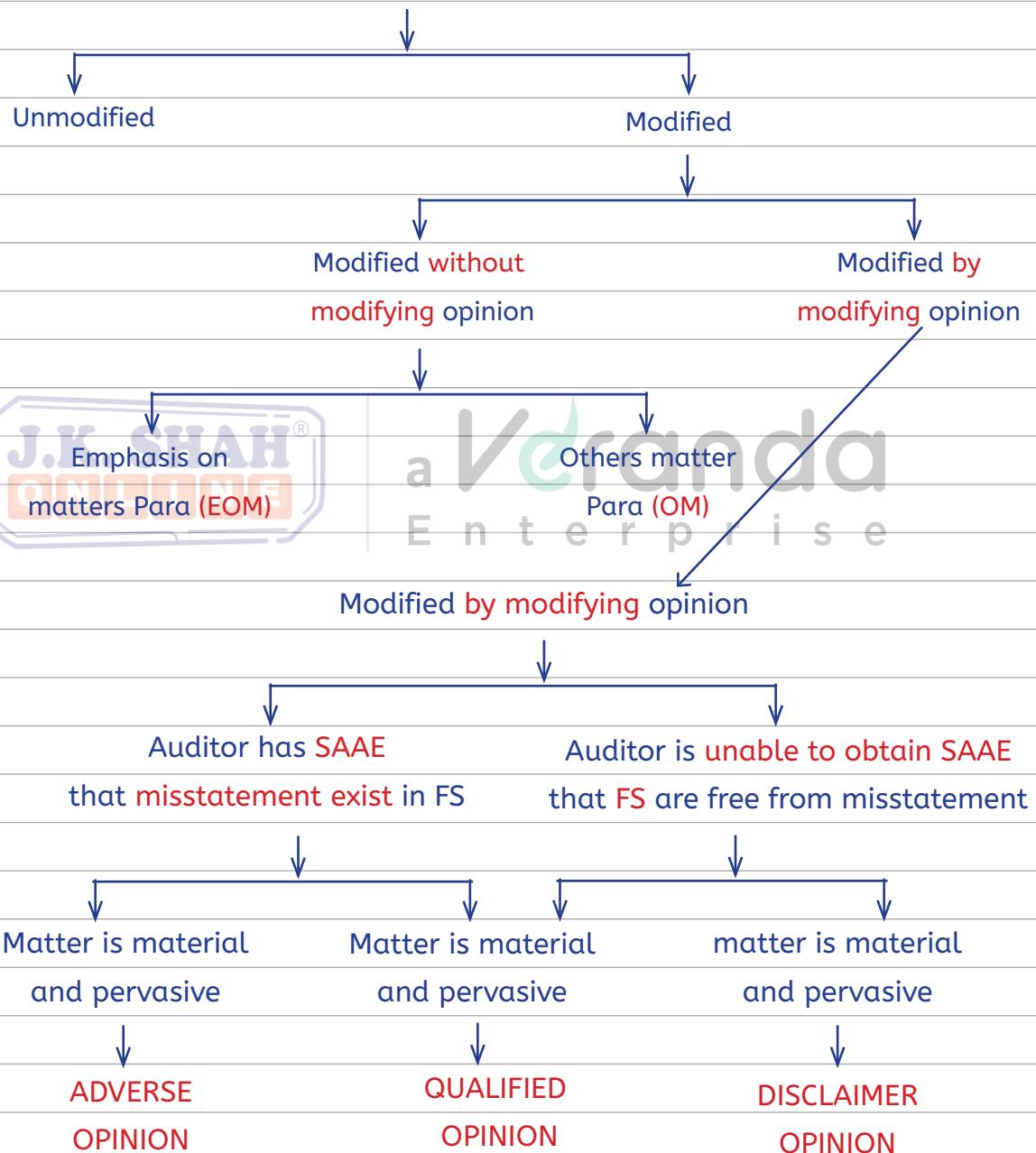
Q6 DETERMINING KEY AUDIT MATTERS

- 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:
 - (a) KAM are those matters that, in the auditor's professional judgment, were of **most significance** in the audit of the FS [of the current period]; and
 - (b) These matters were addressed in the context of the audit of the FS as a whole, and in forming the auditor's opinion thereon, and **the auditor does not provide a separate opinion on these matters**.

SA 705

MODIFICATIONS TO THE OPINION IN
THE INDEPENDENT AUDITORS REPORT

Q1 TYPE OF REPORT



Note 1- Pervasive :

Pervasive effects on the FS are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the FS;
- (ii) If so confined, represent or could represent a substantial proportion of the FS; or
- (iii) In relation to disclosures, are fundamental to users' understanding of the FS.

Note 2- Communication with Those Charged with Governance:

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with TCWG the circumstances that led to the expected modification and the wording of the modification.

Note 3 - Description of Auditor's Responsibilities for the Audit of the Financial Statements

When the Auditor Disclaims an Opinion on the Financial Statement:

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 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct and audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's reports;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised)

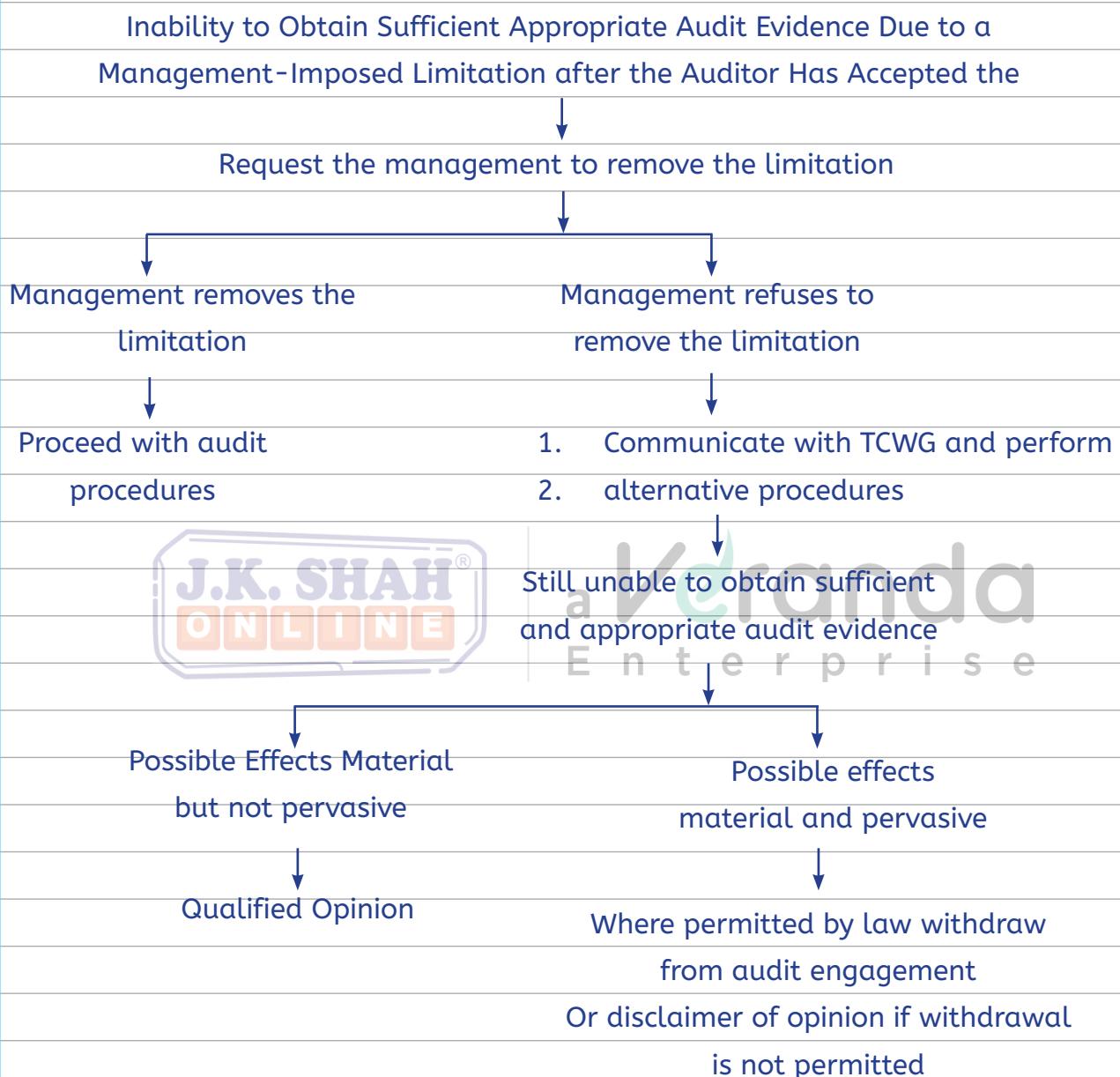
Note 4 - Consideration when the Auditor Disclaims an Opinion on the Financial Statements:

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

Q2

CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has accepted the Engagement



SA 706

EOM PARA & OM PARA IN
INDEPENDENT AR

Q1 EMPHASIS OF MATTER PARA

1. MEANING:

- A matter, although appropriately presented or disclosed in FS, is that is of such importance that it is fundamental to users understanding of the FS.

2. EMPHASIS OF MATTER PARA IN THE AUDITOR'S REPORT

- Use the heading 'Emphasis of Matter' or other appropriate heading
- Include in the Para a clear reference to matter being emphasized
- Indicate that the auditor's opinion is not modified in respect of the emphasized matter

3. EXAMPLES:



(LACS)



→ An uncertainty relating to the future outcomes of an exceptional litigation or regulatory action.



→ Early application of new accounting standard that has a pervasive effect on FS in advance of its effective date.



→ A major catastrophe that have a significant effect on the entity's financial position



→ A significant event that occurs after the date of FS and the date of auditors report

4. EOM NOT A SUBSTITUTE FOR

- A modified opinion in accordance with SA 705 when required by the circumstances of a specific audit engagement;
- Disclosures in the FS that the AFRF management to make, or that are otherwise necessary to achieve fair presentation; or
- 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.

5. THE AUDITOR SHALL INCLUDE EOM PROVIDED

- (a) Not required to modify opinion in accordance with SA 705 as a result of the matter
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated

Q2

OTHER MATTER PARA IN AUDITORS REPORT

1. MEANING:

- If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in FS that,
- in auditors judgement, is relevant to users understanding of the audit, the auditors responsibilities or auditor's report
- The auditor shall do so in a Para in the auditor's report , with the heading 'others matter' or other appropriate heading.

2. The auditor shall include an Other Matter paragraph in the auditor's report, provided:

- This is not prohibited by law or regulation; and
- When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

3. If auditor expects to include EOM or OM, the auditor shall communicate with TCWG regarding:

- this explanation and the
- wordings of this para

4. EXAMPLES(OFU)



(RALI)

- R** → Reasons why auditor is unable to resign from the engagement even though there is limitation of scope.
- A** → Another set of FS has been prepared by the same entity in accordance with another general purpose framework & that the auditor had issued a report on those FS.
- L** → Law, regulation or generally accepted practise that may require or permit the auditor to elaborate on matters that provide further explanation
- I** → Auditors report is intended solely for intended users.

SA 710

COMPARATIVE INFO-
CORRESPONDING FIGURES

Q1 MEANING

A) COMPARATIVE INFORMATION

- The amounts and disclosures included in the FS
- in respect of one or more prior periods in accordance with the AFRF.

B) CORRESPONDING FIGURE

- Comparative information
- Where amounts & other disclosures for the preceding period
- Are included
- As part of **current period** FS
- And are intended to be read in relation to the **amounts & other disclosures** relating to the current period.
- These corresponding figures are not presented as **complete financial statements** capable of standing alone, but are **integral part of the current period financial statement** intended to be read only in relationship to current period figures.

C) COMPARATIVE FINANCIAL STATEMENT

- Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion.
- The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the **current period** only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to **each period** for which financial statements are presented.

Q2 AUDIT PROCEDURES FOR COMPARATIVE INFO

- (i) The auditor shall determine whether FS include the comparative info required by the AFRF & whether such info is appropriately classified. For this purpose the auditor shall evaluate whether:
 - (a) The **comparative info agrees with the amounts & other disclosures presented in the prior period; and**
 - (b) The **accounting policies reflected in the comparative info 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 & adequately presented & disclosed.**
- (ii) If the auditor **becomes aware of a possible material misstatement in the comparative info** while performing the current period Audit
 - The auditor shall perform such **additional audit procedures** as are necessary in the circumstances to obtain **SAAE** to determine whether a material misstatement exists.
- (iii) If the auditor had audited the prior periods FS, the auditor shall also follow the relevant requirements of **SA 560**.
- (iv) As required by **SA 580**, the auditor shall request **WR** for all periods referred to in the auditor's opinion.

The auditor shall also obtain a **specific WR** regarding any **prior period item** that is separately disclosed in cy statement of P/L.

Q3 THE AUDITOR'S OPINION SHALL NOT REFER TO THE CORRESPONDING FIGURES EXCEPT IN THE FOLLOWING CIRCUMSTANCES

CASE 1: PREVIOUS REPORT CONTAINS A QUALIFICATION:

- When the auditors report on prior period as previously issued.
- ▶ included a modified opinion
- ▶ and the matter giving rise to modification is resolved & properly accounted for & disclosed in FS according to AFRF.
- The auditors opinion of the current period need not refer to modifications.
- When the auditor report on prior period as previously issued.
- ▶ included a modified opinion.
- ▶ and matter giving rise to modification is unresolved.
- The auditor shall modify the auditor's opinion on current period FS.

CASE 2: If the auditor obtains AE that a MMS exists in the prior period financial statements on which an unmodified opinion has been previously issued:

- the auditor shall verify whether the misstatement has been dealt with as required under the AFRF and,
- if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period FS

CASE 3 : If the FS of the prior period were audited by a predecessor auditor and

- the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:
 - (a) That the financial statements of the prior period were audited by the predecessor auditor;
 - (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
 - (c) The date of that report.

CASE 4: If the prior period financial statements were not audited:

- the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.
- Such a statement does not, however, relieve the auditor of the requirement to obtain SAAE that the opening balances do not contain misstatements that materially affect the current period's financial statements

Q4**COMPARATIVE FINANCIAL STATEMENT**

(A) **Auditor's Opinion- To Refer Each Period :**

When comparative fs are presented, the auditor's opinion shall refer to each period for which fs are presented and on which an audit opinion is expressed.

(B) **When Reporting On Prior Period Fs In Connection With The Current Period's Audit**

If the auditor's opinion on such prior period FS 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

(C) **If the FS of the prior period were audited by a predecessor auditor the auditor shall state in an Other Matter paragraph in the auditor's report:**

- (a) That the financial statements of the prior period were audited by the predecessor auditor;

(b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and

(c) The date of that report.

- If the auditor concludes that a material misstatement exists that affects the prior period FS on which the predecessor auditor had previously reported **without modification**,
- the auditor shall communicate the misstatement with the **appropriate level of management and TCWG** and request that the predecessor auditor be informed.
- If the prior period FS are **amended**, and the predecessor auditor agrees to issue a new auditor's report on the amended FS of the prior period, the auditor shall **report only on the current period**.

(D) If the prior period financial statements **were not audited**:

- the auditor shall state in an **Other Matter paragraph** in the auditor's report that the corresponding figures are unaudited.
- Such a statement does not, however, **relieve the auditor of the requirement to obtain SAAE that the opening balances** do not contain misstatements that materially affect the current period's financial statements

SA 299

RESPONSIBILITY OF JOINT AUDITOR

Q1 DEFINITION

- A Joint audit is an audit of FS
- of an entity by **two or more auditors**
- appointed with the objective of issuing the AR.
- Such auditors are described as joint auditors

Q2 ADVANTAGES AND DISADVANTAGES

ADVANTAGES

1. Sharing of expertise.
2. Advantage of mutual consultation.
3. Lower workload.
4. Better quality of performance.
5. Improved service to the client.
6. In respect of multi-national 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.
7. Lower staff development costs.
8. Lower costs to carry out the work.
9. A sense of healthy competition towards a better performance.

DISADVANTAGES

1. The fees being shared.
2. Psychological problem where firms of different standing are associated in the joint audit.
3. General superiority complex of some auditors.
4. Problems of co-ordination of the work.
5. Areas of work of common concern being neglected.
6. Uncertainty about the liability for the work done

Q3

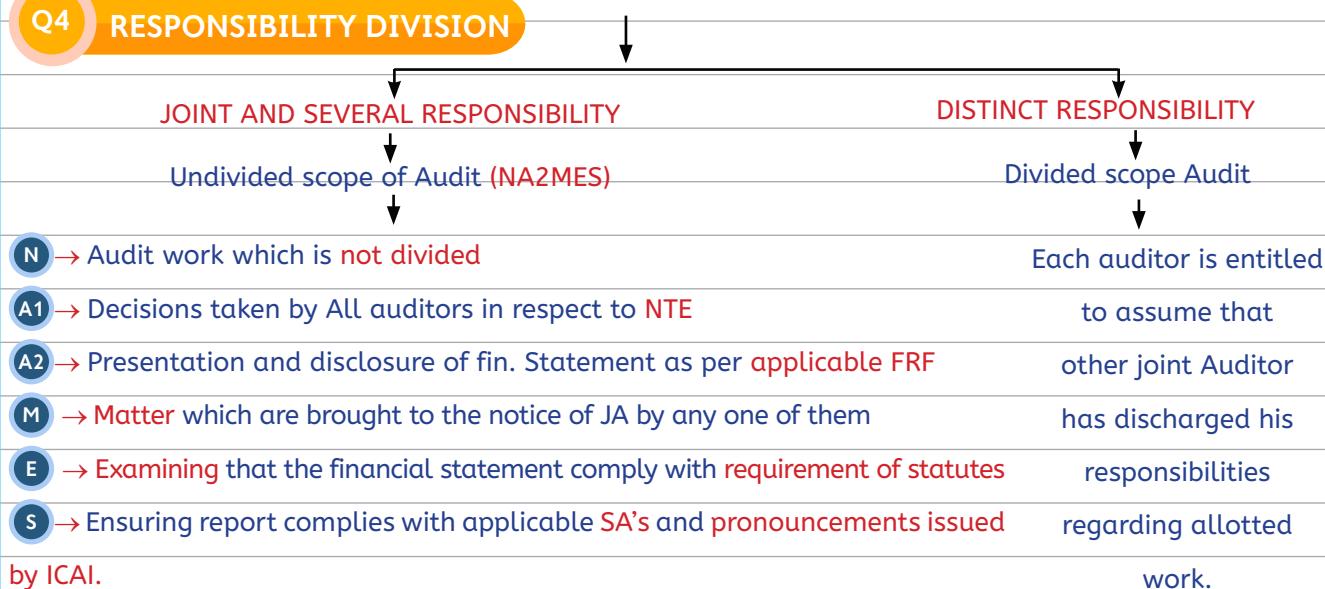
SPECIAL CONSIDERATIONS IN CARRYING OUT AUDIT BY JOINT AUDITORS

(PREND²S)

- P** → the engagement partner and other key members of the engagement team from each of the joint auditors should be involved in planning the audit.
- R** → each of the joint auditors should consider and assess the ROMMS and communicate to other joint auditors.
- E** → the joint auditors should obtain common engagement letter and common management representation letter.
- N** → the joint auditors should discuss and document the NTE of the AP for Common and specific allotted areas of audit to be performed.
- D** → before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:
 - Identify division of audit areas and common audit areas
 - Ascertain the reporting objectives of the engagement
 - Consider the results of preliminary engagement activities
 - Consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
 - Ascertain the NTE of resources necessary to perform the engagement.
- D** → the work allocation document should be signed by all the joint auditors and communicated to those charged with governance
- S** → the joint auditors should jointly establish an overall audit strategy which sets the scope, timing and direction of the audit, and also guides the development of the audit plan

Q4

RESPONSIBILITY DIVISION



Q5 REPORTING RESPONSIBILITIES

- The joint auditors are required to issue **common audit report**
- However, where the joint auditors **are in disagreement** with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a **separate audit report**.
- Each joint auditor with a **differing opinion** would be required to issue a separate audit report and the **reference to the other joint AR** would be required to be made by each such joint auditor in their respective audit report.
- Such reference shall be made under the heading "**Other Matter Paragraph**" as per SA 706
- 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 AR and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement.



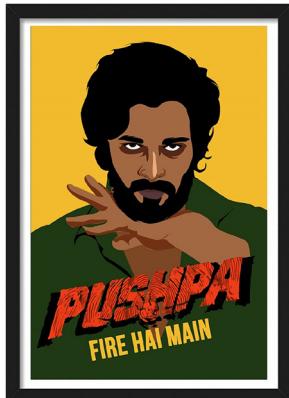
SA 600

USING THE WORK OF
ANOTHER AUDITOR

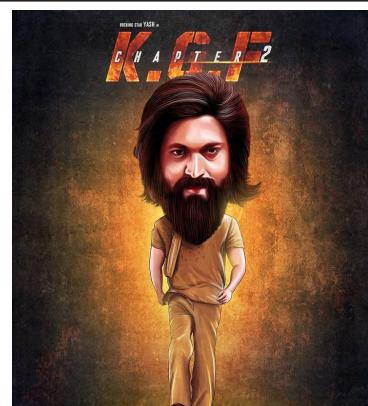
Q1 INTRODUCTION (OFU)

- When the auditor delegates work to assistants or uses work performed by other auditors and experts,
- he will continue to be responsible for forming and expressing his opinion on the financial information.
- However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

Q2 MEANING



a Veranda
Enterprise



Principal Auditor

The auditor with responsibility for reporting on the financial information of an entity when that financial information includes the financial information of one or more components audited by another auditor

Other Auditor

other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.

Q3 RIGHTS OF THE PRINCIPAL AUDITOR

Visit component Normally rely on the work, unless there are special circumstances Evaluate if he is competent (provided he is not a member of the institute)



Q4 DUTIES OF THE PRINCIPAL AUDITOR

7. Should document in his working papers the components whose financial information was audited by other auditors;	1. Advise the other auditor of the use that is to be made of the other auditor's work
6. Discuss with the other auditor and the management of the component, the audit findings .	2. Areas requiring special consideration
5. Significant findings of the other auditor.	4. Audit procedures applied in form to questionnaire
	3. Significant accounting, auditing and reporting requirements

TOPIC 8 : BRANCH AUDITOR - REFER LAW

TOPIC 9: REPORTING UNDER LAW - REFER LAW

CARO 2020

FS

AR

CARO

1. Applicability : All companies including foreign companies

2. Excluded:  (BIPS)

B- Banking Co

I- Insurance Co

P- Pvt Ltd Co

PUSC + Res \leq 1crore AND

Loan \leq 1crore AND

Revenue \leq 10crore

S – Sec 8 co, small co, one person co

3. Status of the co shall be checked on the **balance sheet date**.

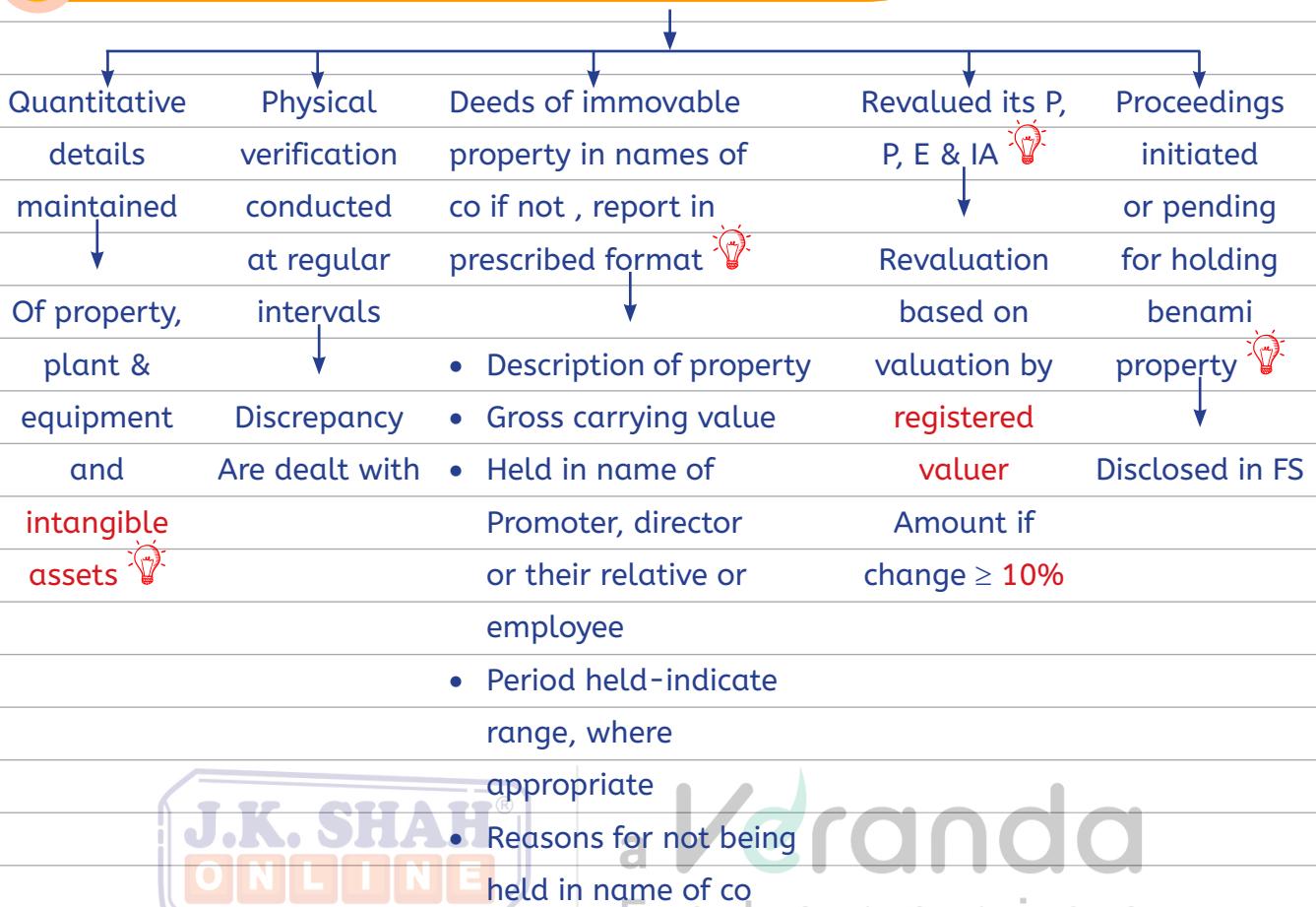
4. If applicable to **holding co**, it shall also apply to **subsidiary**.

5. The order shall not apply for **Consolidated FS** except in clause (xxi)

The auditor's report of holding company shall also be an indicative of the companies included in the consolidated FS whose CARO reports contain qualifications/adverse remarks 

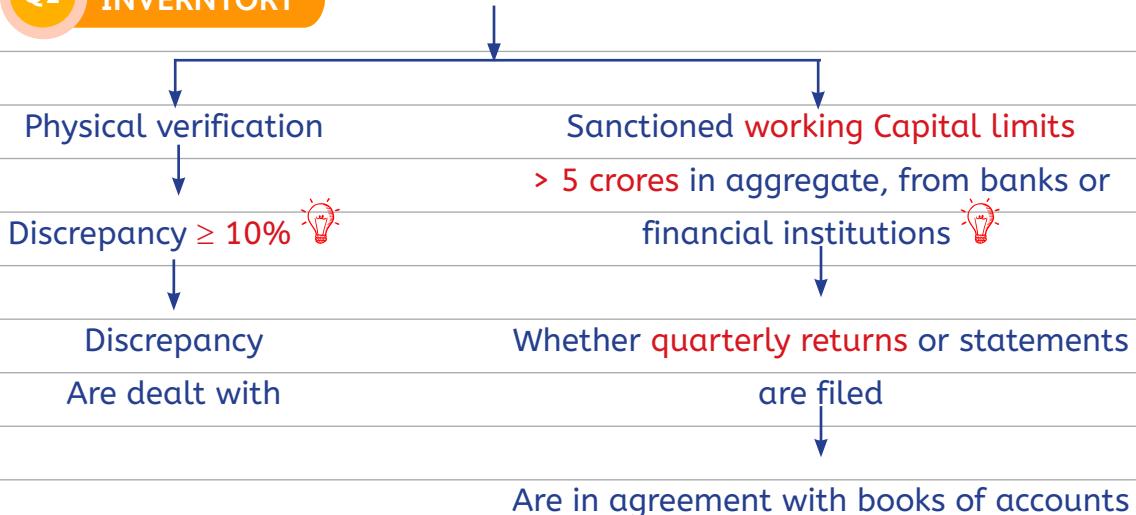
Q1

PROPERTY, PLANT, EQUIPMENT & INTANGIBLE ASSET



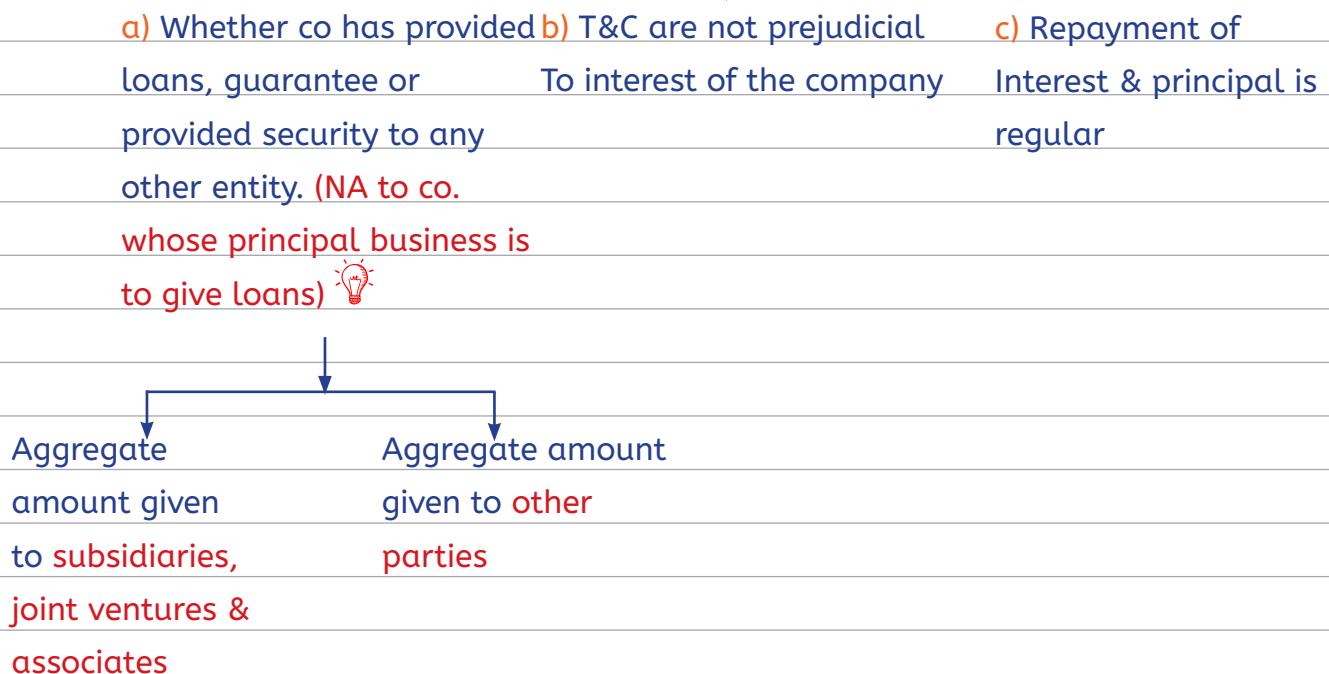
Q2

INVENTORY



Q3

INVESTMENTS, GUARANTEE, SECURITY & LOANS GRANTED BY CO



(iii) Investments, Guarantee, Security & loans granted by co

d) If overdue > 90 day any steps for recovery taken

e) Loans & advances has fallen due during the year has been renewed or extended or fresh loans granted to settle the overdues of existing loan 

f) If loans or advances granted in nature of loans either repayable on demand or without specifying terms or period of repayment 

Specify the aggregate amount

% of the aggregate to total loans or advances

(NA to co. whose principal business is to give loans)

% of total loans to loans to promoter & related parties

(iv) Compliance of sec 185 & 186

Q5 PUBLIC DEPOSIT (INCLUDING DEEMED DEPOSITS) 

↓
Directives of RBI Provisions of Co's Act Order of CLB/Tribunal

(vi) Cost records maintained as per sec 148

Q7 STATUTORY DUES (including GST)

↓
Undisputed Disputed
↓ ↓
If O/S > 6m then report Always report amount & authority

Q8 DISCLOSURE OF TRANSACTIONS NOT RECORDED 

↓
Whether any transactions not recorded in books have been surrendered or disclosed as income during tax assessments under income tax act, 1961

↓
If so, whether the previously unrecorded income has been properly recorded in the books of accounts during the year

Q9 DEFAULT IN REPAYMENT OF LOANS OR OTHER BORROWINGS 

↓
a) If default in repayment to any lender b) Whether the company is declared willful defaulter by any bank or financial institute or other lender c) Whether term loans were applied for which the loans were obtained

↓
If yes, report the period and amount of default as per prescribed format

- 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

↓
If not, the amount of loan so diverted and the purpose for which it is used.

Q9 DEFAULT IN REPAYMENT OF LOANS OR OTHER BORROWINGS 

d. Whether funds raised on **short term** basis have been **utilized** for **long term** purpose

If yes, the **nature** and **amount** to be indicated

e. Whether the funds are used to meet obligations of **its** **subsidiaries, associates or joint ventures**

If so, details thereof with **nature** of such transactions and the **amount** in each case.

f. Whether the company has raised loans on the **pledge** of **securities** held in its **subsidiaries, joint ventures or associate companies**

If so, give **details** thereof and also **report default** if any

Q10 MONEY RAISED BY IPO, FPO & PREFERENTIAL ALLOTMENT/PRIVATE PLACEMENT OF SHARES OR CONVERTIBLE DEBENTURES 

a) Whether money raised by IPO or FPO are applied for the purpose for which they are raised.

If not, details together with **delays** or **default** and **subsequent rectification**, if any, shall be reported

b) Whether the company has made any **preferential allotment** or **private placement** of share or convertible debentures

If so, whether **sec 42 & 62** of **companies Act,2013** have been complied with.

If not, provide details in **respect of amount involved** and **nature of non compliance**

Q11 FRAUD

On company or by the company is reported during the year

If yes, Report **Nature** & **Amount** of fraud

143(12) of companies **Act,2013** has been complied with 

Whether the auditor s considered **whistle blower** complaints, if any, received during the year by the company 

Q12 NIDHI COMPANY

a. Net owned funds:
Deposits 1: 20

b. 10% unencumbered term deposit (liquid)

c. Whether there has been any default in payment of interest on deposit or principal

If yes, details thereof 

Q13 RELATED PARTY

Is as per sec 177, 188 and AS- 18



Sec 177: of Companies Act, 2013 amended to empower Audit Committee to give omnibus approvals for related party transactions on annual basis

Sec 188: Prior approval of Board of Directors of the Company is required so as to enter into any contract or arrangement with related party

AS 18: Related party disclosure

Q14 INTERNAL AUDIT SYSTEM 

a. Whether co has an ICS commensurate with the size and nature of its business

b. Whether reports of IA were considered by statutory auditor



Sec 138 of Companies Act, 2013 – Internal Audit

Listed Co

Public co

Pvt co

PUSC \geq 50cr or

T/O \geq 200cr or

Borr \geq 100cr

T/O \geq 200cr or

Borr \geq 100cr

Borr \geq 100cr

Q15 NON CASH TRANSACTION 

With directors or persons connected with him

If so, whether the provisions of **sec 192** of Co. Act 2013 have been complied with



Sec 192: prior approval for such arrangement is accorded by a resolution of the company in general meeting

Q16 SEC 45 IA OF RBI, ACT 1934

a. Whether the co. is required to be registered u/s 45- IA of RBI Act, 1934 (i.e NBFC)	b. Whether the co. has conducted any Non-banking Financial or housing Finance activities without a valid certificate of registration	c. Whether the co. is a Core Investment Co (CIC) as defined by RBI if so, whether it continues to fulfil the criteria & if it is exempted, it continues to fulfil such criteria	d. Whether the co. Group has more than one CIC if yes, indicate the number of CIC which are part of the group
If so, whether the registration has been obtained			

CORE INVESTMENT CO

Core Investment Company (CIC) is a non-banking financial company carrying on the business of acquisition of shares and securities and which

- (a) holds not less than **90 per cent** of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies and
- (b) its investments in the equity shares in group companies constitutes not less than **60 per cent** of its net assets as on the date of the last audited balance sheet.

Q17 CASH LOSSES 

- Whether the co has incurred **cash losses** in the FY & immediately preceding FY
- If so, state the **amount of cash losses**

Q18 RESIGNATION OF STATUTORY AUDITOR 

↓
Whether there has been any resignation of the statutory auditors during the year

↓
If so, whether the auditor has taken into **consideration the issues, the objections or concerns raised by the outgoing auditor**

Q19 CAPABILITY OF CO MEETING ITS LIABILITIES EXISTING AT THE BS DATE 

↓
On the basis of the **Financial ratios, ageing and expected dates of realization of financial assets and payments of financial liabilities**

↓
Or other info, the auditors knowledge of **BOD and managements plan**

↓
Whether the auditor is of the opinion that **no material uncertainty exists** as on the **date of Audit report** that **co is capable** of meeting its liabilities existing at the date of BS

↓
And when they fall due within a period of **one year** from the date of BS

Q20 TRANSFER AMOUNT REMAINING UNSPENT U/S 135(5) TO FUND SPECIFIED IN SCH VII 

 **Sec 135(5):** The Board of every company shall ensure that the company spends, in every financial year, at least **two per cent.** of the **average net profits** of the company made during the three immediately preceding financial years, in pursuance of its **Corporate Social Responsibility Policy**

SCH VII: Activities which may be included by companies in their **Corporate Social Responsibility Policies Activities**

↓

↓

a. whether, in respect of other than ongoing projects, the company has transferred **unspent amount** to a Fund specified in **Schedule VII** to the Companies Act **within a period of six months** of the expiry of the financial year

b. whether any amount remaining unspent pursuant to any ongoing project, has been transferred to special account

Q21

REPORTING ON CONSOLIDATED FINANCIAL STATEMENTS



Whether there have been any qualifications or adverse remarks by the respective auditors in the CARO reports of the companies included in the **consolidated financial statements**

if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

The change in reporting requirements clearly shows that regulator's expectations from the auditors are increasing significantly.

More emphasis is added on utilization of funds, financial stability of the company and regulatory compliances.

Auditors need to be more conscious, skeptical and accurate while discharging his/her duties.

9

SPECIAL FEATURES OF AUDIT OF
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Q6	Audit of Hospital
Q7	Audit of Club
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Q3	Objective of Audit of Local Bodies
Q4	Audit Programme for Local Bodies



PART 1 - DIFFERENT ENTITIES

Q1 AUDIT OF SOLE TRADER

1. A sole trader is **under no legal obligation** to have his accounts audited.
2. However, many such individuals get their financial statement audited due to **regulatory requirements**.
3. Auditors of sole- proprietary concern shall be **appointed by the sole proprietor** himself. In case of change of auditor, it would be duty of **incoming auditor** to **communicate with the previous auditor**. As such, sole proprietor can determine the **scope of the audit** as well as the **conditions** under which it will be carried out.
4. It is desirable that the contract of appointment of auditor in such a case should be **in writing**; also that it should clearly define the scope of the work which the auditor is expected to carry out. This helps to **prevent misunderstanding**.

Q2 AUDIT OF FIRM

(A) Appointment of Auditors:

1. The auditor to a firm is usually appointed by the **partners** either on the basis of a **decision taken by them** or to comply with a condition in the **partnership agreement**.
2. His **remuneration** is also fixed by the **partners**.
3. It is important that the **letter of appointment** should clearly state the **nature and scope of audit** which is to be carried out and particulars of limitations.
4. In case of change of auditor, it would be duty of **incoming auditor** to **communicate with the previous auditor**.
5. In case the firm is required to get its accounts audited under the **requirements of any statute**, the auditor will have to qualify the report in case of non-compliance with the **accounting standards**.

(B) Matters to be considered before starting audit:

1. Audit of Firm: Matter to be considered before starting audit. (DOB MAIL S₂)
 - D → Duration of Partnership
 - O → who shall operate the Bank A/c
 - B → Borrowing Capacity of the partnership
 - M → Provision as regard to maintenance of Books of Accounts
 - A → Amount of Capital that should be contributed by each partner

- (I) → The rate at which interest will be allowed on capital & charged on drawing.
- (L) → Limitations & Restrictions that have been agreed upon
- (S₁) → Name & Style under which business shall be conducted
- (S₂) → Whether any salaries are payable.

(C) **Advantages of Audit of a Partnership Firm:** On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:

- (1) **Disputes:** Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.
- (2) **Dissolution:** On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
- (3) **Reliable:** Audited statement of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
- (4) **Admission:** Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.
- (5) **Control:** An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.

(D) **Matters which should be specially considered in the audit of accounts of a partnership:**

- (i) **Letter of Appointment:** Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
- (ii) **Partnership Documents:** Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets,

extraordinary contracts entered into and other such matters as are not of a routine nature.

- (iii) **Objects of Partnership:** Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
- (iv) **Books of Account:** Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
- (v) **Mutual Interest:** Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.
- (vi) **Provision for Taxes:** Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
- (vii) **Division of Profits:** Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

Q3

BASICS OF LIMITED LIABILITY PARTNERSHIPS (LLP) AUDIT

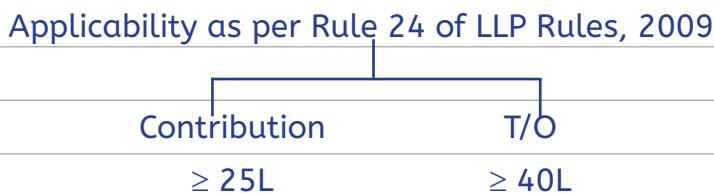
(A) Meaning:

- 1. LLP is governed by Limited Liability Partnership Act, 2008.
- 2. **Minimum of 2 Partners** can form an LLP and atleast two partners would be Designated Partners who would be required to take DPIN (**Designated Partner Identification Number**)
- 3. It defines a **Small Limited Liability Partnership** to denote any LLP:
 - (a) the **Contribution** of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding **five crore rupees**, as may be prescribed; and
 - (b) the **Turnover** of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, **does not exceed forty lakh rupees** (INR 40,00,000) or such higher amount, not exceeding **fifty crore rupees**, as may be prescribed;

- (B) **LLP is required to maintain Books of Accounts:** An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. LLP's are required to maintain books of accounts which shall contain-
 - 1. Particulars of **all sums of money received and expended by the LLP** and the matters in respect of which the receipt and expenditure takes place,

2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

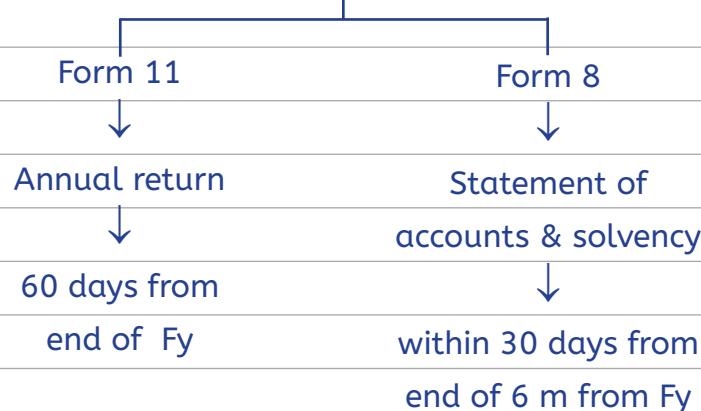
(C) Audit of the Accounts of an LLP:



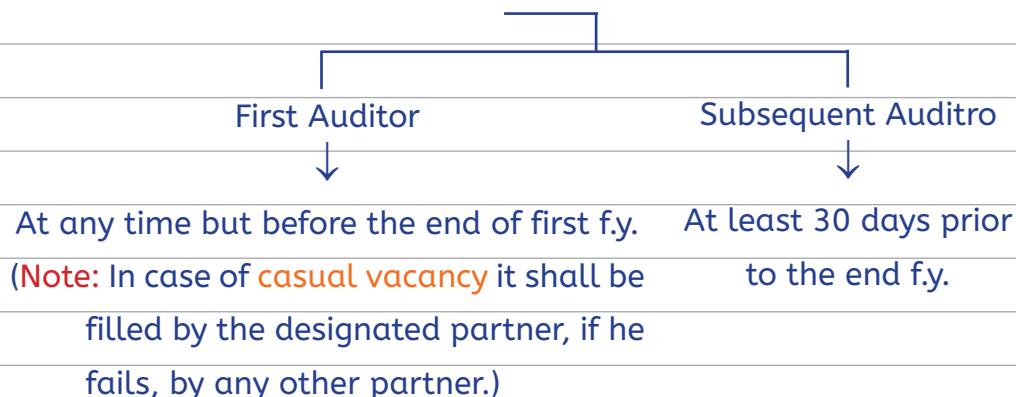
(D) Advantages / Purpose / Need of Audit:

1. Detection of Errors: Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements.
2. Disputes: Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts.
3. Reliability: Banks & financial institutions lend money to the firms only on the basis of audited accounts.
4. Better Compliance and Management: Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP.
5. Reconstitution: For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc. audited accounts are accepted by those concerned who have dealings with the LLP.

(E) Returns to be maintained and filed by an LLP



(F) Appointment of Auditor



(G) Auditor's Duty Regarding Audit of LLP:

1. **Engagement Letter:** The auditor should get definite instructions in writing as to the work to be performed by him.
2. **Minutes Book:** If partners maintain minute book he shall refer it for any resolution passed regarding the accounts.
3. **LLP Agreement:** The auditor should read the LLP agreement & note the following provisions
 - (a) Nature of the business of the LLP.
 - (b) Amount of capital contributed by each partner.
 - (c) Interest – in respect of additional capital contributed.
 - (d) Duration of partnership.
 - (e) Drawings allowed to the partners.
 - (f) Salaries, commission etc. payable to partners.
 - (g) Borrowing powers of the LLP.
 - (h) Rights & duties of partners.
 - (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
 - (j) Any loans advanced by the partners.
 - (k) Profit sharing ratio
4. **Reporting:** The auditor should mention
 - (a) Whether the **records** of the firm appear to be correct & reliable.
 - (b) Whether he was able to obtain **all information & explanation** necessary for his work.
 - (c) Whether any **restriction was imposed** upon him.

Q4 AUDIT OF CHARITABLE INSTITUTION

(1) General (i) Studying the constitution under which the charitable institution has been set up. (ii) Verifying whether the institution is being managed in the manner contemplated by the law under which it has been set up. (iii) Examining the system of internal check, especially as regards accounting of amounts collected. (iv) Verifying in detail the income and confirming that the amounts received have been deposited in the bank regularly and promptly. (v) Examine the Trust Deed or the Regulations as laid down.	(2) Subscriptions and donations (i) Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year. (ii) Whether official receipts are issued; (a) confirming that adequate control is imposed over unused receipt books; (b) obtaining all receipt books covering the period under review; (c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into; (d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts; (e) paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; (f) verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.	(3) Legacies - Verifying the amounts received by reference to correspondence with any figures and other available information.	(4) Grants (i) Vouching the amount received with the relevant correspondence, receipts and minute books. (ii) Obtaining a certificate from a responsible official showing the amount of grants received.	(5) Investments Income (i) Vouching the amounts received with the dividend and interest counterfoils. (ii) Checking the calculations of interest received on securities bearing fixed rates of interest. (iii) Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend. (iv) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.
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(6) Rent: (i) Examining the rent roll and inspecting tenancy agreements, noting in each case: (a) the amounts of the rent, and (b) the due dates. (ii) Vouching the rent on to the rent roll from the counterfoils of receipt books and checking the totals of the cash book.	(7) Special function, etc. - Vouching gross receipts and outgoings in respect of any special functions, e.g. concerts, dramatic performance, etc., held in aid of the charity with such vouchers and cash statements as are necessary.	(8) Income Tax Refunds - Where income-tax has been deducted at source from the Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of incometax. This involves: (i) vouching the Income-tax refund with the correspondence with the Income-tax Department; and (ii) checking the calculation of the repayment of claims.	(9) Expenditure (i) Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly. (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test- basis. (iii) Verifying the cash and bank payments. (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.
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Q5

AUDIT OF EDUCATIONAL INSTITUTIONS (SCHOOL, COLLEGE OR UNIVERSITY)

(A) General:

1. Examine the **Trust Deed or Regulations**, in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the **Act of Legislature and the Regulation framed thereunder**.
2. Read through the **minutes of the meetings** of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(B) Fee from Students:

1. Check names entered in the **Students Fee Register** for each month or term, **with the respective Class Registers**, showing names of students on rolls and test amount of fees charged;
2. Check fees received by **comparing counterfoils** of receipts granted with entries in the **Cash Book** and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
3. Total up the various columns of the **Fees Register** for each month or term to ascertain that fees paid in advance have been carried forward and that the **arrears that are irrecoverable have been written off** under the sanction of an appropriate authority.
4. Check admission fees with **admission slips** signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
5. See that free **studentship and concessions** have been granted by a person **authorised to do so**, having regard to the Rules prepared by the Managing Committee.
6. Confirm that fines for **late payment or absence**, etc. have been either collected or remitted under proper authority.
7. Confirm that **hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded**.

(C) Other Receipts/Grants & Donations:

1. Verify **rental income** from landed property with the rent rolls, etc.
2. Vouch income from **endowments and legacies**, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
3. Verify any **Government or local authority grant** with the memo of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.

(D) Expenditure:

1. Verify that the **Provident Fund money** of the staff has been invested in appropriate securities.
2. **Vouch donations**, if any with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
3. Vouch, all **capital expenditure** in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
4. Vouch, in the usual manner, all establishment expenses and enquire into any **unduly heavy expenditure** under any head. If there was any annual budget prepared, see that any excess under any head over the budgeted amount was duly sanctioned by the Managing Committee.
5. See that increase in the salaries of the staff have been **sanctioned and minuted by the Committee**.

(E) Assets & Liabilities :

1. Report any **old heavy arrears** on account of fees, dormitory rents, etc. to the Managing Committee.
2. Confirm that **caution money and other deposits** paid by students on admission, have been shown as **liability** in the balance sheet not transferred to revenue, unless they are not refundable.
3. See that the **investments** representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
4. Ascertain that the system ordering inspection on receipt and issue of **provisions, foodstuffs, clothing and other equipment** is efficient and all bills are duly authorised and passed before payment.
5. Verify the inventories of **furniture, stationery, clothing, provision and all equipment etc.** These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

(F) Compliances:

1. Confirm that the **refund of taxes deducted from the income from investment (interest on securities etc.)** has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
2. **separate statements of account** have been prepared as regards **Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.**

Q6 AUDIT OF HOSPITAL

1. **Register of Patients:** Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, **counterfoils** and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **Income from Investments, Rent etc:** See with reference to the property and **Investment Register** that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers.
6. **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee.
7. **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
9. **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
10. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
11. **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
12. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.

Q7

AUDIT OF CLUB

1. **Entrance Fee:** Vouch the receipt on account of **entrance fees** with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
2. **Subscriptions:** Vouch **members' subscriptions** with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
3. **Arrears of Subscriptions:** Ensure that **arrears of subscriptions** for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
4. **Arithmetical accuracy:** Check totals of various columns of the Register of members and tally them across.
5. **Irrecoverable Member Dues:** See the Register of Members to ascertain the **Member's dues** which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
6. **Pricing:** Verify the internal check as regards members being charged with the **price of foodstuffs** and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.
7. **Member Accounts:** Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
8. **Purchases:** Vouch **purchase** of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
9. **Margins earned :** Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal **rates of gross profit** have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
10. **Inventories:** Check the **inventory** of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
11. **Investments:** Inspect the share scrips and bonds in respect of **investments**, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
12. **Management Powers:** Examine the **financial powers of the secretary** and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

Q7 AUDIT OF CINEMA

1. Verify the internal control mechanism-
 - (a) that entrance to the cinema-hall during show is only through printed tickets;
 - (b) that they are serially numbered and bound into books;
 - (c) that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
 - (d) that for advance booking a separate series of tickets is issued; and
 - (e) that the inventory of tickets is kept in the custody of a responsible official.
- (2) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
3. Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
4. Reconcile the amount of Tax collected with the total number of tickets issued for each class and vouch and verify the tax returns filed each month.
5. Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.
6. Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalized.
7. Confirm that depreciation on machinery and furniture has been charged at an appropriate rate.
8. Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
9. Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.
10. The arrangement for collection of the share in the restaurant income should be enquired into either a fixed sum or a fixed percentage of the taking may be receivable annually. In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, etc. as in the case of club.

Q9 HIRE - PURCHASE

- (1) A Hire-purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which-
 - (i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments,
 - (ii) the property in the goods is to pass to such person on the payment of the last of such instalments, and
 - (iii) such person has a right to terminate the agreement at any time before the property so passes.
- (2) While checking the hire- purchase transaction, the auditor may examine the following:

- (i) Hire purchase agreement is in writing and is signed by all parties.
- (ii) Hire purchase agreement specifies clearly-
 - (a) The hire-purchase price of the goods to which the agreement relates;
 - (b) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
 - (c) The date on which the agreement shall be deemed to have commenced;
 - (d) The number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments, and the date
 - (e) The goods to which the agreement relates, in a manner sufficient to identify them.
- (iii) Ensure that instalment payments are being received regularly as per the agreement.

Q10 LEASES

1. In a lease agreement, a party (called 'lessee') acquires the right to use an asset for an agreed period of time in consideration of payment of rent to another party (called 'lessor').

2. In certain lease agreements, the legal ownership of the asset remains with the lessor (the leasing company), but in substance, all the risks and rewards of ownership of the asset are transferred to the lessee. Such leases are termed as finance leases. An operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

3. Auditor's Procedures: In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor:

- (a) The object clause of leasing company to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities.
- (b) Whether there exists a procedure to ascertain the credit analysis of lessee like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.
- (c) The lease agreement should be examined and the following points may be noted:
 - (i) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed.
 - (ii) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
 - (iii) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
 - (iv) whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.

4. Ensure that the invoice is retained safely as the lease is a long-term contract.

5. Examine the acceptance letter obtained from the lessee indicating that the equipment has been received in order and is acceptable to the lessee.

6. See the Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.

7. See that the copies of the insurance policies have been obtained by the lessor for his records.

NOTE 1: Operating Lease Vs Finance Lease

	Operating Lease	Finance Lease
Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant and Machinery, Land, Office Building etc.
Ownership	Ownership of the asset remains with the lessor for the entire period of lease.	Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.
Accounting treatment	Operating lease is generally treated like a renting arrangement. That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee's balance sheet.	Finance lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.
Purchase Option	Under operating lease, the lessee does not have any option to buy the asset during the lease period.	Finance lease allows the lessee to have a purchase option at less than the fair market value of the asset.
Lease Term	Lease term generally extends to less than 75% of the projected useful life of the leased asset.	Lease term is generally more than or equal to estimated economic life of the asset under the lease arrangement.
Operating/running expenses	Lessee pays only the monthly lease payments. No running or administration costs are to be borne for example: registration, repairs etc. since it gives only right to use the asset.	Lessee generally bears insurance, maintenance and taxes.
Tax benefit	Since operating lease is as good as renting, lease payment is considered as expense. No depreciation can be claimed by the lessee.	Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.

Q11 AUDIT OF HOTELS
(1) Internal Controls -

1. **Pilfering** is one of the greatest problems in any hotel and the importance of internal control cannot be undermined.

2. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible.

3. The auditor should verify a few restaurant bills by reference to **K.O.T.s (Kitchen Order Tickets)** or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

4. The auditor should satisfy himself that all **taxes collected from occupants** on food and occupation have been paid over to the proper authorities.

5. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a **very large extent on the gross margin shown by the accounts**.

6. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

(2) Room Sales & Hall Bookings -

1. The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor.

2. The source of these entries is invariably the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.

3. Any difference between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorised.

4. In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room.

5. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.

6. The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts. The auditor should ensure that proper records are maintained for booking of halls and other premises for special parties and recovered on the basis of the tariff.

(3) Inventories -

1. The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

2. Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores.

3. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end.

Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such inventories are reasonable. In order to satisfy himself of this, the auditor should consider attending the physical inventory taking and carrying out certain pricing and calculation tests.

(4) Fixed Assets :

1. The accounting policies for fixed assets of individual hotels are likely to differ. However, many hotels account for certain quasi-fixed assets such as silver and cutlery on inventory basis.

2. This can lead to confusion between each inventory items and similar assets which are accounted for on a more normal form on assets basis.

3. In such cases, it is important that very detailed definitions of inventory items exist and the auditor should carry out tests to ensure that the definitions have been closely followed.

4. The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, whereas costs of major alterations and additions to the hotel building and facilities capitalised.

(5) Casual Labour :

1. The hotel trade operates to very large extent on casual labour.

2. The records maintained of such wage payments are frequently inadequate.

3. The auditor should ensure that defalcation on this account does not take place by suggesting proper controls to the management.

(6) Travel Agents & Shops:

1. For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.

2. Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf

Q12 AUDIT OF NON - GOVERNMENTAL ORGANISATION (NGO'S)

(A) Introduction:

- (1) NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.
- (2) Non-Governmental Organisations are generally incorporated as societies under the **Societies Registration Act, 1860** or as a trust under the **India Trust Act, 1882**, or under any other law corresponding to these Laws enforced in any part of India. NGOs can also be incorporated as a company under section 8 of the **Companies Act, 2013**.

(B) Sources and Applications of Funds

- (1) The main sources of funds include grants and donations, fund raising programmes, advertisements, fees from the members, technical assistance fees / fee for services rendered, subscriptions, gifts, sale of produce or publications, etc.
- (a) Donations and grants received in the nature of **promoter's contribution** are in the nature of capital receipts and shown as liabilities in the Balance Sheet of NGO. These may either be in the form of corpus contribution or a contribution towards revolving fund. **A contribution made towards the capital or the corpus of an NGO is known as corpus contribution.**
- (b) Section 11(1)(d) of the Income Tax Act 1961 also states that income in the form of **voluntary contributions** made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the computation of total income.
- (c) The objective of a contribution or grant towards a **Revolving Fund** is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. However, any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account.
- (d) Donations and grants received for acquisition of **specific** fixed assets are those grants whose primary condition is that an NGO accepting them should purchase, construct or otherwise acquire the assets for which the grant is given.
- (e) Many a times NGOs receive **contributions in kind**. These contributions include assets such as land, buildings, vehicles, office equipment, etc. and articles related to

programmes / projects such as food, books, building materials, clothes, beds, and raw material for training purposes, e.g., Wool, reeds, cloth, etc.

(2) The areas of application of funds for an NGO include Establishment Costs, Office and Administrative Expenses, Maintenance Expenses, Programme / Project Expenses, Charity, Donations and Contributions given, etc.

(C) Provisions Relating to Audit:

1. The Foreign Contribution (Regulation) Act 2010 has prescribed the format and requires that the same be furnished to the Ministry of Home Affairs within 60 days from the close of the financial year i.e. by May 30 each year.

(1) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.

(2) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 2010, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.

(3) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.

(4) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.

(5) Examination of minutes of the Board/Managing Committee/Governing Body/ Management and Committees thereof to ascertain the impact of any decisions on the financial records.

(6) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

(7) Setting of materiality levels for audit purposes.

(8) The nature and timing of reports or other communications.

(9) The involvement of experts and their reports.

(10) Review the previous year's Audit Report.

While planning
the audit, the
auditor may
concentrate on
the following:

2. The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted.

(1) **Corpus Fund:** The contributions / grants received towards corpus be vouched with special reference to the letters from the donor(s). The interest income be checked with Investment Register and Physical Investments in hand.

(2) **Reserves:** Vouch transfers from projects / programmes with donors letters and board resolutions of NGO. Also check transfer of gross value of asset sold from capital reserve to general reserve and adjustments during the year.

(3) **Ear-marked Funds:** (Earmarking refers to a fund allocation practice in which an entity, a government, or an individual sets aside a determined amount of funds to use for a specific goal). Check requirements of donors institutions, board resolution of NGO, rules and regulations of the schemes of the earmarked funds.

(4) **Project / Agency Balances:** Vouch disbursements and expenditure as per agreements with donors for each of the balances.

(v) **Loans:** Vouch loans with loan agreements, counterfoil of receipt issued.

(vi) **Fixed Assets:** Vouch all acquisitions / sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/ agreements for the grant. In the case of immovable property check title, etc.

(vii) **Investments:** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and disinvestments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.

(viii) **Cash in Hand:** Physically verify the cash in hand and imprest balances, at the close of the year and whether it tallies with the books of account.

(ix) **Bank Balance:** Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.

(x) **Inventory:** Verify inventory in hand and obtain certificate from the management for the quantities and valuation of the same.

(xi) **Programme and Project Expenses:** Verify agreement with donor/contributor(s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/ projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.

(xii) **Establishment Expenses:** Verify that provident fund, life insurance premium, employees state insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

3. The receipt of income of NGO may be checked on the following lines:

(i) Contributions and Grants for projects and programmes: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 2010	(ii) Receipts from fund raising programmes: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.	(iii) Membership Fees: Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.	(iv) Subscriptions: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine / circulars / periodicals. Check the receipts with subscription rate schedule.	(v) Interest and Dividends: Check the interest and dividends received and receivable with investments held during the year.
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Q13 AUDIT OF TRUSTS & SOCIETIES

(1) There are three basic legal forms of charitable entities under Indian law: trusts, societies, and section 8 companies. The legal framework governing the charitable institution will depend on the form of business organization the charitable institution takes.

- If the charitable institution is formed as a Public Trust, it will be governed by the Public Trust Act applicable in the relevant State. However, if no Public Trust Act exists in that state, then the applicable legislation will be the Indian Trusts Act, 1882.
- If the charitable institution is formed as a Society, it will be governed by the Societies Registration Act, 1860.
- The charitable institution can also be formed as a non-profit company under section 8 of the Companies Act, 2013.
- Apart from the above legislations, the Income Tax Act 1961 will be applicable to charitable institutions.
- And in the case of foreign contributions to these charitable institutions, the Foreign Contribution (Regulation) Act, 2010 will be applicable.

(2) **BOOKS OF ACCOUNT:** Charitable and religious trusts should maintain regular books of account. This will enable management to demonstrate due discharge of responsibilities they assume. The Auditor is required to report whether the Trust has maintained proper books of accounts, including the following, namely:

- (i) cash book;
- (ii) ledger;
- (iii) journal;
- (iv) copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the trust, and copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by the trust;
- (v) original bills wherever issued to the person and receipts in respect of payments made by the person;
- (vi) any other book that may be required to be maintained in order to give a true and fair view of the state of the affairs of the person and explain the transactions effected;

(3) FINANCIAL STATEMENTS: Every year the trust has to prepare financial statements like the Balance sheet and Income and expenditure statements based on its books of accounts. The format for preparation and presentation of financial statements is prescribed under respective state laws.

TRUSTS & SOCIETIES

TRUSTS

The auditor has to ascertain :-

- (i) whether accounts are maintained regularly and in accordance with the provisions of the applicable Act and the rules;
- (ii) whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.
- (iii) whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;
- (iv) whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;
- (v) whether a register of movable and immovable properties is maintained, the changes therein are communicated from time to time to the regional office.
- (vi) whether the maximum and minimum number of the trustees is maintained;
- (vii) whether the meetings are held regularly as provided in such instrument
- (viii) whether the minute books of the proceedings of the meeting is maintained
- (ix) whether any of the trustees has any interest in the investment of the trust
- (x) whether any of the trustees is a debtor or creditor of the trust.

SOCIETIES

The auditor's considerations:-

- (i) The auditor should ascertain governing legislation of society i.e. Societies Registration Act, 1860 or any applicable state law under which it has been registered.
- (ii) Object of society needs to be ascertained from its memorandum of association/bye laws. Its activities may include charitable, social, cultural or educational activities.
- (iii) Ascertain whether society has obtained registration under Foreign Contribution (Regulation) Act, 2010 in case foreign contributions are received.
- (iv) Ascertain whether it is also registered under relevant provisions of Income Tax Act which may make it eligible for tax exemption on its income.
- (v) Obtain an understanding of internal control to design audit procedures with special reference to donations and various expenditures incurred in relation to achievements of objects of society.
- (vi) Evaluate appropriateness of accounting policies with special reference to donations and grants. Also evaluate accounting policies in relation to specific grants.
- (vii) In case some expenses incurred by society are reimbursed by donors, ascertain how these are recognized in financial statements.
- (viii) Ascertain, if any inquiry has been held by Registrar under applicable law in the working or financial condition of society and its implications for auditor's opinion.
- (ix) Ascertain all cases of irregular, illegal or improper expenditure or failure or omission to recover monies or other property belonging to society or of loss or waste of money or other property thereof.
- (x) Ascertain whether such expenditure or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of governing body.

PART 2 - AUDIT OF CO-OPERATIVE SOCIETIES

Q1 MEANING

Co-operative society is a **business organisation** with a special mode of doing business, by pulling together all the means of production **co-operatively**, **elimination of middlemen** and **exploitation from outside forces**.

Q2 AUDIT AS PER SECTION 17 OF THE CO-OPERATIVE SOCIETIES ACT, 1912

The following points should be kept in mind in connection with the audit of a co-operative society:

1. **Qualifications of Auditors** - Apart from a chartered accountant within the meaning of the **Chartered Accountants Act, 1949**, some of the State Co-operative Acts have permitted **persons holding a government diploma in co-operative accounts or in co-operation and accountancy** and also a person who has served as an auditor in the co-operative department of a government to act as an auditor.
2. **Appointment of the Auditor** - by the **Registrar of Co-operative Societies**. The **audit fees** are paid by the society on the basis of **statutory scale of fees** prescribed by the Registrar, according to the category of the society audited.
3. **Books, Accounts and other records of Co-operative Societies** - Under **section 43(h)** of the Central Act, a **state government** can frame rules prescribing the books and accounts to be kept by a co-operative society. For example, in **Maharashtra**, the **co-operative societies** are required to maintain books of account in terms of the instructions of the Registrar as following:
 - (i) All sums of money **received and expended** by the society and the matters in respect of which receipts and expenditure take place.
 - (ii) All **sales and purchases of goods** by the society.
 - (iii) **Assets and liabilities** of the society.Depending upon the **nature and object** of the society, different kinds of books and registers will be maintained, so as to disclose a proper and fair picture of financial transactions. In case of **large scale co-operative organisation**, different subsidiary **books** and registers shall be maintained and the daily summary totals will be transferred to main **Cash Book**.

For example:

- (a) Daily cash sales summary register.
- (b) A register of collection from debtors if credit sales are allowed by bye-laws of society.
- (c) A register of recovery of loans from salaries and directly by receipts from members in case of credit society.
- (d) Loan disbursement register in case of credit society.
- (e) Any other columnar subsidiaries depending upon the nature and functions of society.

4. Restrictions on share holdings - no member of a society other than a registered society can hold such portion of the share capital of the society as would exceed a maximum of twenty percent of the total number of shares or of the value of shareholding to ₹ 1,000/-.

5. Restrictions on loans - It states that a registered society shall not make a loan to any person other than a member. However, with the special sanction of the Registrar, a registered society may make a loan to another registered society. The State Government may further put such restrictions as it thinks fit.

6. Restrictions on borrowings - a registered society shall accept loans and deposits from persons who are not members subject to the restrictions and limits of the bye-laws of the society.

7. Investment of funds - According to section 32 of the Central Act, a society may invest its funds in any one or more of the following:

- (a) In the Central or State Co-operative Bank.
- (b) In any of the securities specified in section 20 of the Indian Trusts Act, 1882.
- (c) In the shares, securities, bonds or debentures of any other society with limited liability.
- (d) In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.
- (e) In any other moneys permitted by the Central or State Government.

8. Appropriation of profits - a prescribed percentage of the profits should be transferred to Reserve Fund, before distribution as dividends or bonus to members.

9. Contributions to Charitable Purposes - a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose.

10. Investment of Reserve Fund outside the business or utilisation as working capital - Some of the State Acts provide that a society may use the Reserve Fund:

- (a) in the business of a society, as working capital (subject to the rules made in this behalf).

- (b) may invest as per provisions of the Act.
- (c) may be used for some public purposes likely to promote the object of the society.

The auditor should ensure strict compliance with the State Act and Rules in this regard.

11. **Contribution to Education Fund** - Some of the State Acts provide that every society shall contribute annually towards the Education Fund of the State Federal Society, at the appropriate rate as per the class of the society. Contribution to Education Fund is a charge on profits and not an appropriation.

Q3 SPECIAL FEATURES OF CO-OPERATIVE AUDIT

1. **Examination of overdue debts** - Overdue debts for a period from 6 months to 5 years and more than 5 years will have to be classified and shall have to be reported by an auditor. The auditor will have to ascertain whether proper provisions for doubtful debts are made and whether the same is satisfactory.

2. **Overdue Interest** - Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

3. **Certification of Bad Debts** - A peculiar feature regarding the writing off of the bad debts as per Maharashtra State Co-operative Rules, 1961, is very interesting to note. As per the said rules, bad debts can be written off only when they are certified as bad by the auditor. Where no such requirement exists, the managing committee of the society must authorise the write-off

4. **Valuation of Assets and Liabilities** - Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted.

5. **Adherence to Co-operative Principles** - The auditor will have to ascertain in general, how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working.

6. **Observations of the Provisions of the Act and Rules** - An auditor of a cooperative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws.

7. **Verification of Members' Register and examination of their pass books** - Examination of entries in members pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation. Specifically in the rural and agricultural credit societies, members are not literate and as such this is a good safeguard on their part.

8. **Special report to the Registrar** - During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar. In the following cases, for instance, a special report may become necessary:

(i) **Personal profiteering by members of managing committee** in transactions of the society, which are ultimately detrimental to the interest of the society.

(ii) **Detection of fraud** relating to expenses, purchases, property and stores of the society.

(iii) **Specific examples of mis-management**. Decisions of management against cooperative principles.

(iv) In the case of urban co-operative banks, **disproportionate advances to vested interest groups**, such as relatives of management, and deliberate negligence about the recovery thereof.

9. **Audit classification of society** - After a judgement of an overall performance of the society, the auditor has to award a class to the society. This judgement is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification.

10. **Discussion of draft audit report with managing committee** - On conclusion of the audit, the auditor should ask the **Secretary of the society** to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee.

Q4 MULTI-STATE CO-OPERATIVE SOCIETIES

1.

Book of Accounts - Multi State Cooperative Society



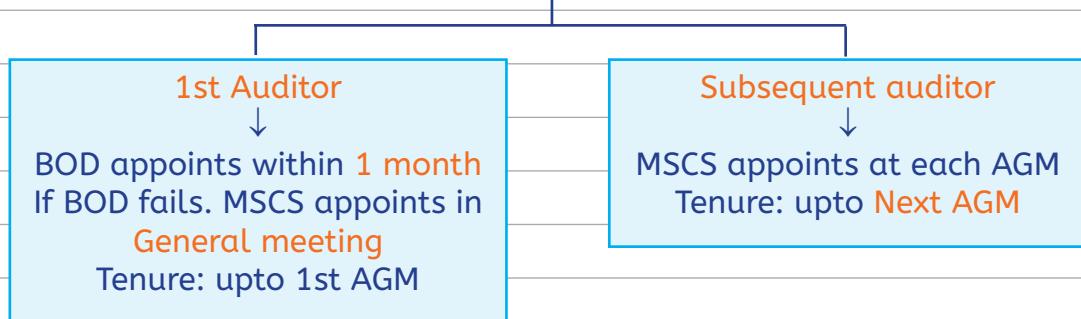
2. Qualification of Auditors - Section 72 of the Multi-State Co-operative Societies

Act, 2002 states that a person who is a Chartered Accountant within the meaning of the **Chartered Accountants Act, 1949** can only be appointed as auditor of Multi-State co-operative society. However the following persons **are not eligible for appointment** as auditors of a Multi-State co-operative society-

- (a) A body corporate.
- (b) An **officer or employee** of the Multi-State co-operative society.
- (c) A person who is a **member** or who is in the **employment**, of an **officer or employee** of the Multi-State co-operative society.
- (d) A person who is **indebted to the Multi-State co-operative society** or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an **amount exceeding one thousand rupees**.

Note: If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have **vacated his office** as such.

3. Appointment of Auditors -



4. Power and duties of Auditors – Section 73 :

1. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State co-operative society or elsewhere,
2. shall be entitled to require from the officers or other employees of the Multi- State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.
3. As per section 73(2), the auditor shall make following inquiries:
 - (a) Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi- State co- operative society or its members,
 - (b) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,
 - (c) Whether personal expenses have been charged to revenue account, and
 - (d) Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.

5. Content of Auditor's Report -

- (a) In the case of the **balance-sheet**, of the state of the Multi-State co-operative society's affairs as at the end of its **financial year**; and
- (b) In the case of the **profit and loss account**, of the profit or loss for its **financial year**.
The auditor's report shall also state:
 - (i) Whether he has **obtained all the information and explanation** which to the best of his knowledge and belief were necessary for the purpose of his audit.
 - (ii) Whether, in his opinion, **proper books of account have been kept** by the Multi-State co-operative society so far as appears from his examination of these books and proper returns adequate for the purpose of his audit have been received from branches or offices of the Multi-State cooperative society not visited by him.

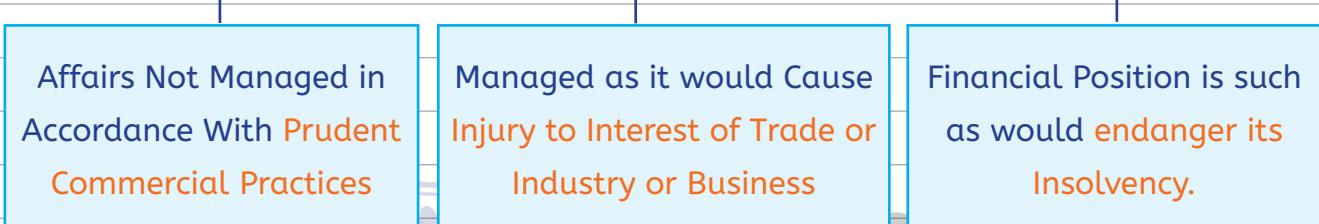
(iii) Whether the report on the accounts of any branch office audited by a person other than the Multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

(iv) Whether the Multi-State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

6. Power of Central Government to direct special audit in certain cases-

Power of Central Government to Direct Special Audit



- Central Government's Order:** The Central Government may at any time by order direct that a special audit of the Multi-State co-operative society's accounts for such period or periods as may be specified in the order shall be conducted.
- Appointment of the Auditor:** It may appoint either a chartered accountant or the Multi-State co-operative society's auditor himself to conduct the special audit.
- Shareholding Restriction:** However, Central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one percent or more of the paid-up share capital in such Multi-State co-operative society.
- Special Auditor's Powers, Duties & Report:** The special auditor shall have the same powers and duties in relation to the special audit as an auditor of a Multi-State co-operative society has under section 73. However the special auditor shall instead of making his report to the members of the Multi-State co-operative society make the report to the Central Government.
- Action by the Central Government:** On receipt of the report of the special auditor the Central Government may take such action on the report as it considers necessary. However, if the Central Government does not take any action on the report within four months from the date of its receipt, that Government shall send to the Multi-

6. Expenses pertaining to the Special Audit: The expenses of, and incidental to, any special audit under this section (including the remuneration of the special auditor) shall be determined by the Central Government which determination shall be final and paid by the Multi-State Co-operative society and in default of such payment, shall be recoverable from the Multi-State Co-operative society as an arrear of land revenue.

Q5

INQUIRY BY CENTRAL REGISTRAR UNDER SECTION 78

Inquiry - sec 78:

(A) When

Request from:

- federal co-op to which MSCC is affiliated or
- a Creditor or
- 1/3rd of member of BOD or
- 1/5th of total no. of member of MSCS

(B) How

Central Registrar

Himself or direct any person authorised by from writing inquiry/insepction.

• Constitution

• Working

• Financial condition

(C) Opportunity of being heard

Notice of inq! insepction atleast 15 day prior to holding ing/inspectin.

(D) Power:

<ol style="list-style-type: none"> 1. Access to books, accounts, documented & related document. 2. Summon any person in who's possession there are books, accounts documents & related documents. 3. Require officer or employee of soc. to call a meeting by giving a notice of not less than 7 days. 4. If office fails or refuses he shall power to call a meeting himself. 5. Examine a person on oath 	<ol style="list-style-type: none"> 1. Access to books, account documents & related docs. 2. Can take them into custody in case of serious irregularity. 3. Call meeting of the soc. 4. Ask member / officer of soc. to furnish into related working of the society.
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Report

Within 3 months furnish report to:

- MSCS
- Financial Institution
- Person or who's request inq is conducted

Within 3 months furnish report to

- MSCS

PART 3 - (A) GOVERNMENT AUDIT

Q1 CONSOLIDATED FUND OF INDIA

As per Article 266, the Consolidated Fund of India consists of all the **revenue** received from direct and indirect taxes, **all the loans taken** by the Govt. of India and **all the amount of repayment of loans received** by the Govt. of India).

Q2 GOVERNMENT AUDITING

The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government auditing is:

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials
- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

Q3 OBJECTIVES

1. Accounting for Public Funds: Government audit serves as a mechanism or process for public accounting of government funds.	2. Appraisal of Government policies: It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.	3. Base for Corrective actions: Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measure
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Q4 LEGAL FRAMEWORK AND COMPTROLLER & AUDITOR GENERAL

(A) APPOINTMENT & REMOVAL

1. The Constitution guarantees the independence of the C&AG of India by prescribing that he shall be appointed by the President of India and shall not be removed from office except on the ground of proven mis-behaviour or incapacity.

As in the case of a Judge of the Supreme Court, he can be removed only when each House of Parliament decides to do so by a majority of not less than 2/3rd of the members of the House present and voting.'

2. TENURE & Salary:

The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 passed in pursuance of the provisions of the Constitution lays down a fixed tenure of the office prescribing that he shall be paid a salary which is equal to the salary of the Judge of the Supreme Court.

3. VARIOUS CONSTITUTIONAL PROVISIONS:

Article 149 states that the C&AG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by the Parliament.

Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C & AG prescribe.

Article 151 requires that the reports of the C&AG relating to the accounts of the Union/ State shall be submitted to the President/Governor who shall cause them to be laid before House of Parliament/ State Legislature.

The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines these functions and powers in detail.

Q5 COMPTROLLER AND AUDITOR GENERAL'S — DUTIES AND POWERS

Duties of the C&AG:

(i) **Compile and submit Accounts of Union and States** - shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control.

(ii) **General Provisions Relating to Audit** -
It shall be the duty of the Comptroller and Auditor General –

(a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;

(b) to audit and report all transactions of the Union and of the States relating to **Contingency Funds and Public Accounts**;

(c) to audit and report on all **trading, manufacturing and profit and loss accounts** and **balance-sheets** and other subsidiary accounts kept in any department of the Union or of a State.

(iii) **Audit of Receipts and Expenditure** - Where anybody or authority is **substantially financed** by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall.

NOTE: Meaning of Substantially financed: Where the **grant or loan** to a body or authority from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly in a financial year **is not less than ` 25 lakhs** and the amount of such grant or loan is **not less than 75% of the total expenditure** of that body or authority, such body or authority shall be deemed, for this purpose to be substantially financed by such grants or loans as the case may be.

(iv) **Audit of Grants or Loans** - Where any grant or loan is given for any **specific purpose** from the Consolidated Fund of India or of the Comptroller and Auditor General shall scrutinise the **procedures by which the sanctioning authority satisfies itself as to the fulfillment** of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

(v) **Audit of Receipts of Union or States** - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of

India and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

- (vi) **Audit of Accounts of Stores and Inventory** - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.
- (vii) **Audit of Government Companies and Corporations** - The Comptroller and Auditor-General of India shall appoint the auditor under section 139(5) or 139(7) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India.

Powers of C & AG:

The C & AG Act gives the following powers to the C&AG in connection with the performance of his duties-

- (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
- (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.
- (d) In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine.

Q6

EXPENDITURE AUDIT

The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred.

These standards are—

- (i) that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.

- (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the **audit of sanctions**.
- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as **audit against provision of funds**.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as **propriety audit**.
- (v) that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the **performance audit**.

(A) Audit against Rules & Orders -

- 1. Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder.
- 2. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a **competent authority**.
- 3. Audit of expenditure against regularity is of a **quasi-judicial type** of work performed by the audit authorities.
- 4. It involves interpretation of the Constitution, statutes, rules, regulations and orders.
- 5. The final power of interpretation of these, however, does not vest with the C&AG.
- 6. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:
 - (i) Rules and orders regulating the powers to **incur and sanction expenditure** from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
 - (ii) Rules and orders dealing with the **mode of presentation of claims** against government, withdrawing moneys from the **Consolidated Fund**, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
 - (iii) Rules and orders regulating the **conditions of service, pay and allowances**, and pensions of government servants.

The job of audit is to see that these rules regulation and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be.

But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) they are not inconsistent with any provisions of the Constitution or any laws made thereunder;
- (b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- (c) they do not come in conflict with the orders of, or rules made by, any higher authority; and
- (d) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

(B) Audit of sanctions -

- 1. The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority
- 2. The audit of sanctions is directed both in respect of ensuring that the expenditure is properly covered by a sanction, and also to satisfy that the authority sanctioning it is competent for the purpose by virtue of the powers vested in it by the provisions of the Constitution and of the law, rules or orders made thereunder, or by the rules of delegation of financial powers made by an authority competent to do so.

(C) Audit against provision of funds - Audit against provision of funds aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.

(D) Propriety audit - According to 'Propriety audit', the auditors try to bring out cases of improper, avoidable, or ineffective expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

- (a) The expenditure should not be **prima facie** more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (b) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (c) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
 - (i) the amount of expenditure involved is insignificant; or
 - (ii) a claim for the amount could be enforced in a Court of law; or
 - (iii) the expenditure is in pursuance of a recognised policy or custom; and

(iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

(E) **Performance audit** - The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit:

Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e., the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner.

Economy audit looks into whether government have acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.

Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

The procedure for conducting performance audit covers:

- identification of topic,
- preliminary study,
- planning,
- execution of audit, and
- reporting.

Q7 AUDIT OF RECEIPTS

The audit of receipts is neither all pervasive or as old as audit of expenditure but has come to stay in some countries. Such an audit provides for checking;

- (i) whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities;
- (ii) whether adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper

allocation of cases;

- (iii) whether such **regulations and procedures** are actually being carried out;
- (iv) whether adequate checks are imposed to ensure the **prompt detection and investigation of irregularities**, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or willful omission or negligence to levy or collect taxes or to issue refunds; and
- (v) review of **systems and procedures** to see that the internal procedures adequately **secure correct and regular accounting of demands** collection and refunds and pursuant of dues up to final settlement and to suggest improvement.
- (vi) The **extent and quantum** of audit required to be done under each **category of audit** are determined by the C&AG. These are neither negotiable nor questioned. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader.

Q8 AUDIT OF STORES AND INVENTORIES

Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted: to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.

- to bring to the notice of the government **any deficiencies in quantities of stores held or any defects in the system of control.**
- to verify that the **purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.**
- to ensure that the **prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores**, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.
- to check the accounts of **receipts, issues and balances** regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence.

Q9 AUDIT OF COMMERCIAL ACCOUNTS

(a) departmental enterprises (b) statutory bodies, (c) government companies set up engaged in commercial corporations, created by under the Companies Act, 2013. and trading operations, specific statutes mostly Audit of government companies is which are subject to the financed by government in conducted by their own auditors same laws, financial and the form of loans, grants, under the statute appointed by other regulations as other etc.; and C&AG. In addition, the C&AG government departments Audit of statutory bodies conducts a supplementary test audit and agencies; or corporations depends of the accounts, as well as periodical Audit of is undertaken in on the nature and type of financial audit and appraisal of the same manner as any the statute governing the performance. The C&AG also issues department of government bodies or corporations. direction to the company auditors for where commercial accounts Financial / accounts audit reporting on specific aspects of their are kept. is conducted by the C&AG, audit work. These are reviewed, and

and where compilation of condensed in the audit reports to the accounts is vested with the government/legislatures. C&AG has C&AG, functions, norms adopted the mechanism of an Audit and standards of works Board-comprising of representatives usually followed by the of the audit and nominees of professional auditors are government including functional adopted mutatis mutandis. specialists to process reviews or appraisals on performance.

Q10 ROLE OF C&AG IS PRESCRIBED UNDER SUB SECTION (5), (6) AND (7) OF SECTION 143 OF THE COMPANIES ACT, 2013.

1. **Power to appoint Government Company Auditor:** Section 143(5) appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India.
2. **Power to conduct Supplementary Audit & comment thereupon:** The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,

(a) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(b) comment upon or supplement such audit report under section 143(6)(b). Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section of section 136.

3. **Test Audit:** Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

Q11 REPORTING PROCEDURES

1. Article 151 of the Indian Constitution enjoins that the C&AG shall report on the accounts of the Union and of each of the States to the President or the Governor concerned and the latter shall cause the report to be laid before the legislatures.
2. The reports should not only be presented to the legislatures but thereafter also publicised adequately in order to create a proper climate of public opinion for taking remedial action where necessary, on the findings of the Auditor General.
3. This may also constitute a more effective safeguard in the future.
4. The reporting is factual and the conclusions are left to be drawn by the reader. This is presumably to ensure total objectivity.
5. Nothing debars C&AG from making recommendations in the audit report but traditionally this has been left to be done by the Public Accounts Committee.

PART 3 - (B) AUDIT OF LOCAL BODIES

Q1 INTRODUCTION

(1) A **Municipality** can be defined as a unit of local self-government in an urban area. By the term 'local self-government' is ordinarily understood the administration of a locality – a village, a town, a city or any other area smaller than a state – by a body representing the local inhabitants, possessing fairly large autonomy, raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and, therefore, distinct from state and central services.

(2) Municipal government in India covers five distinct types of urban local authorities:

- the municipal corporations,
- the municipal councils,
- the notified area committees,
- the town area committees and
- the cantonment committees.

(3) Municipal authorities are endowed with specific local functions covering

- (a) regulatory,
- (b) maintenance and
- (c) development activities.

(4) Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads:

- (a) general administration and revenue collection,
- (b) public health,
- (c) public safety,
- (d) education,
- (e) public works, and
- (f) others such as interest payments, etc.

(5) Property taxes and octroi are the major sources of revenue of the municipal authorities; other municipal taxes are profession tax, non-mechanised vehicles tax, taxes on advertisements, taxes on animals and boats, tolls, show-tax, etc.

(6) Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

- (a) General purpose grants: These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.

(b) Specific purpose grants: These grants which are tied to the provision of certain services or performance of certain tasks.

(c) Statutory and compensatory grants: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

Q2 FINANCIAL ADMINISTRATION**(a) Budgetary Procedure:**

- This is geared to subserve the twin considerations of financial accountability and control of expenditure.
- The main objective is to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or council.
- Budget preparation is usually the occasion for determining the levels of taxation and rates and the ceilings on expenditure.
- One important feature of the municipal budgets is that there is no strict separation between revenue and capital items; usually there is a 'head' called extraordinary items which cover most of the capital transactions.
- There are, however, a number of special funds (e.g. roads) or in some cases separate budgets for specific municipal functions (e.g. education) or enterprise activities (e.g., water supply and sanitation, transport, electricity, etc.)

(b) Expenditure Control:

- The system of financial control existing in the state and central government level is conditioned by the fact that there is a clear demarcation between the legislature and executive.
- The integration of legislation and executive powers in the municipal council makes it difficult for its executive to function as its inquisitorial body as well.
- This leaves the system of external audit by state government as the only instrument of controlling municipal expenditure.

(c) Accounting System:

Municipal accounting and budget format have been criticised as neither simple nor comprehensible, sometimes providing inadequate information and at other times a surfeit of information. Both these situations are not conducive to a proper system of management information.

Q3 OBJECTIVE OF AUDIT OF LOCAL BODIES

The important objectives of audit are:

- (a) reporting on the fairness of the content and presentation of financial statements;
- (b) reporting upon the strengths and weaknesses of systems of financial control;
- (c) reporting on the adherence to legal and/or administrative requirements;
- (d) reporting upon whether value is being fully received on money spent; and
- (e) detection and prevention of error, fraud and misuse of resources.

- Audit is another method of financial control on local governments. This provision is coupled with the privilege of ultra vires.
- An action of the local authority if it is beyond legal authority can result in 'surcharge' by audit.

Q4 AUDIT PROGRAMME FOR LOCAL BODIES

- (i) **APPOINTMENT:** The Local Fund Audit Wing of the State Govt. is generally in-charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc. have power to appoint their own auditors for regular external audit. So the auditor should ensure his appointment.
- (ii) **AUDITOR'S CONCERNS:** The auditor while auditing the local bodies should report on the
 - fairness of the contents and presentation of financial statements,
 - the strengths and weaknesses of system of financial control,
 - the adherence to legal and/or administrative requirements;
 - whether value is being fully received on money spent.His objective should be to detect errors and fraud and misuse of resources.
- (iii) **RULES & REGULATIONS:** The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.
- (iv) **AUTHORISATIONS:** He should ensure that all types of sanctions, either special or general, accorded by the competent authority.
- (v) **PROVISIONING:** He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.
- (vi) **PERFORMANCE:** The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

10

AUDIT OF BANKS

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Q1 TYPES OF BANKS

There are different types of banking institutions prevailing in India which are as follows:

1. **Commercial banks** are the most wide spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are:
 - (a) accepting deposits and
 - (b) granting advances
2. **Regional Rural Banks** known as **RRBs** are the banks that have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities.
Examples are: Punjab Gramin Bank, Tripura Gramin Bank, Allahabad UP Gramin Bank, Andhra Pradesh Grameen Vikas Bank, etc.
3. **Co-operative Banks** function like Commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act of the respective state or the Multistate Cooperative Societies Act and usually cater to the needs of the agricultural and rural sectors.
Examples are: The Gujarat State Co-operative Bank Ltd., Chhattisgarh Rajya Sahakari Bank Maryadit, etc.
4. **Payments Banks** are a new type of banks which have been recently introduced by RBI. They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However, customers can open Current & Savings accounts and also avail the facility of ATM cum Debit cards, Internet-banking & Mobilebanking.
Examples are: Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank, etc.
5. **Development Banks** had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country.
Examples are: Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI) , etc.
6. **Small Finance Banks** have been set up by RBI to make available basic financial and banking facilities to the unserved and **unorganised** sectors like small marginal farmers, small & micro business units, etc.
Examples are: Equitas Small Finance Bank , AU Small Finance Bank , etc.

Q2 RESERVE BANK OF INDIA: REGULATING BODY

The functioning of banking industry in India is regulated by the **Reserve Bank of India (RBI)** which acts as the **Central Bank** of our country.

RBI is responsible for:

1. development and supervision of the constituents of the Indian financial system
2. the monetary and credit policies
3. regulating the activities of commercial and other banks.

Important functions of RBI are:

1. issuance of currency;
2. regulation of currency issue;
3. acting as banker to the central and state governments; and
4. acting as banker to commercial and other types of banks.

Q3 REGULATORY FRAMEWORK

1. Banking Regulation Act, 1949.
2. State Bank of India Act, 1955.
3. Companies Act, 2013.
4. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.
5. Regional Rural Banks Act, 1976.
6. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
7. Information Technology Act, 2000.
8. Prevention of Money Laundering Act, 2002.
9. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
10. Credit Information Companies Regulation Act, 2005.
11. Payment and Settlement Systems Act, 2007.
12. RBI Act 1934

Q4 PECULIARITIES INVOLVED

1. Huge volumes and complexity of transactions;
2. Wide geographical spread of banks' network;
3. Large range of products and services offered;
4. Extensive use of technology;
5. Strict vigilance by the banking regulator etc.

Q5

TYPES OF BANK AUDIT REPORTS TO BE ISSUED (GENERALLY)

Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

- (1) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
- (2) Long Form Audit Report. (LFAR)
- (3) Report on compliance with SLR requirements.
- (4) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
- (5) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
- (6) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
- (7) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
- (8) Report on instances of adverse credit-deposit ratio in the rural areas.

Q6

FORM AND CONTENT OF FINANCIAL STATEMENTS

1. Sub-sections (1) and (2) of Section 29 of the Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company and their authentication.
2. Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act.
3. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.
4. Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, in so far as they apply to banking companies or the Accounting Standards issued by the ICAI.

Q7 AUDIT OF ACCOUNTS

Sub-section (1) of section 30 of the Banking Regulations Act, 1949 requires that the balance sheet and profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

Q8 ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITOR

Applicable as to a Company Auditor

Q9 APPOINTMENT OF AUDITOR

(1) The auditor of a banking company is to be appointed by the bank to be appointed at the annual general meeting of shareholders, acting through its Board of Directors. (In either case, approval of the Reserve Bank of India is required before the appointment is made.)

(2) The auditor of a nationalised bank is to be appointed by the bank concerned with the approval of the Central Government.

(3) The auditors of regional rural banks are to be appointed by the bank concerned with the approval of the Central Government.

Q10 REMUNERATION OF AUDITOR

(1) The remuneration of auditor of a banking company is to be fixed in accordance with the provisions of Section 142 of the Companies Act, 2013 (i.e., by the company in general meeting or in such manner as the company in general meeting may determine).

(2) The remuneration of auditors of nationalised banks and State Bank of India is to be fixed by the Reserve Bank of India in consultation with the Central Government.

Q11 POWERS OF AUDITOR

The auditor of a banking company, nationalised bank, State Bank of India, or regional rural bank has the same powers as those of a company's auditor in the matter of access to the books, accounts, documents and vouchers.

Q12 AUDITOR'S REPORT

In the case of a nationalised bank, the auditor is required to make a report to the Central Government in which he has to state the following:

↓ ↓ ↓ ↓

(a) whether, in his opinion, the (b) whether or not (c) whether or not the (d) any other matter
 FS present a true and fair view the transactions returns received from which he considers
 of the affairs of the bank and of the bank, which the offices and branches should be brought
 in case he had called for any have come to his of the bank have been to the notice of the
 explanation or information, notice, have been found adequate for the Central Government.
 whether it has been given made within the purpose of his audit;
 and whether it is satisfactory; powers of that bank; and

Note: The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor's report in the case of a nationalised bank.

Q13 FORMAT OF REPORT

1. The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of Standards on Auditing discussed in Chapter 8 on Audit Report.
2. The auditor should ensure that not only information relating to number of unaudited branches is given but quantification of advances, deposits, interest income and interest expense for such unaudited branches has also been disclosed in the audit report.
3. The auditor of a banking company is also required to state in his report the matters covered by Section 143 of the Companies Act, 2013.
4. However, it is pertinent to mention that the reporting requirements relating to the Companies (Auditor's Report) Order, 2020 is not applicable to a banking company, as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949.

Q14 LONG FORM AUDIT REPORT

1. Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR).
2. The matters which the banks require their auditors to deal with in the long form audit report have been specified by the Reserve Bank of India.

3. The Statutory Central Auditors are required to submit the LFAR to the banks latest by **30th June** every year.
4. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required.
5. While the format of LFAR does not require an executive summary to be given, members may consider providing the same to bring out the key observations from the whole document.

Q15 **REPORTING TO RBI**

1. The RBI issued a Circular relating to implementation of recommendations of Committee on Legal Aspects of Bank Frauds applicable to all scheduled commercial banks (excluding Regional Rural Banks). Regarding liability of accounting and auditing profession, the said circular provided as under.
2. If an accounting professional, whether in the course of internal or external audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of excess power or smell any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action”.
3. As per the above requirement, the member shall be required to report the kind of matters stated in the circular to RBI.
4. Auditor should also consider the provisions of **SA 250, “Consideration of Laws and Regulations in an Audit of Financial Statements”**. The said Standard explains that the duty of confidentiality is over-ridden by statute, law or courts.
5. **SA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”** states that an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
6. It must be noted that auditor is not expected to look into each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing his normal duties comes across any instance, he should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

Q16 **(I) MEANING**

Advances are amount of money or credit, given as a loan from a bank to another party with an agreement that the money will be repaid.

Q16 (II) TYPES OF ADVANCES

Funded Loans & Non-Funded Loans -

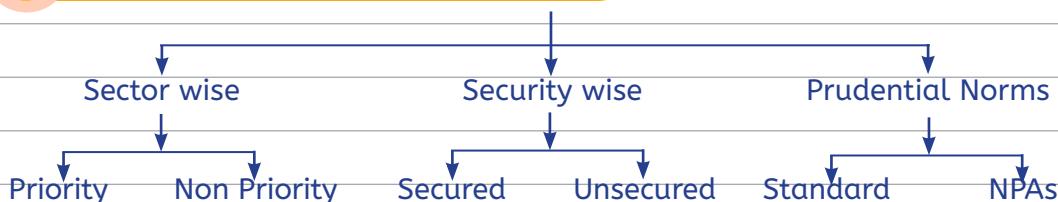
Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower. Examples of funded loans are Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans. Non-funded facilities are those which do not involve such transfer. Examples of non-funded loans are Letters of credit, Bank guarantees, etc.

Q16 (III) LEGAL REQUIREMENTS OF DISCLOSURE IN THE BALANCE SHEET

- A. (i) Bills purchased and discounted
- (ii) Cash credits, Overdrafts and loans repayable on demand
- (iii) Term Loans
- B. (i) Secured by tangible assets
- (ii) Covered by Bank/Government guarantees
- (iii) Unsecured

(I) Advances in India:		(II) Advances outside India:
(i) Priority sectors		(i) Due from Banks
(ii) Public sector		(ii) Due from others:
(iii) Banks		(a) Bills Purchased and discounted
(iv) Others		(b) Syndicated loans
		(c) Others

Q16 (IV) CLASSIFICATION OF ADVANCES



1. SECTOR WISE:

RBI issues common guidelines for lending to Priority Sector which banks are required to follow. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement. RBI also issues targets for banks for lending to Priority Sector.

2. SECURITY WISE:

(a) **Primary** security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

(b) **Collateral security** is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

Examples of most common types of securities accepted by banks are the following:

- Personal Security of Guarantor
- Goods/Stocks/Debtors/Trade Receivables
- Gold Ornaments and Bullion
- Immovable Property
- Plantations (For Agricultural Advances)
- Third Party Guarantees
- Banker's General Lien
- Life Insurance Policies
- Stock Exchange Securities and Other Instruments

3. MODE OF CREATION OF SECURITY:

(i) **Mortgage:** Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.

- **Registered Mortgage** can be effected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.
- **Equitable mortgage**, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

(ii) **Pledge:** A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

(iii) **Hypothecation:** The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower. Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank.

(iv) **Assignment:** Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims, such as book debts and life insurance policies are accepted by banks as security by way of assignment.

(v) **Set-off:** Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts of the same person provided both the accounts are in the same name and same right. For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

(vi) **Lien:** Lien is if creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.

Q16 (V) PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES

Standard	Sub Standard	Doubtful Assets	Loss Assets
The asset exhibits no problem in the normal course other than the usual business risk.	Asset which has been classified as NPA for a period not exceeding 12 months.	Asset which has remained NPA for a period exceeding 12 months	Asset in respect of which loss has been identified
SMA (special mention A/c)	Secured:	Doubtful upto 1 year = 25%	↓
SMA (A/c showing stress signal)	Secured:	Doubtful from 1 to 3 year = 40%	100%
SMA 1 (Overdue 31 to 60 days)	15% of total O/S	Doubtful more upto 3 year = 100%	
SMA 2 (Overdue 61 to 90 days)	Unsecured 25% of total O/S	100% for unsecured	

Q16 (VI) NPA

(1) An asset becomes NPA when it ceases to generate income for the Bank.

A non-performing asset (NPA) is a loan or an advance where:

- interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

(2) **Out of Order:**

An account should be treated as 'out of order' if:

- the outstanding balance remains continuously in excess of the sanctioned limit/ drawing power or

- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or
- credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

(3) **Overdue:** Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Note: (1) Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.

(2) Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

(4) **Accounts regularized near the Balance Sheet Date:**

(i) The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity.

(ii) Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA.

(iii) The auditor should check for sample transactions immediately before the closing of the Financial Year and immediately after the closing of the Financial year to get a knowledge of the objective behind the transactions.

(iv) if any/some transactions are being reversed during the first few days after closing which might show an arrangement to prevent the Borrower account(s) from slipping into the NPA category.

(5) **Government Guaranteed advances:**

• Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

• If the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

• **Consortium advances** mean advancing loans to a borrower by two or more Banks jointly by forming a **Consortium**.

• Usually, a Bank with a higher share will **lead the consortium**.

• Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting

with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

- The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank.

Note: Drawing Power Allocation in case of Consortium Cash Credit Account.

- The Lead Bank would be responsible for computing the drawing power (DP) of the borrower and allocate the same to member banks. In certain special circumstances, at the request of the Borrower, the Lead Bank may allot a higher or lower share of drawing power to the member bank, as against their share of advances.

(6) Accounts where there is erosion in the value of security / frauds committed by borrowers:
Erosion means the gradual destruction or diminution of something not prudent to follow stages of asset classification. It should be straight-away classified as doubtful or loss asset as appropriate as follows:

↓

(i) when the realisable value of the security is less than 50 per cent of the value assessed by the bank.

Such NPAs may be straight-away classified under doubtful category applicable to doubtful assets.

(ii) If the realisable value of the security, as assessed by the bank / approved valuers / RBI is less than 10 per cent of the outstanding in the borrowing accounts, the existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

(7) Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc.: Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.

(8) Advances to Staff:

- (i) In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.
- (ii) Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates.
- (iii) The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

(9) Agricultural Advances:

As per the guidelines, Agricultural Advances are of two types:

- (1) Agricultural Advances for “long duration” crops; and
- (2) Agricultural Advances for “short duration” crops.

The “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “short duration” crops.

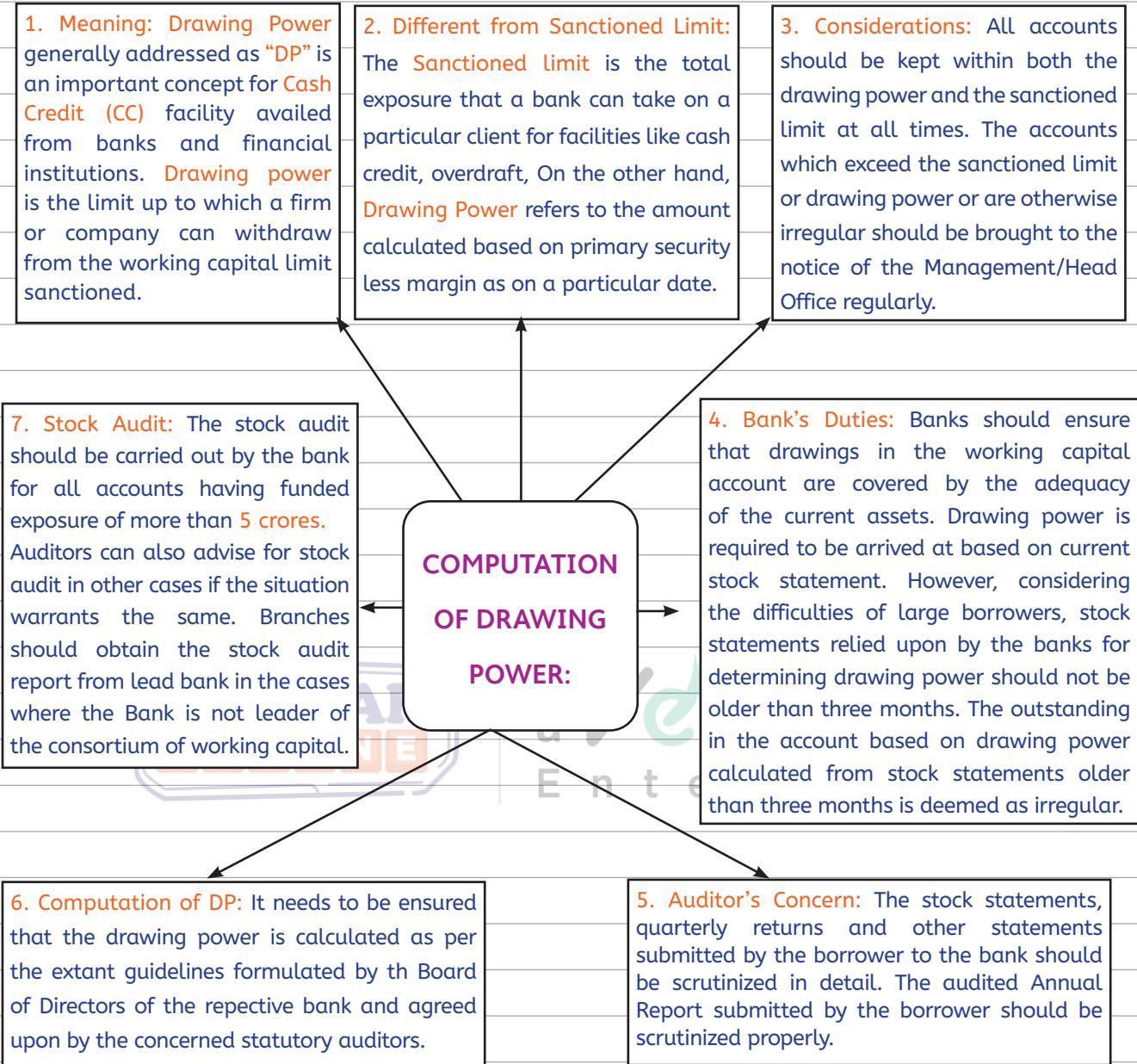
The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

Note:**Agricultural Advances Affected by Natural Calamities:**

- (i) Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities.
- (ii) Banks may decide on their own relief measures, viz., conversion of the short term production loan into a term loan or re-schedule of the repayment period and the sanctioning of fresh short term loan, subject to the guidelines contained in RBI’s latest Master Circular.
- (iii) In such cases, the NPA classification would be governed by such rescheduled terms.

Q17 COMPUTATION OF DRAWING POWER


Particulars of current assets				DP
(A)	Stocks			
	Stocks at realizable value			1000
	Less: Unpaid stocks:			
	- Sundry creditors	300		
	- Acceptances/LCs etc.	300	600	
	Paid for stocks		400	
(B)	Margin @ 25%		100	
	Debtors			
	Total Debtors		1000	
	Less: Ineligible debtors		200	
	Eligible debtors		800	
	Margin @ 40%		320	480
Total DP				780

Q18 AUDIT OF ADVANCES

(A) In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following: (ODD UV DP)

- (o) → Amounts included in balance sheet in respect of advances which are **outstanding** at the date of the balance sheet.
- (D) → Advances represent amount **due to the bank**.
- (D) → Amounts due to the bank are appropriately supported by loan **documents** and other documents as applicable to the nature of advances.
- (U) → There are no **unrecorded advances**.
- (V) → The stated basis of **valuation of advances is appropriate** and properly applied and the recoverability of advances is recognised in their valuation.
- (D) → The advances are **disclosed, classified and described** in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (P) → Appropriate **provisions** towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

(B) The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by: (A CODER)

- (A) → carrying out appropriate **analytical procedures**.
- (C) → checking **compliance with RBI norms** including appropriate classification and provisioning; and
- (O) → reviewing the **operation of the accounts**;
- (D) → examining loan **documentation**;
- (E) → examining the **existence, enforceability and valuation of the security**;
- (R) → examining the **validity of the recorded amounts**;

(C) **Evaluation of Internal Controls over Advances:**

- The bank should make an advance only after satisfying itself as to the **credit worthiness** of the borrower and after obtaining sanction from the appropriate authorities of the bank.
- All the necessary **documents** (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- The compliance with the terms of sanction and **end use of funds** should be ensured.
- **Sufficient margin** as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.

- If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
- In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
- Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts should be kept within both the drawing power and the sanctioned limit.
- All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
- The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.

Q19

AUDIT OF REVENUE ITEMS - PROFIT AND LOSS ACCOUNT

1. Auditor's Concern:

- In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that
- the recorded income arose from transactions, which took place during the relevant period and pertained to the bank,
- there is no unrecorded income and the income is recorded at appropriate amount.

2. **RBI's Directions:** RBI has advised that in respect of any income which exceeds one percent of the total income of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as per Accounting Standard 9.

3. **Materiality:** If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.

4. Revenue Certainty:

- Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned.
- It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection.

- In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.

5. Revenue Uncertainty:

- In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on nonperforming assets until it is actually realised.
- When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for.
- This will apply to Government guaranteed accounts also.

6. Advances against Securities: Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

7. Bills Purchased:

- In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years.
- [The Unexpired discount/ rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"].
- Interest (discount) component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted off from the discount earned on bills discounted.

8. Bills for Collection:

- In the case of bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected.
- The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc.
- This procedure is in consonance with the nature of obligations of the bank in respect of bills for collection.
- The commission of the branch becomes due only when the bill has been collected.

9. Renegotiations:

- Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.
- Test check the interest earned by the banks for the sample selected.

- Test check the fees and commissions earned by the banks made for commission on bills for collection, letters of credit and bank guarantees.

10. Reversal of Income:

(a) If any advance, including bills purchased and fees, commission and banks which have wrongly discounted, becomes NPA as similar income that recognised income in the any large debits in the Interest at the close of any year, the have accrued should past should reverse the Income account that have not entire interest accrued and cease to accrue in the interest if it was recognised been explained. It should be credited to income account current period and as income during the current enquired whether there are any in the past periods, should should be reversed year or make a provision for communications from borrowers be reversed or provided for if or provided for with an equivalent amount if it pointing out differences in the same is not realised. This respect to past periods, was recognized as income interest charge and whether will apply to Government if uncollected. in the previous year(s). appropriate action has been guaranteed accounts also. taken in this regard.

11. On leased assets:

The component of finance income (as defined in AS 19 – Leases) on the leased asset which was accrued and credited to the income account before the asset became non-performing and remaining unrealised, should be reversed or provided for in the current accounting period.

12. On Take-out finance:

- A takeout loan is a method of financing whereby a loan that is procured later is used to replace the initial loan.
- More specifically, a takeout loan, or takeout financing, is long-term financing that the lender promises to provide at a particular date or when particular criteria for completion of a project are met.
- Takeout loans are commonly used in property development.
- In the case of take-out finance, if based on record of recovery, the account is classified by the lending bank as NPA, it should not recognize income unless realised from the borrower/taking-over institution (if the arrangement so provides).

OBJECTIVE OF TAKEOUT FINANCE

(a) To expand sources of Finance for infrastructure projects by facilitating participation of new entities

(b) To address sectoral/ group/entity exposure issues and asset liability in mismatch concerns of tenders

(c) To boost the availability of longer tenor debt finance for projects

13. On Partial Recoveries in NPAs:

- In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are required to adopt an accounting policy and exercise the right of appropriation of recoveries in a uniform and consistent manner.
- The appropriate policy to be followed is to recognise income as per AS 9 when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted.
- Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

14. Memorandum Account:

- On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest.
- However, banks may continue to record such accrued interest in a Memorandum account in their books for control purposes.
- For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

15. Income from Investments:

(a) Interest Income on Investments: This includes all income derived from Government securities, bonds and debentures of corporates and other investments by way of interest and dividend, except income earned by way of banking activity and from subsidiaries and joint ventures abroad/in India. Broken period interest or paid on securities purchased and amortisation of premium on SLR investments is net off from the interest income on investments.

(b) Profit on Sale of Investments: Profit on sale of investments is taken to profit and loss account.

(c) Profit / Loss on Revaluation of Investments: are in terms of guidelines issued by the RBI, investments are to be valued at periodical intervals and depreciation taken to profit and loss account.

Q20 EXPENSES

Expenditure is to be shown under three broad heads:

(A) Interest expenses:

- (1) The auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of

deposits and borrowings to the average quantum of the respective liabilities during the year.

- (2) The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.
- (3) The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences.
- (4) The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated.
- (5) The auditor should, on a test check basis, verify the calculation of interest and ensure that:
 - (a) Interest has been provided on all deposits upto the date of the balance sheet;
 - (b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
 - (c) Interest on savings accounts are in accordance with the rules framed by the bank/ RBI in this behalf.
 - (d) Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.
- (6) The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period.
- (7) The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly.
- (8) The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers.

(B) For audit of Operating expenses, the auditor should:

- (1) study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.
- (2) should examine whether there are any divergent trends in respect of major items of expenses.

(3) perform substantive analytical procedures (proforma given below for reference) in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.

(4) verify expenses with reference to supporting documents and check the calculations wherever required.

(C) For audit of Provisions and contingencies the auditor should:

- (1) ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- (2) obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets.
- (3) obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.
- (4) obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
- (5) examine the other provisions for expenses vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Q21 DISCLOSURE OF THE PRIOR PERIOD ITEMS

Since the format of the profit and loss accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, may be given.

Q22 CONDUCTING AN AUDIT

The audit of banks or their branches involves the following stages:

1. Initial consideration by the statutory auditor

- (i) **Declaration of Indebtedness:** The RBI has advised that the banks, before appointing their statutory central/branch auditors, should obtain a declaration of indebtedness. Indebtedness refers to the situation of owing money to the bank in any case, whatsoever.
- (ii) **Internal Assignments in Banks by Statutory Auditors:** The RBI decided that the audit firms should not undertake statutory audit assignment while they are associated

with internal assignments in the bank during the same year, like Concurrent audits (Internal Audit of Banks conducted monthly during the year)

(iii) **Planning:** Standard on Auditing (SA) 300, "Planning an Audit of Financial Statements" requires that the auditor shall undertake the following activities prior to starting an initial audit:

- (a) Performing procedures required by SA 220, "Quality Control for Audit Work" regarding the acceptance of the client relationship and the specific audit engagement; and
- (b) Establish understanding of terms of engagement as per SA 210, "Agreeing the Terms of Audit Engagements".

(iv) **Communication with Previous Auditor:** As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him in writing. He should get a NO Objection Certificate (NOC) from the previous auditor through this communication as to know whether he has any objections to such an appointment made, for any valid reasons.

(v) **Terms of Audit Engagements:** SA 210, "Terms of Audit Engagements" requires that for each period to be audited, the auditor should agree on the terms of the audit engagement with the bank before beginning significant portions of fieldwork. It is imperative that the terms of the engagement are documented, in order to prevent any confusion as to the terms that have been agreed in relation to the audit and the respective responsibilities of the management and the auditor, at the beginning of an audit assignment.

(vi) **Initial Engagements:** The auditor needs to perform the audit procedures as mentioned in SA 510 "Initial Audit Engagements-Opening Balances" and if after performing that procedures, the auditor concludes that the opening balances contain misstatements which materially affect the financial statements for the current period and the effect of the same is not properly accounted for and adequately disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate.

(vii) **Assessment of Engagement Risk:** The assessment of engagement risk is a critical part of the audit process and should be done prior to the acceptance of an audit engagement since it affects the decision of accepting the engagement and also in planning decisions if the audit is accepted.

(viii) **Establish the Engagement Team:** The assignment of qualified and experienced professionals is an important component of managing engagement risk. The size and composition of the engagement team would depend on the size, nature and complexity of the bank's operations.

(ix) **Understanding the Bank and its Environment: SA 315 “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”** lays down that the auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error and sufficient to design and perform further audit procedures.

2. **Identifying and Assessing the Risks of Material Misstatements:** SA 315 requires the auditor to identify and assess the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures.

3. **Understanding the Bank and Its Environment including Internal Control:**
An understanding of the bank and its environment, including its internal control, enables the auditor:

- to identify and assess risk;
- to develop an audit plan so as to determine the operating effectiveness of the controls and to address the specific risks.

4. **Understanding the Bank’s Accounting Process:** The accounting process produces financial and operational information for management’s use and it also contributes to the bank’s internal control. Thus, understanding of the accounting process is necessary to identify and assess the risks of material misstatement whether due to fraud or not and to design and perform further audit procedures.

5. **Understanding the Risk Management Process:** Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

- (a) **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing) should be consistent with the bank’s business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- (b) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank’s goals should be identified, measured and monitored against pre-approved limits and criteria.
- (c) **Control activities:** A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

(d) **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(e) **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

6. **Engagement Team Discussions:** The engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.

7. **Establish the Overall Audit Strategy:** SA 300 "Planning an Audit of financial Statements" states that the objective of the auditor is to plan the audit so that it will be performed in an effective manner. For this purpose, the audit engagement partner should:

- establish the overall audit strategy, prior to the commencement of an audit; and
- involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.

8. **Develop the Audit Plan:** SA 300 deals with the auditor's responsibility to plan an audit of financial statements in an effective manner. It requires the involvement of all the key members of the engagement team while planning an audit.

9. **Audit Planning Memorandum:** The auditor should summarise the audit plan by preparing an audit planning memorandum in order to:

- Describe the expected scope and extent of the audit procedures to be performed by the auditor.
- Highlight all significant issues and risks identified during their planning and risk assessment activities, as well as the decisions concerning reliance on controls.
- Provide evidence that they have planned the audit engagement appropriately and have responded to engagement risk, pervasive risks, specific risks, and other matters affecting the audit engagement.

10. **Determine Audit Materiality:** The auditor should consider the relationship between the audit materiality and audit risk when conducting an audit. The determination of audit materiality is a matter of professional judgment and depends upon the knowledge of the bank, assessment of engagement risk and the reporting requirements for the financial statements.

11. **Consider Going Concern:** While obtaining an understanding of the bank, the auditor

should consider whether there are events and conditions which may cast significant doubt on the bank's ability to continue as a going concern.

12. Assess the Risk of Fraud including Money Laundering: As per **SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "**Know Your Customer (KYC)**" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines – Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

13. Assess Specific Risks: The auditors should identify and assess the risks of material misstatement at the financial statement level which refers to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions.

14. Risk Associated with Outsourcing of Activities: The modern day banks make extensive use of outsourcing as a means of both reducing costs as well as making use of services of an expert not available internally. There are, however, a number of risks associated with outsourcing of activities by banks and therefore, it is quintessential for the banks to effectively manage those risks.

15. Response to the Assessed Risks: **SA 330 "The Auditor's Responses to Assessed Risks"** requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. The auditor should design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

16. Stress Testing: Stress testing is a software testing activity that determines the robustness of software by testing beyond the limits of normal operation. Stress testing is particularly important for "mission critical" software, but is used for all types of software (**Source – Wikipedia**). RBI has required that all commercial banks shall put in place a Board approved 'Stress Testing framework' to suit their individual requirements which would integrate into their risk management systems.

17. BASEL III framework: Basel norms or accords are the International Banking regulations issued by the BCBS. The Basel Committee on Banking Supervision (BCBS) and the

Financial Stability Board (FSB) has undertaken an extensive review of the regulatory framework in the wake of the sub-prime crisis. In the document titled 'Basel III: A global regulatory framework for more resilient banks and banking systems', released by the BCBS in December 2010, it has inter alia proposed certain minimum set of criteria for inclusion of instruments in the new definition of regulatory capital. The set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord.

18. Reliance on / review of other reports: The auditor should take into account the adverse comments, if any, on advances appearing in the following-

- Previous year's audit reports.
- Latest internal inspection reports of bank officials.
- Reserve Bank's latest inspection report.
- Concurrent / Internal audit report.
- Report on verification of security.
- Any other internal reports specially related to particular accounts.
- Manager's charge-handing-over report when incumbent is changed. The above reports should be reviewed in detail. The Statutory Central Auditors must review the Annual Financial Inspection report of RBI relating to the bank and ensure that the variations in provisions, etc. reported by RBI have been properly considered by the bank management.

11**ETHICS AND TERMS OF
AUDIT ENGAGEMENTS****CONTENTS**

Q1	Principles Based Approach Vs Rules Based Approach
Q2	Fundamental Principles of Professional Ethics
Q3	Independence of Auditor
Q4	SA 210: Agreeing to The Terms of Audit Engagements
Q5	Professional Skepticism
Q6	Audit Quality
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Q8	SA 220

Enterprise

Q1
PRINCIPLES BASED APPROACH VS RULES BASED APPROACH:

PRINCIPLES BASED APPROACH	RULES BASED APPROACH
<ul style="list-style-type: none"> Requires compliance with spirit of ethic 	<ul style="list-style-type: none"> Strictly follows clearly established rules
<ul style="list-style-type: none"> Exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. 	<ul style="list-style-type: none"> Narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules
<ul style="list-style-type: none"> It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions. 	<ul style="list-style-type: none"> Somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Q2
FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS

A. Integrity:

- Requires an accountant to be **straight forward and honest** in all professional and business relationships.
- Integrity** implies **fair dealing and truthfulness**.
- A professional accountant **shall not knowingly be associated** with reports, returns, communications or other information where the accountant believes that the information contains a **materially false or misleading statement**.

B. Objectivity:

An auditor not to compromise professional judgment **because of bias, conflict of interest or undue influence of others**.

C. Professional competence and due care:

- Comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards.

D. Confidentiality:

- Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships.
- Such confidential information may be disclosed, for example, when it is required by law.

E. Professional Behaviour:

- A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

Q3 INDEPENDENCE OF AUDITOR:

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

A. INDEPENDENCE OF MIND VS APPEARANCE:

INDEPENDENCE OF MIND	INDEPENDENCE IN APPEARANCE
<ul style="list-style-type: none"> the state of mind that permits the provision of an opinion 	<ul style="list-style-type: none"> the avoidance of facts and circumstances
<ul style="list-style-type: none"> without being affected by influences 	<ul style="list-style-type: none"> that are so significant that
<ul style="list-style-type: none"> allowing an individual to act with integrity, & exercise objectivity & professional skepticism; 	<ul style="list-style-type: none"> a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."

B. THREATS TO INDEPENDENCE:
1. Self-interest threats:

- Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include
 - (i) direct financial interest or materially significant indirect financial interest in a client
 - (ii) loan or guarantee to or from the concerned client
 - (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement
 - (iv) close business relationship with an audit client
 - (v) potential employment with the client and
 - (vi) contingent fees for the audit engagement

2. Self-review threats:

- Self-review threats occur when during a review of any judgement or conclusion reached in a previous audit or
- non-audit engagement, (management services, internal audit, investment advisory service) or
- when a member of the audit team was previously a director or senior employee of the client.
- when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats:

- Advocacy threats occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised,
- e.g., when an auditor deals with shares or securities of the audited company, or
- becomes the client's advocate in litigation and third party disputes.

4. Familiarity threats:

- They occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways including:
 - close relative of the audit team working in a senior position in the client company
 - former partner of the audit firm being a director or senior employee of the client
 - long association between specific auditors and their specific client counterparts and
 - acceptance of significant gifts or hospitality from the client company, its directors or employees.

5. Intimidation threats:

- Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism.
- Basically, these could happen because of
 - threat of replacement over disagreements with the application of accounting principles, or
 - pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation.

C. SAFEGUARDS TO INDEPENDENCE:

The following are the guiding principles in this regard

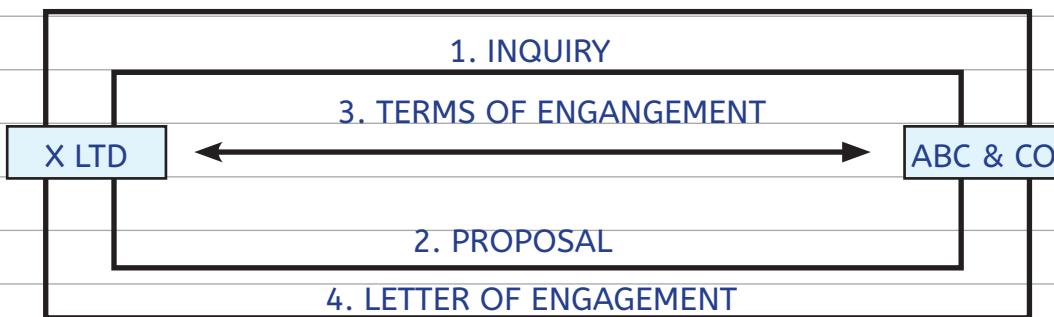
- For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.

- Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.

Q4

SA 210: AGREEING TO THE TERMS OF AUDIT ENGAGEMENTS

5. LETTER OF APPOINTMENT



A. PRECONDITIONS:

Determine whether FRF is acceptable or not Obtain agreement from management regarding their responsibilities

- 1. For preparation of FS
- 2. Internal control (IC)
- 3. To provide auditor with
 - a. Access with Info
 - b. Access to additional Info
 - c. Unrestricted access to persons within the entity

Note: If preconditions are not present do not accept the audit.

B. CONTENTS OF ENGAGEMENT LETTER  (FORAM)

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

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

C. LIMITATION ON SCOPE:

Circumstances beyond the control of the entity Nature and time of audit procedure Imposed by management

D. LIMITATION ON SCOPE OF AUDIT AT BEGINNING:

If Management & TCWG imposes **LOSA**
 ↓
 Auditor shall evaluate the possible effects
 ↓
 If **LOSA** will result in the auditor disclaiming an opinion
 ↓
 The auditor shall **not accept** such appointment,
 unless required by law or regulation to do so

E. ACCEPTANCE OF CHANGE IN THE TERMS OF ENGAGEMENT:

During the course of audit
 ↓
 If management requests to **change** the **TOE**
 ↓
 Inquire about the reasons
 ↓
 VALID
 (reasonable justification)
 ↓
 Accept only in writing
 ↓
 INVALID
 ↓
 Do not accept. If management & TCWG do not allow
 auditor to continue the original engagement
 ↓
 ROSA
 ↓
 Restriction on scope of audit
 ↓
 WITHDRAW
 ↓
 After fulfilling legal obligation

Note 1: When Reasonable Justification Exists?

- a change in circumstances affecting the need for the service, a **misunderstanding** as to the nature of an audit as originally requested

- or a restriction on the scope of the audit engagement
- A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.
- In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.
- An example might be where the auditor is unable to obtain SAAE regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

Note 2: What should auditor consider before agreeing to change the audit engagement to the engagement providing lower level of assurance?

- Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may also need to assess any legal or contractual implications of the change.
- If the auditor concludes that there is reasonable justification to change the audit engagement, the audit work performed to the date of change may be relevant to the changed engagement.
- In order to avoid confusing the reader, the report on the related service would not include reference to:
 - (a) The original audit engagement or
 - (b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

Note 3: Recourse available to auditor in situation of non- agreement to a change in terms of engagement

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

- (a) Withdraw from the audit engagement where possible under applicable law or regulation and

(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as TCWG, owners or regulators.

F. RECURRING AUDIT:  (MORONS)

- M** → Entity misunderstands the objective & scope
- O** → A significant change in ownership
- R** → A change in legal or regulatory requirement
- O** → A change in other reporting requirement
- N** → A change in nature & size of the entity's business
- S** → Recent change of senior management

Q5 PROFESSIONAL SKEPTICISM

A. MEANING:

- Professional Skepticism refers
- to an attitude that includes a questioning mind,
- being alert to conditions which may indicate possible misstatement due to error or fraud,
- and a critical assessment of audit evidence

B. WHEN TO APPLY:

- C** → Evidence that contradicts other audit evidence obtained
- R** → Information that brings into question the reliability of documents
- A** → Circumstances that suggest the need for audit procedures in addition to those required by the SAs
- P** → Conditions that may indicate possible fraud

C. BENEFITS:

- (i) Overlooking Unusual Circumstances
- (ii) Over generalising when drawing conclusions from audit observations
- (iii) Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof

Note : Management and TCWG are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism

Q6 AUDIT QUALITY

PARTICULARS	SQC-1	SA 220
SCOPE	Deals with quality control	
	All engagements (including audit, reviews, and other assurance and related services)	Specific to audit engagement
APPLICABILITY	To the entire firm	To a particular audit engagement

Q7 SQC 1 : QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFO AND OTHER ASSURANCE AND RELATED SERVICE

1. LEADERSHIP

- SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements.
- Such policies and procedures should require the firm's CEO or the firm's managing partners to assume ultimate responsibility .
- The example set by firm's leadership encourages an inner culture that recognizes high quality audit work..
- Persons assigned operational responsibilities for the firm's quality control system should have sufficient and appropriate
 - experience,
 - ability and
 - the necessary authority to assume that responsibility

2. ETHICAL REQUIREMENTS:

- The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI.
- The Code establishes the fundamental principles of professional ethics which include
 - integrity,
 - objectivity,
 - professional competence and due care,
 - confidentiality and
 - professional behaviour.
- Observance of "Independence" in all engagements is the basic requirement.

- The firm should establish **policies and procedures** designed to provide it with **reasonable assurance** that the firm, its personnel and experts maintain **independence** where required by the Code.
- Such policies and procedures should enable the firm to: -
 - (a) **Communicate its independence** requirements to its personnel
 - (b) Identify and evaluate **circumstances** and **relationships** that **create threats to independence**, and
 - to take appropriate action to **eliminate those threats** or
 - **reduce them to an acceptable level** by applying **safeguards**, or,
 - if considered appropriate, to withdraw from the engagement.
- **All breaches of independence** should be promptly notified to firm for appropriate action
- **At least annually**, the firm should obtain **written confirmation of compliance** with its policies and procedures on independence from **all firm personnel** required to be independent.

3. Acceptance and Continuance of Client Relationships and Specific Engagements:

- A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:
 - Integrity of Client
 - Competence (including capabilities, time and resources) to perform engagement
 - Compliance with ethical requirements.

Note: With regard to the integrity of a client, matters that the firm considers include, for example: (B2A MAAL)

- (B) → **Business reputation** of the client's principal owners, key management, related parties and TCWG
- (B) → The nature of the client's operations, including its **business practices**.
- (A) → Information concerning the **attitude** of the client's principal owners, key management and TCWG
- (M) → Indications that the client might be involved in **money laundering** or other criminal activities.
- (A) → Whether the client is **aggressively** concerned with maintaining the firm's fees as low as possible.
- (A) → The reasons for the proposed **appointment** of the firm and non-reappointment of the previous firm.
- (L) → Indications of an inappropriate **limitation** in the scope of work.

Note 2: If there is any conflict of interest between the firm and client:

- It should be properly resolved before accepting the engagement.
- Where the firm obtains information that would have caused it to decline an engagement it should include consideration of:
 - (a) The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
 - (b) The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

4. Human resources:

- The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with
 - professional standards and
 - regulatory and legal requirements and to
 - enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
- Such policies and procedures should address relevant HR issues including
 - recruitment,
 - training,
 - performance evaluation
 - compensation,
 - career development,
 - professional development of firm's personnel.

5. Engagement Performance : (PAR²C²)

- P → Unless otherwise specified by law or regulation, engagement documentation is the **property of the firm**.
The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed.
- A → The firm should establish policies and procedures for engagement teams to complete the **assembly of final engagement files** on a timely basis.
The assembly of engagement files should be completed in **not more than 60 days after date of auditor's report**
- R1 → Significant judgments made in an engagement should be **reviewed by an engagement quality control reviewer** for taking an **objective view** before the report is issued.

The extent of the review depends on the

- complexity of the engagement and
- the risk that the report might not be appropriate in the circumstances.
- The review does **not reduce the responsibilities** of the engagement partner.
- Engagement quality control review is **mandatory** for all audits of financial statements of listed entities.
- There might be **difference of opinion** within engagement team, with those consulted and between engagement partner and engagement quality control reviewer.
- The report should **only be issued after resolution** of such differences. The matter should be resolved by following **established procedures of firm** like by consulting with another practitioner or firm, or a professional or regulatory body.

R2 → Engagement documentation has to be retained for a period of time no shorter than **seven years** from the date of the auditor's report, or, if later, the date of the group auditor's report.

C1 → Consultation should take place in **difficult or contentious matters**. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise

C → Policies and procedures should be designed to maintain the **confidentiality, safe custody, integrity, accessibility and retrievability** of engagement documentation.

6. Monitoring:

- The firm should ensure that policies and procedures relating to the system of quality control are **relevant, adequate, operating effectively** and **complied with** in practice.
- Such policies and procedures should include an **ongoing consideration and evaluation** of the firm's system of quality control, including a **periodic inspection of a selection of completed engagements**

Q8 SA 220

1. LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM:

- The **engagement partner** shall take **responsibility** for the overall quality on each audit engagement to which that partner is assigned.

(a) He shall **deliver the following messages** to the audit team clearly:

- Performing work that **complies with professional standards and regulatory and legal requirements**
- Complying with the firm's **quality control policies** and procedures as applicable

- Issuing auditor's reports that are appropriate in the circumstances; and
- The engagement team's ability to raise concerns without fear of reprisals

(b) The fact that quality is essential in performing audit engagements.

2. RELEVANT ETHICAL REQUIREMENTS:

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under

- Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
- Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

3. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS:

Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate: (C₂SI)

- (c) → Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources
- (c) → Whether the firm and the engagement team can comply with relevant ethical requirements
- (s) → Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship
- (i) → The integrity of the principal owners, key management and those charged with governance of the entity

4. ASSIGNMENT OF ENGAGEMENT TEAMS :

It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with

- professional standards and
- regulatory and legal requirements

5. ENGAGEMENT PERFORMANCE:

- Engagement partner is also responsible for ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team not only within the team but also with others at appropriate level **within or outside the firm**.
- For audits of FS of **listed entities**, and those other audit engagements, if any, for which the firm has determined that an **EQCR** is required, the engagement partner shall:
 - (a) Determine that an engagement quality control reviewer has been **appointed**.
 - (b) **Discuss significant matters** arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
 - (c) **Not date the auditor's report** until the completion of the engagement quality control review.
- **If differences of opinion arise** within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team **shall follow the firm's policies and procedures** for dealing with and resolving differences of opinion.

6. MONITORING:

- The engagement partner should **document following matters** pertaining to an audit engagement:
 - (a) **Issues identified** with respect to compliance with relevant **ethical requirements** and how they were resolved.
 - (b) Conclusions on compliance with **independence requirements** that
 - (c) Conclusions reached regarding the **acceptance and continuance of client relationships** and audit engagements.
 - (d) The nature and scope of, and conclusions resulting from, **consultations** undertaken during the course of the audit engagement.

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CA INTER AUDITING AND ETHICS

Question Bank Book

JAN 25



PROF. ROHIT SHROFF



1

**NATURE, SCOPE AND
OBJECTIVES OF AUDIT**

1.1 - 1.6

2

**AUDIT STRATEGY, AUDIT
PLANNING AND AUDIT
PROGRAMME**

2.1 - 2.6

3

**RISK ASSESSMENT &
INTERNAL CONTROL**

3.1 - 3.26

4

AUDIT EVIDENCE

4.1 - 4.32

5

AUDIT OF ITEMS OF FS

Covered in
Summary
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6

AUDIT DOCUMENTATION

6.1 - 6.4



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COMPLETION AND REVIEW

7.01 - 7.13

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8.1 - 8.28

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**SPECIAL FEATURES OF
AUDIT OF DIFFERENT
TYPES OF ENTITIES**

9.1 - 9.13

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10.1 - 10.13

11

**ETHICS AND TERMS OF
AUDIT ENGAGEMENTS**

11.1 - 11.7

1

NATURE, SCOPE AND
OBJECTIVES OF AUDIT

Question 1:

An audit is independent examination of financial information of any entity, whether profit oriented or not and irrespective of its legal size or form, when such an examination is conducted with a view to expressing an opinion thereon. Explain how the person conducting this task should care to ensure that FS would **not mislead**.

 **Answer:** Meaning + Analysis of Definition

Question 2:

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

 **Answer:** Meaning + Analysis of Definition

Question 3:

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

 **Answer:** Meaning + Analysis of Definition

Question 4:

Both accounting and auditing are closely related

 **Answer:** Relationship between accounting and auditing.

Question 5:

State the objectives of Audit according to SA 200

 **Answer:** Relationship between accounting and auditing.

Question 6:

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



Objectives of auditor

+ CA Pushpa did not comply with the objectives

Question 7:

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



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

+ CA Pushpa did not comply with the objectives

Question 8:

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

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



Answer: What is included in scope of audit + Proper disc

Question 9:

A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a **CA for verification of books of accounts/ financial**

records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report?



Answer:

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

Question 10:

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



Answer: Scope of audit.

Question 11:

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



Answer:

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

Question 12:

An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the *prima facie* findings of the auditor. Discuss

 **Answer:** Audit vs Investigation.

Question 13:

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

 **Answer:** Inherent Limitations.

Question 14:

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

 **Answer:** Inherent Limitations.

Question 15:

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

 **Answer:** Inherent Limitations – Nature of audit procedures

Question 16:

The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain.

 **Answer:** Inherent limitations-Only Timeliness

Question 17:

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

 **Answer:** Inherent Limitations

- Nature of audit procedure
- Difference between audit and investigation

Question 18:

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

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

Question 19:

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

 **Answer:** Inherent Limitations – Nature if audit procedure

Question 20:

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters

 **Answer:**

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Question 21:

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

 **Answer:** Advantages of Audit

Question 22:

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

 **Answer:** Advantages of Audit

Question 23:

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

 **Answer:** 3 parties**Question 24:**

Explain the qualities of an auditor

 **Answer:** Qualities**Question 25:**

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

 **Answer:** Types of engagement**Question 26:**

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

 **Answer:** Audit vs Review

2

AUDIT STRATEGY, AUDIT PLANNING
AND AUDIT PROGRAMME

Question 1:

The auditor T of Hand Fab Ltd is worried as to management of **key resources** to be employed to conduct audit.

Required: How the audit strategy would be helpful to the auditor?

 **Answer:** Refer - Establishing the overall audit strategy- Assistance for the auditor for solution

Question 2:

MG & Co, a firm of auditors, having a standing of 30 years is appointed as a statutory auditor of company engaged in manufacturing of defence equipment. Due to opening of 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?

 **Answer:**

Consideration for involvement of experts by auditors falls within domain of planning. While planning an audit, auditor would have to consider whether involvement of experts is necessary. In the stated case, company is involved in technical and complex operations. Therefore, while planning an audit, auditors would have to consider whether involvement of expert is necessary.

Question 3:

CA Kartik is planning for audit of a company engaged in manufacturing of cosmetics. Considering nature of operations of the company, he had planned to include **testing of controls** of the company over purchases, sales and inventories.

One fine day, he reaches the corporate office and asks for **manuals and required documentation to ensure surprise element in testing**. He had never shared with management his intention to carry out above procedures. Is approach of CA Kartik proper?

**Answer:**

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

Question 4:

W, the auditor of SKM Ltd. asks its finance and audit head to prepare audit strategy for conducting audit of SKM Ltd. W also insists him to draw detailed audit procedures.

On the request of auditor W completes audit strategy as well as audit procedures as prepared by finance head of the company. Subsequently, auditor realizes that effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment.



Answer: Refer - Overall audit strategy and the audit plan- The auditor's responsibility

- Accordingly, approach of W was wrong and he should have prepared overall audit strategy and detailed audit procedures.

Question 5:

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?



Answer: These are planned **risk assessment procedures** to identify and assess risk of material misstatement. The objective of planned inquiry of inhouse legal counsel is to identify and assess risk of material misstatement. Such planned risk assessment procedures are included in audit plan in accordance with SA-300.

Question 6:

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?



Changes in laws and regulations affecting the company is a factor to be considered while establishing overall audit strategy. There has been change in information technology regulations applicable to the company. Noncompliance of the same can have implications in form of civil and criminal liabilities. Such an important matter concerning changes in laws and regulations is to be considered by auditor while establishing overall audit strategy.

Question 7:

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 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?



Attitude of Rohit is not proper. The assistants should observe matters objectively and bring significant matters to the notice of supervisor/principal.

Reasons for cancellation of many e-way bills in month of March need to be looked into. Matter should be informed to engagement partner.

Question 8:

Discuss how performing preliminary engagement activities as part of planning an audit assists auditor.



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

Question 9:

Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client.



Refer to point on evaluating compliance with ethical requirements including independence.

Question 10:

“Purported disadvantages of an audit programme can be **overcome**”. Do you agree?

 **Answer:**

Purported disadvantages of audit programme may be eliminated by **imaginative supervision** of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

Question 11:

An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure.

 **Answer:** Refer to point on documentation**Question 12:**

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.

 **Answer:** Refer to point on Planning supervision and review of work of engagement team members**Question 13:**

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.

 **Answer:** Usefulness of Careful and Adequate Audit Planning**Question 14:**

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.

 **Answer:** Planning - a continuous process

Question 15:

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

 **Answer:** Process of establishing the overall audit strategy

Question 16:

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,

 **Answer:** Cases by which auditor can ascertain the reporting objectives of the engagement

Question 17:

You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the **factors** to be considered by you while establishing overall audit strategy.

 **Answer:** Factor to be considered by you while establishing overall audit strategy.

Question 18:

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

 **Answer:** Characteristics of the engagement that define its scope.

Question 19:

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.

 **Answer:** Changes to Planning decisions

Question 20:

The establishment of the overall audit strategy and the detailed audit plan are closely interrelated. Explain.

 **Answer:** Relationship between the Overall Audit Strategy and the Audit Plan

Question 21:

Arpana Hospitals Ltd. having Gross Professional Charges of ₹50 crores is engaged in providing healthcare services. STP & Co., a firm of auditors is appointed as its auditors. Advise what special points to be kept in mind for the purpose of **construction of an Audit programme**. Explain.

 **Answer:** Points to be considered in constructing Audit Programme

Question 22:

Evolving one audit programme applicable to all audit engagements under all circumstances is not practicable. Explain

 **Answer:** Evolving one audit programme

Question 23:

"The utility of the audit programme can be retained and enhanced only by keeping the programme and also the client's operations and internal control under **periodic review** so that inadequacies or redundancies of the programme may be removed". Explain,

 **Answer:** Periodic Review of The Audit Programme

Question 24:

"TP & 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 firm 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

 **Answer:** Assistant Engaged - be encouraged to keep an open mind

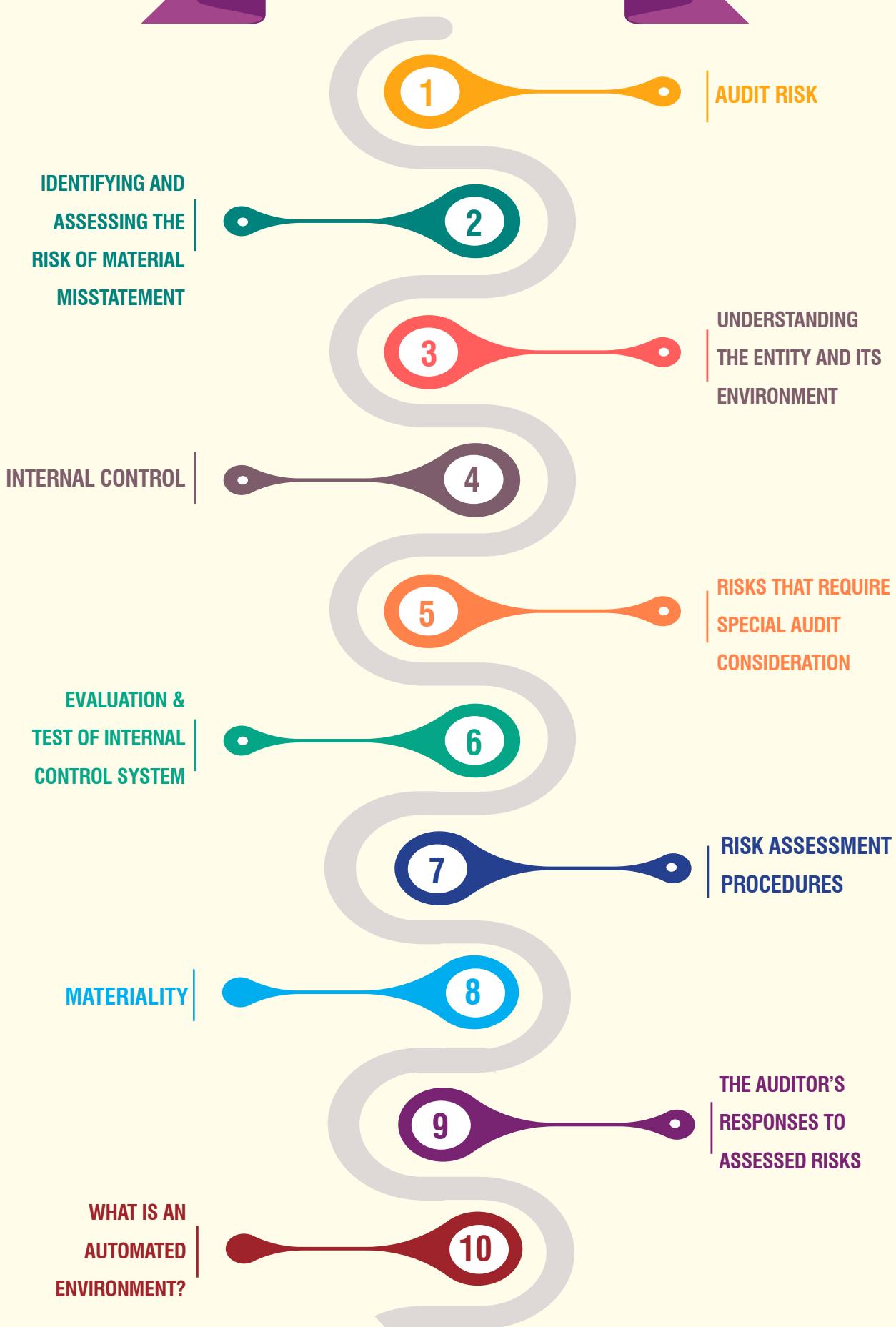
Question 25:

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.

 **Answer:** Disadvantages of an audit programme

CHAPTER 3

RISK ASSESSMENT & INTERNAL CONTROL



1

AUDIT RISK

Question 1:

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.

 Answer:

Inherent, control and detection risks.

- (a) Inherent Risk. Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.
- (b) Control Risk: 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 **collusion among employees** may be there and risk to auditor would again be that inventory records would be inaccurate.
- (c) Detection Risk: Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also **employ sampling techniques** to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated.

Question 2:

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.

 Answer: Audit risk

Question 3:

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?

**Answer:**

Component of RoMM: Facts given in the question highlights 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.

Conclusion: Component of RoMM involved is "inherent risk."

Question 4:

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.

**Answer:**

Component of RoMM: Facts given in the question highlights that 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.

Conclusion: Component of RoMM involved is "control risk."

Question 5:

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?

**Answer:**

Detection Risk: Facts given in the question highlights that there is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition.

Conclusion: The risk alluded to it is "detection risk."

Question 6:

Jojo Limited is planning to list on Bombay Stock Exchange next year. As an auditor of Jojo Limited, Identify any one reason of increased audit risk due to listing of the company next year.



Answer: Reason of increased audit risk due to listing.

Based on the facts given in the question, there is a greater chance of misstatements in the financial statements due to planned listing next year. There could be a possibility of **intentional manipulation of F.S.** so that good response is received to proposed issue.

Conclusion: There is Increased audit risk i.e., risk of expressing inappropriate opinion by the auditor when financial statements are materially misstated.

Question 7:

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.



Answer: Combined Assessment of RoMM.

Question 8:

The assessment of risks is a matter of professional judgment. Explain stating clearly what is not included in Audit Risk?



Answer: Note 2 + 3

Question 9:

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.



Answer: Audit Risk + Note 2

2

IDENTIFYING & ASSESSING THE RISK
OF MATERIAL MISSTATEMENT

Question 1:

The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels.

 **Answer:** The risks of material misstatement may exist at two levels.

Question 2:

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.

Or

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.

 **Answer:** Refer to Q.2

3

UNDERSTANDING THE ENTITY
AND ITS ENVIRONMENT

Question 1:

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.

 Answer:

ROMAN: '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. Hence, auditor should proceed accordingly.

Question 2:

While auditing the books of accounts of Heavy Material Limited for the financial year 2023-24, 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.

 Answer:

Approach of team member of the auditor of Heavy Material Limited is incorrect because understanding the business and the business environment of company whose audit is to be conducted is very important, as it helps in planning the audit and identifying areas requiring special attention during the course of audit of that company.

Question 3:

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.

 Answer:

While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area.

Question 4:

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.

 **Answer:** Understanding of the Entity - a continuous process.

Question 5:

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.

 **Answer:** Knowledge of Client's Business: ROMAN

Question 6:

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.

 **Answer:** ROMAN

4

INTERNAL CONTROL

Question 1:

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.

 **Answer:**

Understanding Internal Controls:

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.

Question 2:

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.

 **Answer:**

Understanding Internal Controls: The view of the team member of the auditor is incorrect because understanding the internal control of the company would help the auditor and his team members in designing the nature, timing and extent of audit procedures to be applied while conducting the audit of the company.

Question 3:

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?

 Answer:

Understanding Internal Controls: The study of company policies and practices regarding employee recruitment, training, orientation and related matters including hiring of best candidates is part of understanding HR function of the company. It, in turn, helps in understanding **control environment of the company**. By gaining such a knowledge, she can better understand internal control of the company.

Question 4:

During the audit of same 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.

 Answer:

Understanding Internal Controls: She is keen to find out whether there exists a proper system of **segregation of duties** in the company. She is gaining an understanding of internal control of the company.

In particular, she is understanding "**control activities**". When a person recording a transaction is different from one authorizing it, she gains confidence that there exists a system for preventing misstatements. It helps her in gaining insight into the internal control system of the company.

Question 5:

The auditor shall obtain an understanding of the major activities that the entity uses to **monitor** internal control over financial reporting. Explain.

 Answer: Activities used to monitor **internal control over financial reporting**.**Question 6:**

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

- (I) Management has **created and maintained** a culture of honesty and ethical behaviour, and
- (II) 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.

 Answer: Elements of Control Environment.

Question 7:

A satisfactory control environment may help reduce the risk of fraud but is not an absolute deterrent for fraud", Explain

 **Answer:** Impact of Satisfactory Control Environment

Question 8:

Briefly discuss the limitations of internal control.

 **Answer:** Inherent Limitations of Internal Control

Question 9:

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.

 **Answer:** Internal control over safeguarding of assets.

Question 10:

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.

 **Answer:** Components of Internal Control.

Question 11:

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting Discuss "Monitoring of control" as a component of internal control.

 **Answer:** Monitoring of Controls.

Question 12:

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**.

 **Answer:** Benefits of understanding of Internal Control

Question 13:

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.

 **Answer:** Factors relevant to the auditor's judgment about whether a control

Question 14:

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.

 **Answer:** Understanding of Information Systems.

Question 15:

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.

 **Answer:** Control Activities

Question 16:

Define Monitoring of Controls and respect of monitoring of controls, answer the following questions:

- (i) How monitoring of controls would be helpful in assessing the effectiveness of controls?
- (ii) How can management accomplish monitoring of controls?
- (iii) What is included in the Management's monitoring activities?

 **Answer:** Monitoring of controls.

Question 17:

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 to obtain an **understanding** of the control environment?

Answer: Elements of Control Environment & Evaluation of Control environment by auditor.

Question 18:

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.

 **Answer:**

Review of Internal Controls: Review of internal controls will enable the auditors to know whether the controls adequately safeguard the assets.

5

RISKS THAT REQUIRE SPECIAL
AUDIT CONSIDERATION

Question 1:

What is understood by "non-routine transactions? Briefly outline why risks of material misstatement is greater for such transactions.

 **Answer:** Non-routine transactions

Question 2:

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. In context of significant risk, explain the factors to be considered by the auditor in exercising judgment as to which risks are significant risks.

 **Answer:** Identification of Significant Risks.

Question 3:

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.

 **Answer:** Risks of Material Misstatement - Greater for Significant Non-Routine Transactions.

Risks of material misstatement - Greater for Significant Judgmental Matters.

Question 4:

Auditor of 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.

 **Answer:** Risks of Material Misstatement - Greater for Significant Non-Routine Transactions.

6

EVALUATION & TESTING OF
INTERNAL CONTROL SYSTEM

Question 1:

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.

 Answer:

Review of Internal Controls: Review of internal controls will enable the auditor to know what are the areas where control is **weak** and where it is **excessive**.

Question 2:

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

 Answer:

The method of evaluation of internal control used in the above question is known as **Internal Control Questionnaire** because in questionnaire method, a number of questions relating to internal control of a company are required to be answered by employees of that company 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.

Question 3:

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.



Answer:
The method of evaluation of internal control referred above is known as **Narrative Record** because in Narrative Record method, a whole description of internal control 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

Question 4:

Zomba Products Private limited is a small company. The control systems in the company are insignificant. How, you as an auditor of the company, would proceed to evaluate Internal control of the company?



Answer: In a small company, control systems are basic and not formalized. Therefore, auditor should proceed to evaluate internal control using **narrative record**.

Question 5:

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.



Answer: Flow Charts



Question 6:

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**.

Or

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.



Answer: Benefits of Evaluation of Internal Control to Auditor.

7

RISK ASSESSMENT
PROCEDURES

Question 1:

On perusing financial statements of Jojo 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?

 Answer:

Risk Assessment Procedure: Facts given in the question highlights that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (In current year). The auditor is using "**analytical procedures**" 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.

Conclusion: Auditor is using "analytical procedures".

Question 2:

Discuss how "**analytical procedures**" performed as "**risk assessment procedures**" can be useful to an auditor.

 Answer: Use of Analytical Procedures as Risk Assessment procedures.

Question 3:

Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls.

 Answer: What is included in RAP.

Question 4:

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.

Or

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.

 **Answer:** Inquiries of management, and of others within the entity.

Question 5:

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.

 **Answer:** Use of Analytical Procedures as Risk Assessment Procedures.

Question 6:

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.

 **Answer:** Examples of audit procedures which include observation or inspection of entity's operations.

8

MATERIALITY

Question 1:

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.

 **Answer:** 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.

Question 2:

CA. 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.

 **Answer:** If there is any statutory requirement of disclosure, it is to be considered material. Schedule III mandates disclosure of nature of security in relation to loan. **The amount involved is irrelevant.**

Question 3:

While conducting the audit of Smart TV Ltd., engagement team of HTR & Co., has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk.

 **Answer:** Audit Risk and Materiality

Question 4:

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.

 **Answer:** Revision as the Audit Progresses

Question 5:

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?

 **Answer:** Factors affecting identification of appropriate benchmark as per SA 320.

Question 6:

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.

 **Answer:** Auditor's assumptions about users of the financial statements.

Question 7:

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain.

 **Answer:** Concept of materiality in the context of the preparation and presentation of F.S.

Question 8:

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.

 **Answer:**

- SA 320 "Materiality in Planning and Performing an Audit" requires the auditor to 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.
- 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 examine and whether to **use sampling and analytical procedures**. This enables the auditor to select **audit procedures that**, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk.
- 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 preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine.

- 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. For example, ₹5,000 may be material for a **small entity**, but even ₹5,00,000 may not be material for a large entity.



9

THE AUDITOR'S RESPONSES
TO ASSESSED RISKS

Question 1:

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.

 Answer:

Facts of the question highlights 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. It means that control is not working as planned. It would not be able to prevent misstatement and very purpose of control is defeated.

It represents a "control deficiency"

Question 2:

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. Explain

 Answer: Refer Q.4

Question 3:

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. **OR**

"A multinational co. wants to appoint you to carry the statutory audit." Discuss with reference to SA 330 the substantive procedures to be performed.

 Answer:

Substantive procedures are audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

- (i) **Tests of details** (of classes of transactions, account balances, and disclosures); and
- (ii) **Substantive analytical procedures**.

SA 3.30 "Responses to Assessed Risks" deals with the auditor's responsibility to design and impale responses to the risks of material misstatements identified and assessed by the auditor in accordance with SA 315. Accordingly,

- 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.
- Depending on the circumstances, the auditor may determine that:
 - (i) Performing only substantive analytical procedures will be sufficient 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.
 - (ii) Only tests of details are appropriate.
 - (iii) A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.
- Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time,
- 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 tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.
- In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size.

Question 4:

XYZ & 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.

 **Answer:** Specific inquiries by auditor when deviations from controls are detected

Question 5:

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 elapsed before retesting

 **Answer:**

Using audit evidence about operating effectiveness of controls obtained in previous audit.

Question 6:

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.

 **Answer:** Matters to be considered in determining the extent of test of controls.

10

WHAT IS AN AUTOMATED
ENVIRONMENT?

Question 1:

Discuss relationship between "General IT controls" and "application controls" in an automated environment.

 **Answer:** General IT controls and Application controls

Question 2:

The auditor should understand and consider the risks that may arise from the use of information technology (IT)

 **Answer:** Risk to internal control imposed by IT

Question 3:

The fundamental principle of an automated environment is the ability to carry out business with less manual intervention. Explain.

 **Answer:** Key features of automated environment

Question 4:

List the points that an auditor should consider to obtain an understanding of the company's automated environment.

 **Answer:** Understanding of the Company's Automated Environment

Question 5:

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 Judgment. Discuss stating the different ways testing is performed in an automated environment

 **Answer:** Testing Methods used while auditing in an Automated Environment.

Question 6:

Analyse how risks in the IT system, if not mitigated, could have an Impact on the audit.

 **Answer:** Impact of IT Related Risks

Question 7:

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.

 **Answer:** Data Center & Network operations

Question 8:

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 judgment of the auditor as to whether gaining knowledge of company's IT systems is required or not. Do you agree with this statement?

 **Answer:** Understanding and Documenting Automated Environment

Question 9:

Explain the objective and enlist the activities Involved in the General IT Controls over "Program Change".

 **Answer:** Objective and activities involved in the General IT Controls over "Program Change"

Question 10:

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?

 **Answer:** Objectives of Access Security

Question 11:

Manual elements in internal control may **be less reliable** than automated elements because they can be more easily bypassed, Ignored, or overridden and they are also more prone to simple errors and mistakes. Give examples of circumstances in which **manual control elements may be less suitable**.

 **Answer:** Circumstances in which Manual Elements are less suitable

Question 12:

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.

 **Answer:** Data Analytics

Question 13:

A company functions in an automated environment. Discuss in what areas **data analytics** can be useful for auditor of the company.

 **Answer:** Data Analytics.

Question 14:

Explain the meaning of **internal financial controls** as per the Companies Act, 2013. Also explain its objectives.

 **Answer:** Meaning and Objectives of Internal Financial Controls.

Question 15:

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.

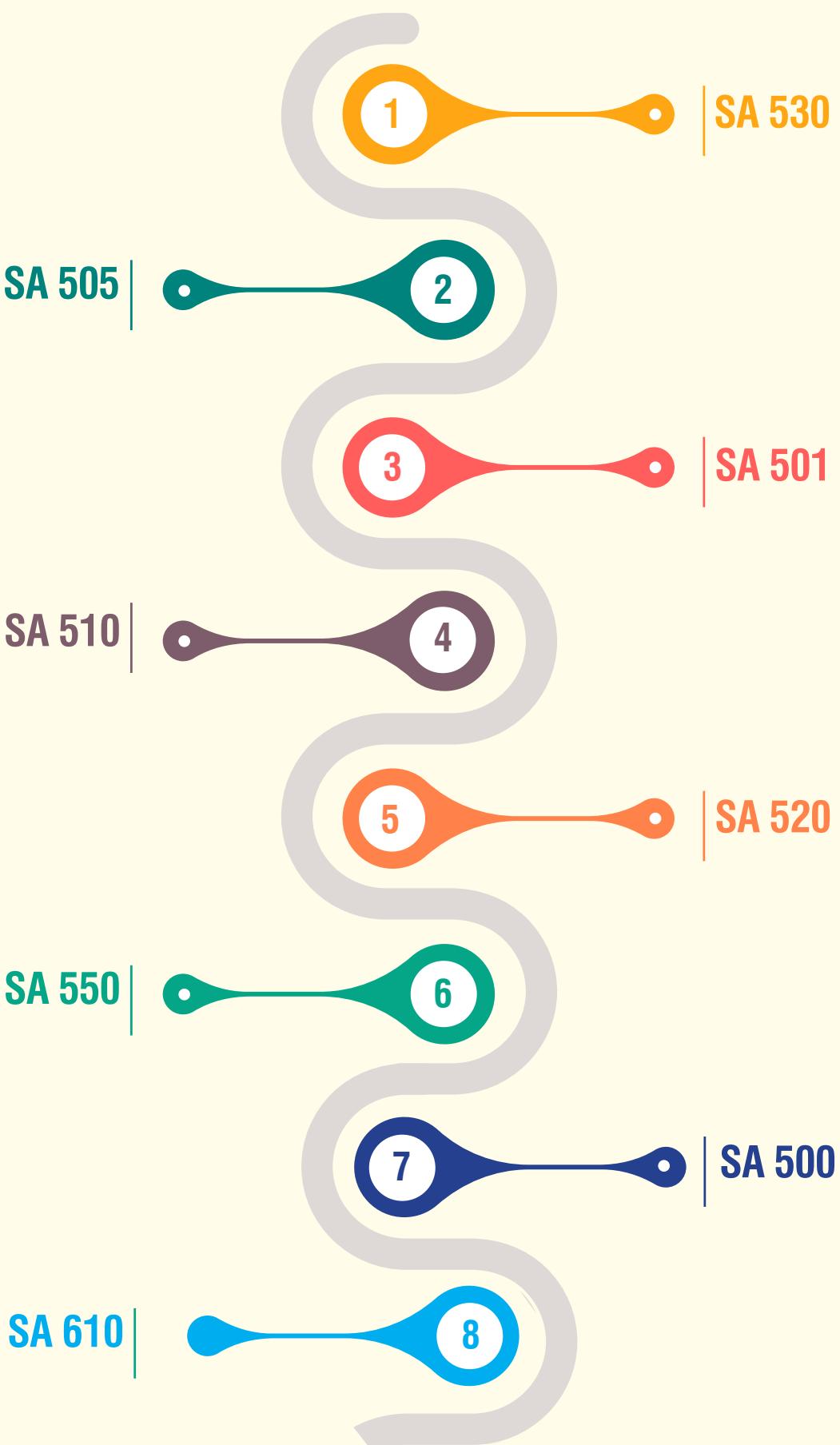
 **Answer:** Meaning of Internal Financial Control + Applicability of reporting reg of IFC

Question 16:

Foreceful Limited is a company dealing in mobile spare parts and having its showrooms in almost all the states in the country. For FY 2022-23, the company transferred its accounts from manual to computerized system (SAP). PQR & Co., Chartered Accountants have specialization in the system audit and have been appointed as the system auditor. PQR & 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

 **Answer:** Assess and report Audit Findings in audit in Automated Environment.

AUDIT EVIDENCE



Question 7:

Whatever maybe the approach, non-statistical or statistical sampling, the sample must be representative. Discuss non-statistical and statistical sampling approaches.

 **Answer:** Statistical and Non-Statistical Sampling.

Question 8:

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.

 **Answer:**

Limitations of Traditional Approach:

- 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.
- Traditional Approach: In traditional approach, more emphasis put on routine checking, which often is not necessary considering the time and the cost involved. In routine checking auditor considers detailed checking and vouching of all entries.
- With the passage of time, formal internal controls are being introduced in the management of affairs of organisations, due to which the possibilities of routine errors and frauds have greatly diminished and auditors often find extensive routine checking as nothing more than a ritual because it rarely reveals anything material.
- Risk Based approach: Audit approach, now a days, has undergone considerable changes and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking.

Question 9:

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.

 **Answer:**

Adopting Standards while using Sampling:

- Auditor is required to express his opinion on the true and fair view of financial statements. For this purpose, auditor is required to decide the extent of checking to be performed. The extent of checking to be undertaken is primarily a matter of judgment of the auditor, there is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent.

- It is also not obligatory that the auditor must adopt the sampling technique.
- To ensure good and reasonable standard of work, auditor should adopt standards and techniques that can lead him to an informed professional opinion. 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 widely followed and which have a recognised basis.
- Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability.

Question 10:

Explain the sampling method which involves selection of a block (s) of contiguous items from within the population. Also give example.

 **Answer:** Block Selection**Question 11:**

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 non-sampling risk with examples.

 **Answer:** Sampling & Non-Sampling Risk**Question 12:**

Explain the following terms with reference to Audit Sampling:

- Stratification 2. Tolerable misstatement 3. Tolerable rate of deviation

 **Answer:** Define all 3**Question 13:**

With reference to Alter Aing the sample stelor he tely the flowing factors that the auditor may consider when determining the sample size for the Test of Details –

- i) The desired level of assurance
- ii) Stratification of the pollution.

 **Answer:**

Factors influencing Sample Size for Test of Details:

Desired Level of Assurance

Stratification of population

Question 14:

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.

 **Answer:** Statistical Sampling + Advantages

Question 15:

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.

 **Answer:** Traditional sampling vs risk based

Question 16:

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.

 **Answer:** Random Sampling

Question 17:

XYZ Ltd. Is engaged in trading of electronic goods and having huge accounts receivables. For analyzing the whole accounts receivables, the auditor wanted to use sampling technique. In considering the characteristics of the population from which sample will be drawn, the auditor determines that stratification or value weighted selection technique is appropriate. SA 530 provides guidance to the auditor on use of stratification & value weighted sampling techniques. Advice the auditor.

 **Answer:** stratification & value weighted sampling

Question 18:

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.

 **Answer:** Examples of factors determining the sample size for TOC

Question 19:

The auditor shall evaluate the results of the sample and whether the use of sample has provided a reasonable basis for conclusions about the population that has been tested. Explain.

 **Answer:** Evaluation**Question 20:**

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 that the auditor may consider when determining the sample size for TOC

 **Answer:** Examples of factors determining the sample size for TOC**Question 21:**

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

 **Answer:** Why Sampling**Question 22:**

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain

 **Answer:** Projection**Question 23:**

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?

SA 505

EXTERNAL CONFIRMATION

Question 1:

Write short notes on: External Confirmations in Audit

 **Answer:** Definition

Question 2:

M Z. Who is appointed as an auditor of Elite co .Ltd wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when designing a confirmation request? Also state the effect of using positive external confirmation request by M.Z

 **Answer:** Positive confirmation

Question 3:

 The management of SLTd. Request you not to seek confirmation from its debtor. As the auditor of S LTD., What can be appropriate response?

OR

Never Permit Limited refused to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that atleast outstanding Above a threshold limits to be to be confirmed and reconciliation is to be carried out before Finalizing audit. If the company does not relent, how will you respond.

 **Answer:** PIE

Question 4:

During the financial year 2022-23, 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 ₹ ,23,000. That trade receivable confirmed to the auditor of Healthy and Wealthy Limited, that they were required to pay an amount of ₹ ,23,000 to Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor.

 **Answer:** Positive confirmation

Question 5:

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?

 **Answer:**

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- Determining the information to be confirmed or requested;
- Selecting the appropriate confirming party;
- Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- Sending the requests, including follow-up requests when applicable, to the confirming party.
- In the given case, it appears that external auditor has delegated 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 not in line with requirements under SA 505.

Question 6:

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?

 **Answer:**

- In terms of requirements of SA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness.

- 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. Keeping in view, unwillingness of CFO is justifiable.

Question 7:

The auditor of H LTD. Wanted to obtain a confirmation from its creditors. But the management made a request to the auditor not to seek Confirmation from certain creditors citing disputes. Can the auditor of H LTD. Accede to this Request? OR

The accountant of C LTD, Has requested you, not to send balance confirmation to a particular group of trade receivable since the said balances are under dispute and matters is pending in the court. As a statutory Auditor, how would you deal?

 **Answer:** PIE

Question 8:

During the course of audit of Star Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one, old outstanding of 5 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

 **Answer:** Where negative confirmations can be used

Question 9:

M/s ABC & Co., LLP are appointed auditors of Sharp Company Ltd. for the year ended 31st March, 209. As part of the audit process, they want to use confirmation procedures as audit evidence during the course of audit. In view of the fact that positive confirmations are not responded favorably, the firm also intends to use negative confirmation requests.

What are the factors to be considered for the same?

 **Answer:** Where negative confirmations can be used

Question 10:

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.

 **Answer:** Controls over preparations

SA 501

AUDIT EVIDENCE - SPECIFIC
CONSIDERATIONS FOR
SELECTED ITEMS

Question 1:

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.

Required :Suggest the audit procedures in the given case

 **Answer:** Case 4

Question 2:

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.

 **Answer:** Inq IMP

Question 3:

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?

 **Answer:**

As per requirements of SA-50, 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 direct communication with the entity's external legal counsel. The above situation warrants direct communication with company's standing external lawyer.

Question 4:

LMN Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. LMN Ltd. appointed M/S OPQ & Co. to

conduct its audit for the financial year 209-20. Mr. O partner of M/S OPQ & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

- You are required to advise M/s OPQ & Co..
- How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?
- How an auditor is supposed to deal when attendance at physical inventory counting is impracticable?

Question 5:

Crush Ltd. is a dealer in fast moving consumer goods, The Company has warehouses throughout the country where the stocks are stored. The Auditor of the Company normally conduct physical verification of stocks along with the Management at the end of the financial year. However, the Auditor could not be physically present during stock-taking at two places on account of certain disturbances in the region. In the light of the above facts. How sufficient appropriate audit evidence regarding the condition and existence of inventory may be obtained?

How an Auditor is supposed to deal when attendance at physical inventory counting is impracticable?

 **Answer:**

(A) Case 1 (B) Case 3

Question 6:

You are the auditor of Easy Communications Ltd. for the year 208-9. The inventory as at the end of the year i.e. 3.3.9 was RS 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?

 **Answer:** Case 2

Question 7:

"If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence of inventory by attending the physical inventory counting unless impracticable." Disuses.

 **Answer:** Case 3

Question 8:

Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 208-9. While verification of company's inventories as on 31st March 209, you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties. What is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be held and the stock as disclosed in company's records actually belongs to them?

 **Answer:** Case 4**Question 9:**

Moon Ltd. is a dealer in electronic appliances. The Company has a centralised warehouse at the outskirts of Mumbai. The Auditors of the company M/s. IK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month. Enumerate the audit procedures to be considered by M/s. JK Associates, if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing.

 **Answer:** Case 2**Question 10:**

GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2023 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates 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

 **Answer:** Refer Segment Reporting**Question 11:**

The Engagement Partner of the audit team of High Inventory Limited assessed that the inventory is material with respect to the audit of the financial statement for the current

period. Upon inquiring with the management, the Engagement Partner identified that the management will be performing an annual physical inventory count at all the warehouses where the entity stores and maintains its inventory. Moreover, management confirmed in its written representation that they will be performing a 100% physical count of inventory for the current period. As a result, the engagement Partner decided not to perform any physical count of inventory as will be a duplication of the work. Moreover, he decided that the written representation from management stating "the inventory exists and is in appropriate physical condition" will be sufficient and appropriate with respect to audit evidence to conclude that the inventory balance in the financial statement is free from any material misstatement.

 **Answer:** WR not SAAE

Inventory counting should be performed

Question 12:

CA Prabhjot has planned observing the physical count of inventories at the plant of a company located in remote area in the state of Uttarakhand as part of a statutory audit exercise as at close of year ending 31st March 2023. He has already informed the management of his intention to reach the plant site by evening of 29th March 2023. He plans to inspect inventories, observe the counting process and perform test counts among other matters. However, an agitation in Himalayan hills has started on 28th March 2023 for the promulgation of a strict law relating to the conversion of agricultural land for commercial use. Many civil society groups are participating in the agitation. NH-7 leading to the plant site is blocked by protestors. The plant is not accessible through any other mode. The blockade is lifted after one month when state government announced the formation of a committee to look into protestors' demands.

Does the above case highlight to a situation of "impracticability of attendance* at inventory counting in terms of requirements of SA 50?

 **Answer:**

SA 50 states that if the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. Therefore, the audit should attend to the physical inventory count after the blockade is lifted and perform audit procedures on intervening transactions.

Question 13:

On reviewing legal expenses account of Zed Ltd., CA. Sunitha, auditor of company, finds that legal fees amounting to Rs. 0 lac was paid to B. George, a reputed lawyer, during the year 2022- 23. On inquiry with management regarding the purpose of such expenditure, evasive reply was received from management stating that a lot of work is performed by the said lawyer on behalf of the company. However, no specific details were provided. She finds it proper to correspond directly with the lawyer. She obtains the address and mail id of the lawyer from his professional services bill. She shoots off an inquiry letter asking for the nature and status of litigation claims against the company on her letterhead. Is her approach proper? Irrespective of the merits of the approach followed by her, what she is trying to achieve by corresponding with lawyer of the company?

 **Answer:**

SA 50 states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting The entity's external legal counsel to communicate directly with the auditor. Therefore, her approach in communicating with an external lawyer is wrong. She has to make management aware of her intention to communicate directly with the lawyer. The letter of enquiry has to be prepared by management and sent by her.

Question 14:

On going through financial statements and records of "TS Ltd., during the course of statutory audit, CA Tanmaya finds that substantial inventories of the company consisting of mast lighting poles remain with "Super Industries* for certain finishing works. While planning audit procedures, he had planned about seeking confirmation from "Super Industries* regarding existence and condition of such mast lighting poles belonging to TS Ltd. lying with them as on 3s March, 2023.

However, the premises of "Super Industries* were raided by DGII officials (Director General of GST Intelligence) in connection with the busting of a fake billing scam. The proprietor of the firm was arrested in November 2022 and came out on bail in the month of March 2023. The details of proprietor and his firm were flashed prominently in local newspapers of the city where company is located. CA. Tanmaya also belongs to the same place. Discuss how he should proceed in the above matter as auditor of TS Ltd.

 **Answer:**

In the given crse, the integrity of the third party appears to be doubtful in view of DGII raids and his possible involvement in a fake billing scam. He has already been behind bars.

Keeping in view above, besides obtaining confirmation from such party, he may attend a third party's physical counting or ask some other auditor to attend physical counting as on reporting date, depending upon practical considerations. He can also inspect the record of goods sent and received back from such party by tracing it to challans, e-ways bills etc. and correlate the above information.

Question 15:

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.

Answer:

Audit procedures to obtain evidences regarding presentation and disclosure of segment information

Question 16:

SPR Ltd. has been into the media business since 1990. During the FY 2023-24 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?

Answer:

Circumstances requiring meeting with External Legal Counsel:

In certain circumstances, the auditor also may judge it necessary to meet 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:

- (i) The auditor determines that the matter is a significant risk.
- (ii) The matter is complex.
- (iii) There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with management in attendance. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

SA 510

INITIAL AUDIT ENGAGEMENT

Question 1:

You have been appointed as the auditor of good Health Ltd. for 204-205 which was audited by C A Trustworthy in 203-4. As the Auditor of the company state the steps you would take to ensure that the closing Balances of 203-4 have been brought to account in 204-5. As Opening balances and the Opening Balances do not contain misstatements.

 **Answer:** Refer Q. no 2

Question 2:

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

 **Answer:** Refer Q. no 2

Question 3:

M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2022-23-. 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 50?

 **Answer:** Refer objectives

Question 5:

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

 **Answer:** Reporting Case 3

Question 6:

What are initial Audit Engagements.?

 **Answer:** Refer Q. no 1

Question 7:

In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of opening balance to ensure that may are free from misstatements, which may materially affects the current FS .Lay down the audit procedure, you will follow in cases

- (i) when the FS are audited for the preceding period by another auditor; and
- (ii) when FS are audited for the first time.

 **Answer:** NOTE AND 2

Question 8:

If , after performing the procedure, you are not satisfied about the correctness of Opening balances ; what approach you will adopt in drafting your audit report .

 **Answer:** Refer Q. no 4

Question 9:

In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of Opening balances' to ensure that they free from misstatements, which may materially affect the current financial statements . Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure , you are not satisfied about the correctness of Opening Balances' what approach you will adopt in drafting your report.?

 **Answer:** Refer Q. no 2

Question 10:

CA. Jack a recently qualified practicing Chartered Accountant got his first audit assignment of Futura (P) L TD. For the financial year 2024-25. He obtained all the relevant appropriate audit evidence for the items related to statement of profit and Loss. However, while auditing the Balance Sheet items, CA. Jack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs 50 Lakhs, continued as it is from the last year , on the affirmation of the management that there is not receipts and further credits during the year . CA Jack therefore, excluded from the audit programme , the audit of the accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor, Comment.?

 **Answer:** Refer Q. no 2

Question 11:

Auditors of M/s Tender India (P.) Ltd. were changed for the accounting year 2023-24. The closing inventory of the company as on 3.3.2023 amounting to ₹ 00 lakhs continued as it is and became A closing inventory as on 3.3.2024. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of 00 lakhs on the understanding that it pertains to the preceding year which was audited by another auditor.

 **Answer:**

Verification of Inventory:

The contention of the management that the inventory has not undergone any change cannot be accepted, 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 not to exclude the audit of closing inventory from his audit programme.

SA 520

ANALYTICAL PROCEDURES

Question 1:**Dedine Analytical Procedures****Answer:** Definition**Question 2:****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”.****Answer:** NSC**Question 3:****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”?****Answer:** Investigation**Question 4:****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?****Answer:** Techniques**Question 5:****Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.****Answer:** Ap at planning phase**Question 6:****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.

 **Answer:** Techniques

Question 7:

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.

 **Answer:** NSC

Question 8:

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.

 **Answer:** techniques

Question 9:

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.

 **Answer:** Inv

Question 10:

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.

 **Answer:** (Trend Analysis only)

Question 11:

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.

 **Answer:** Suitability

Question 12:

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

 **Answer:** Methods (all 4)

SA 550

RELATED PARTIES

Question 1:

Elaborate how the Statutory Auditor can verify the existence of related parties for the purpose of reporting under Accounting Standard 8.

 **Answer:** SIR RILS TOPIC

Question 2:

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.

OR

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. Explain with the help of at least three examples.

 **Answer:**

Nature of Related Party Relationships & Transactions:

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.

Question 3:

How can an auditor verify the **existence of related party relationships and transactions**?

OR

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.



Answer:
Inspection of Records or documents to obtain information about related party relationship and transactions.

Question 6:

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?



Answer: Duties of Auditor in identifying Significant Related Party Transactions

SA 500

AUDIT EVIDENCE

Question 1:

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.

 Answer:

There exists a **very important relationship** between Audit Evidence and opinion of the Auditor. While conducting an audit of a company, the auditor obtains audit evidence and with the help of that audit evidence obtained, the auditor forms an audit opinion on the financial statements of that company.

Question 2:

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.

 Answer:

Audit evidence obtained **externally is more appropriate 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 low risk** that they can be altered or changed.

Question 3:

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 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.

 **Answer:**

Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather sufficiency of audit evidence is related to the **quantity** of audit evidence and appropriateness of audit evidence is related to **quality** of audit evidence.

Question 4:

While auditing the books of accounts of AB Limited for the financial year 2022-23, 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.

 **Answer:**

The audit procedure used by auditor of AB Limited is known as **Inspection** because inspection is an audit procedure in which complete documents and records of a company are checked in detail for the purpose of obtaining audit evidence.

Question 5:

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, 2006. 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.

 **Answer:**

The auditor is verifying aging of trade payables. He is **“reperforming”** the control which was mandated by the management.

Question 6:

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.

**Answer:**

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. Mere inquiry does not lead to obtaining of sufficient appropriate audit evidence. In the instant 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.

Question 7:

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.

Question 8:

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 auditors.

**Answer:** Advantages of Using Audit Trail feature in Accounting Software**Question 9:**

Auditing is a logical process. An audit 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 account. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgement. Discuss explaining clearly the detailed meaning of audit evidence.

**Answer:** Meaning of Audit Evidence**Question 10:** Name the assertion for the following audit procedures:

- (1) Year-end inventory verification.
- (2) Depreciation has been properly charged on all assets
- (3) The title deeds of the lands disclosed in the balance sheet are held in the name of the company
- (4) All liabilities are properly recorded in the financial statements
- (5) Related party transaction are shown properly.

**Assertions for Audit Procedures :**

(i) Year-end inventory verification	Existence
(ii) Depreciation has been properly charged on all assets	Valuation
(iii) Title deed of lands disclosed in the Balance Sheet are held in the name of the Company	Rights & Obligations
(iv) All liabilities are properly recorded in the financial statements	Completeness
(v) Related party transactions are shown properly	Presentation & disclosure

Question 11:

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 evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgement as to sufficiency of audit evidence.

Answer: Sufficiency of Audit Evidence

Question 12:

In the course of audit of SMP Limited for the financial year ended 31st March, 2024 you have observed as an auditors that the company has provided 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.

Answer: Evaluation of appropriateness of work of Management's Expert:

Question 13:

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

(i) Statement of Profit and Loss

Travelling Expenditure ₹ 50,000

(ii) Balance Sheet

Trade receivable ₹ 2,00,000

Answer:

Travelling Expenditure:

- Expenditure has been incurred for the purpose of travelling
- Travelling has been undertaken during the year under audit.
- Total expenditure incurred was ₹ 50,000 during the year.
- It is classified as revenue expenditure and charged to statement Profit and Loss.

Trade Receivable

- These include all sales transactions occurred during the year.
- These have been recorded properly and occurred during the year.
- These constitute assets of the entity.
- These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

Question 14:

“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.

Answer:

Factors affecting nature and timing of Audit Procedure:

- Nature affecting nature and timing of Audit Procedure:
 - (a) Availability of audit evidence in electronic form only.
 - (b) Availability of audit evidence at certain points / periods in time.

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.

- Certain electronic information may not be retrievable after a specified period of time.

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.

Question 15:

CA K audited the books of account of E Ltd. for the financial year 2023-24. The auditor used an audit procedure accounting 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.

Answer:

Audit Procedure: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an

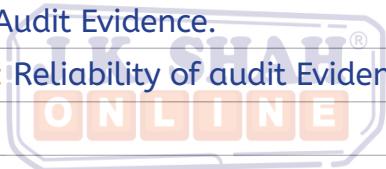
asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Question 16:

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.

 **Answer:** Importance of inq**Question 17:**

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.

 **Answer:** Reliability of audit Evidence.**a Veranda**
Enterprise**Question 18:**

Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & 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.

 **Answer:** Inconsistency in or Doubts over Reliability of Audit Evidence

SA 610

USING THE WORK OF
INTERNAL AUDITORS

Question 1:

A company has stipulated a control through its automated software that interest @ 2% 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?

 **Answer:** Scope of Internal Auditor's Work

Question 2:

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.

 **Answer:** Relying upon work of Internal Auditors

Question 3:

Moon Ltd. of which you are the statutory auditor, have an internal audit being conducted by 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.

 **Answer:** Using direct assistance of internal auditor

Question 4:

CA X, a practicing CA 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 Y, the statutory auditor of the Company, for his view and reporting. Can CA Y rely on such report?

 **Answer:** Evaluation of Internal Audit function so as to reply on work of Internal Auditor

Question 5:

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

 **Answer:** Objective and Scope of Internal Audit Function as per SA 60 w.r.t. Internal Control

Question 6:

Explain how Internal Financial Control and internal controls over financial reporting differ?

 **Answer:** Difference between IFC and ICOFR

Question 7:

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?

 **Answer:**

Auditor's responsibility in relation to audit sampling:

- In the provided situation, the auditor has selected samples based upon his personal experience and knowledge. It is a case of non-statistical sampling approach adopted by the auditor.
- Whatever may be the approach nonstatistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same.
- The auditor cannot escape his responsibility in this regard.

Question 8:

What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling".

 **Answer:**

Meaning of Audit Sampling:

"Audit Sampling" means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of

selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Samples Selection methods:

1. **Random selection:** This method of sampling ensures that all items within a population stand an equal chance of selection by the use of random number tables or random number generators. The sampling units could be physical items, such as sales invoices or monetary units.
2. **Systematic selection:** The number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.
3. **Monetary unit sampling:** It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.
4. **Haphazard selection:** Samples are selected without following a structured technique. 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.
5. **Block selection:** It involves selection of a block(s) 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.

6

AUDIT DOCUMENTATION

Question 1:

A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company.

Explain whether Audit Documentation has any relation with regard to planning the audit of a company.



Answer:

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

Question 2:

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

Explain the relationship between Audit File and Audit Documentation.



Answer:

Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

Question 3:

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



Answer:

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

Question 4:

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

**Answer:**

The auditor shall document discussions of significant matters with **management**, those charged with governance, and others, including the nature of the **significant matters** discussed and **when** and with **whom** the discussions took place.

In the instant 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 issue was **resolved**, it is necessary to **document** the same by including **detail of** the person with **whom discussions** took place along with date.

Question 5:

CA Sonali Morarka has completed audit of a **listed company**. The audit report dated 15th July, 2022 has been issued. However, audit working papers including record of discussions with management, details of audit procedures performed to obtain audit evidence and conclusions reached by her have not been properly assembled.

More than **six months** have elapsed after **issue of audit report**. Subsequently, she has received a letter from regulator in connection with audit of the company requesting her to **share copy of audit file**.

The letter has woken up her from deep slumber. She hurriedly assembled audit file and inserted some more papers which were necessary. However, she put **current date** on these inserted papers and the copy of audit file was sent to regulator.

Discuss, the issues involved, in context of “audit documentation”.

**Answer:**

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than **60 days** after 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 quality of audit.

Question 6:

The form, content and extent of audit documentation depends upon **number of factors**.

List out any four such factors.



Answer: Refer to “Form, content and extent of audit documentation”

Question 7:

Discuss any two purposes of audit documentation.



Answer: Refer to heading “Purpose of audit documentation”

Question 8:

Define audit documentation. Also give some examples.



Answer:

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.) Refer – Examples of Audit Documentation

Question 9:

“Audit documentation **summary** may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits”. Explain.



Answer: Refer Heading – Completion Memorandum or Audit Documentation Summary

Question 10:

What do you mean by **Audit Documentation**? Also explain **the nature and purpose** of audit documentation.



Answer: Meaning of Audit Documentation: + Nature + Purpose

Question 11:

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.

 **Answer:** Assembly of Final Audit File

Question 12:

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.

 **Answer:**

Documentation of Significant Matters and Related Significant Professional Judgments

Question 13:

The working papers of the branch auditor are also the property of the Principal Auditor and the Management of the Company, as they have right to access them. State the relevant SA and comment

 **Answer:** Ownership of Working Papers

Question 14:

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

 **Answer:**

Matters to be recorded while documenting NTE of Audit procedures performed:

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

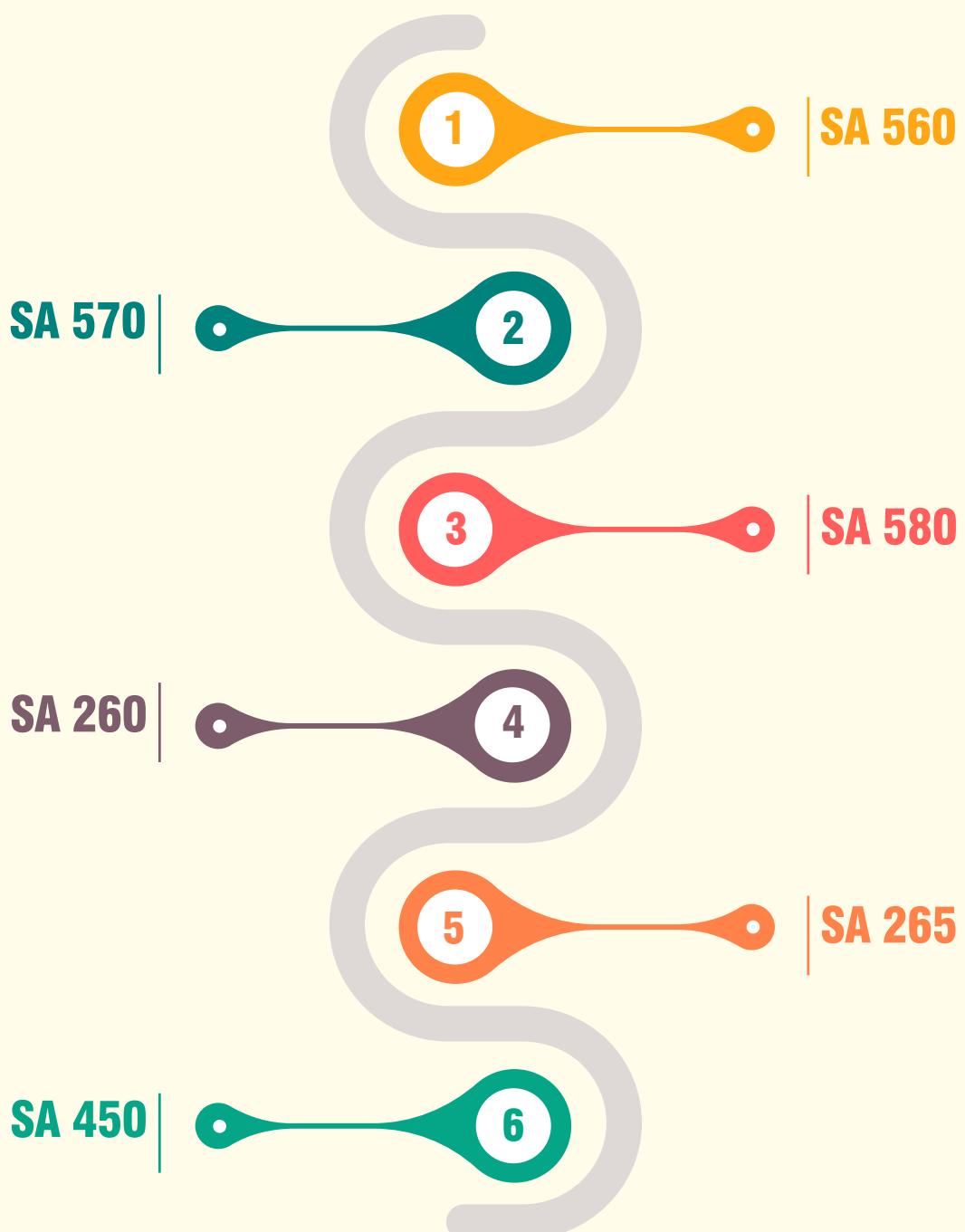
- (i) The identifying characteristics of the specific items or matters tested;
- (ii) Who performed the audit work and the date such work was completed; and
- (iii) Who reviewed the audit work performed and the date and extent of such review.

Question 15:

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.

 **Answer:** Objectives of Auditor as per SA 230

COMPLETION AND REVIEW



SA 560

SUBSEQUENT EVENTS

Question 1:

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 `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.



Answer:

Subsequent Events:

- 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 `5 crore.
- It is an example of 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, auditor should consider impact on auditor's report.

Question 2:

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.

 **Answer:**

Rationale of performing audit procedures for Subsequent Events:

- 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, TCWG, to provide a **written representation** in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.
- Rationale of obtaining written representations is that even after performing abovesaid procedures, she may not come to know **all subsequent events**. Therefore, it is necessary from an on and Review auditor's point of view to obtain acknowledgment from management in the form of Written representations that all such events for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.

Question 3:

Discuss meaning of "Date the financial statements are issued" under SA 560.

 **Answer:** Meaning of "Date the financial statements are issued"

Question 4:

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?

 **Answer:** Audit procedures - Ing. IMP

Question 5:

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.

 **Answer:** Audit Procedures regarding facts which become known to the auditor after the date of the auditor's report but before the date the F.S. are issued.

Question 6:

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 As 4 and also define subsequent events.

 **Answer:** Subsequent Events. AS 4

SA 570

GOING CONCERN

Question 1:

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?

Answer:**Audit Procedures in case of Doubt overgoing Concern Status:**

- 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 auditor's concerns regarding liquidity crisis being faced by the company.
- 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.
- Auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

Question 2:

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?

 **Answer:** Management Unwilling to Make or Extend Its Assessment:

Question 3:

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.

 **Answer:** Objectives of the auditor

Question 4:

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.

 **Answer:** Financial Indicators to be considered for evaluation of Going Concern Assumption

Question 5:

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?

 **Answer:** Management Assessment of Going Concern

Question 6:

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.

 **Answer:** Risk Assessment procedure.

Question 7:

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.

 **Answer:**

Auditor's responsibilities with regard to going concern:

The auditor's responsibilities with regard to going concern are:

- (1) 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
- (2) 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.

Question 8:

While doing audit of ABC Pvt. Ltd., on the basis of sufficient and appropriate evidence, 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:

- (a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements.
- (b) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements.

 **Answer:**

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

SA 580

WRITTEN REPRESENTATIONS

Question 1:

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?

 Answer:

Requirement of Management Representations:

- 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 transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled 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.

Question 2:

The auditor P of PAR and Co., a firm of Chartered Accountants is conducting 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.

 Answer: Reliability of WR

Question 3:

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.



Objectives of Auditor regarding Written representation

Question 4:

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 management to **reconfirm** its acknowledgement and understanding of responsibilities in written representation?



Answer: Refer Q.6

Question 5:

Akash & 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?



Auditor's duties when requested WRs not provided

SA 260**COMMUNICATION WITH
CHARGED WITH GOVERNANCE****Question 1:**

In what ways an effective two-way communication between auditor and those charged with governance is important?

 **Answer:** Effective two way communication

Question 2:

"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.

 **Answer:** Communicating Significant Finding to TCWG.

SA 265

COMMUNICATION DEFICIENCIES IN INTERNAL CONTROL TO TCWG & MANAGEMENT

Question 1:

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.**



Answer:

Communicating Deficiencies in Internal Control:

- 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 TCWG 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.

Question 2:

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**".



Answer:

Matters that auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency.

Question 3:

Write short note on: Contents of written communication of significant deficiencies In Internal control.

Answer: Contents of written communication of significant deficiencies in internal control.



SA 450

EVALUATION OF MISSTATEMENTS
IDENTIFIED DURING THE AUDIT

Question 1:

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.

 Answer:

Evaluation of Misstatements identified during the audit:

- Instances highlighted in given 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.
- Auditor should communicate above identified misstatements to TCWG 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 auditor's report should be communicated to TCWG.

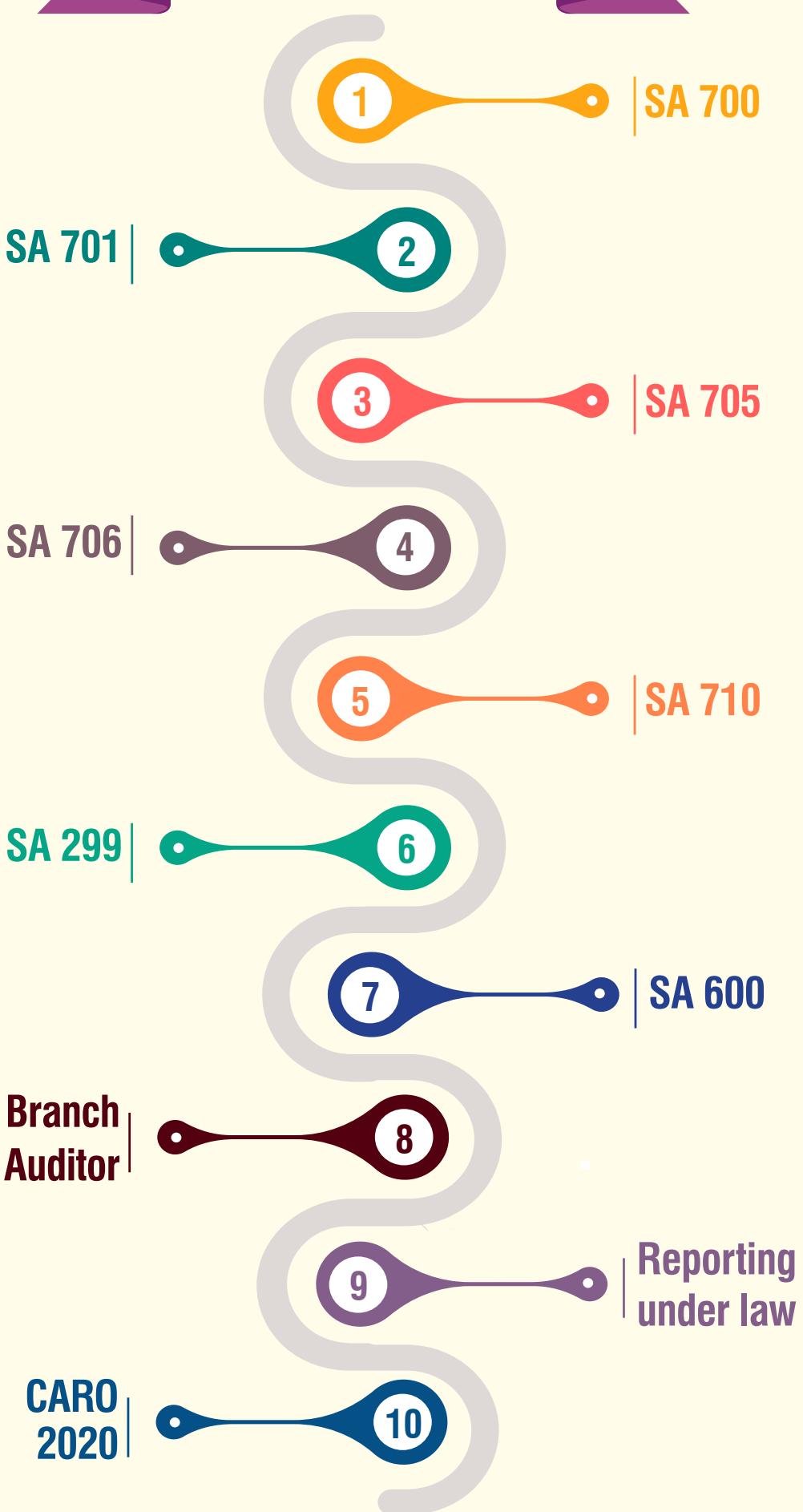
Question 2:

Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.

 Answer: Documentation

CHAPTER 8

AUDIT REPORT



SA 700

FORMING AN OPINION &
REPORTING ON FS

Question 1:

M/s Smart & Associates are the statutory auditors of **Hotmeals Ltd.** for the FY 2021-22. How will the auditor **address** the audit report issued on the financial statements for the FY 2021-22? Also give a **title** to the report

 Answer:

- INDEPENDENT AUDITOR'S REPORT
- To the **Members** of Hotmeals Ltd.

Question 2:

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.

 Answer:

- INDEPENDENT AUDITOR'S REPORT
- To the **Partners** of Richa International

Question 3:

M/s Amitabh & 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 2021-22. 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.

 Answer:

- We have audited the FS of Ringston Limited which comprise the Balance Sheet as at 31.03.2022 and the statement of P&L and the notes to the FS, including a summary of significant accounting policies and other explanatory information.
- In our opinion and to the best of our information and according to the explanations given to us, the aforesaid FS give the information required by the Act in the manner so required and 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 31.03.2022 and the P&L for the year ending on that date.

Question 4:

M/s Kite Rite & Associates are the statutory auditors of Prime Deluxe Limited, for the FY 2021-22. 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 section.

 **Answer:**

We conducted our audit in accordance with the **Standards on Auditing (SAs)** 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 FS section of our report. We are **independent** of the Company in accordance with the Code of Ethics issued by the 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 ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Question 5:

Diamond Shine Ltd. is a company engaged in the manufacture of detergent. M/s Bright & 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.

 **Answer:** Management responsibility**Question 6:**

M/s Ajay Vijay & Associates are the statutory auditors of Sarovar Ltd. for the FY 2021-22. 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.

 **Answer:**

- Auditors responsibility
- Para 1

Question 7:

M/s TUV & Associates are the statutory auditors of Venus Ltd. for the FY 2021-22. 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

 **Answer:**

The following is the correct way of signing an audit report.

M/s TUV & Associates
Chartered Accountants
(Firm's Registration No.)
Signature

(Name of the Member Signing the Audit Report)
(Designation)

(Membership No. XXXXX)

Place of Signature: UDIN: 20037320AAAAAH1111

Date:

Question 8:

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?

 **Answer:**

The 18-digit alpha numeric number noticed by her at end of audit report is (UDIN). It is a system generated unique number. Its basic objective is to curb the malpractices of non-CAs impersonating themselves as CAs. It helps in securing reports and documents issued by practicing CAs.

Question 9:

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.



Answer:

"Basis for Opinion" 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 not proper.

Question 10:

"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.



Answer: Qualitative aspects

Question 11:

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable FRF. Explain stating clearly **specific evaluations** made by the auditor.



Answer: Specific evaluations

Question 12:

The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain.



Answer:

- 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.
- This SA promotes **consistency in the auditor's report** but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions.
- Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes **credibility in the global market place** by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards.
- It also **helps to promote the user's understanding** and to identify unusual circumstances when they occur.

Question 13:

In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. 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.



Answer: possible bias in management's judgments

SA 701

COMMUNICATING KEY AUDIT MATTERS

Question 1:

Write a short note on: Purpose of communicating key audit matters

 **Answer:** Purpose

Question 2:

CA. Amar has come across certain key matters while auditing the accounts of PR Ltd. for the financial year 2017-18. He, being the associate of your firm, seeks your advice on "Communicating Key Audit Matters" in the Auditor's Report. Guide him.

 **Answer:** Communicating KAM

Question 3:

Communicating KAM is not substitute for disc in FS rather communicating KAM ins te

 **Answer:** Communicating KAM is not a substitute for

Question 4:

How would an auditor determine KAM?

 **Answer:** Determining KAM

SA 705

MODIFICATIONS TO THE OPINION IN
THE INDEPENDENT AUDITORS REPORT

Question 1:

Super Duper Ltd. is a company engaged in the manufacture of office furniture. M/s Young Old & Associates are the statutory auditors of the company for the FY 2020-21. 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 & Associates in this case.

 **Answer:** QUALIFIED OPINION

Question 2:

M/s Taj Raj & Associates are the statutory auditors of Polex Ltd. engaged in the manufacture of premium watches, for the FY 2020-21. 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 31.03.2021. 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.

 **Answer:** ADVERSE OPINION

Question 3:

Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2020-21 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.

 **Answer:** DISCLAIMER OF OPINION

Question 4:

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.

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.

Assuming it is not possible to withdraw from engagement, what type of opinion should be expressed by auditor?

 **Answer:** DISCLAIMER OF OPINION

Question 5:

XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2022-23. The company has taken long term funding for fixed capital requirements and short-term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire and the company is unable to renegotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the FS discuss the magnitude of financing arrangements, the expiration and the total financing arrangements; however, the FS do not include discussion on the impact or the availability of refinancing. Thus, the FS (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.?

 **Answer:**

CA Sudhir shall express a qualified opinion as the effects are material but not pervasive

Question 6:

MNO Ltd. is a power generating company having its plants in the north eastern states of the country. For the FY 2022-23, M/s PRT & Associates are the statutory auditors of the company. During the course of audit, the audit team was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment (in XYZ. Ltd.) that represents over 90% of the entity's net assets. What kind of opinion should the statutory auditor's issue in such case?

 **Answer:** Disclaimer of opinion

Question 7:

ADKS & Co LLP are the newly appointed statutory auditors of PKK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of FS. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise.

 **Answer:** SA 705 chart

Question 8:

Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

 **Answer:** SA 705 Chart

Question 9:

M/s Daisy & Associates are the statutory auditors of Zebra Ltd. for the FY 2021-22. CA Daisy, the engagement partner wants to verify the cash in hand as on 31.03.2022. The cash balance of the company as on 31.03.2022 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

 **Answer:** Refer ROSA chart

Question 10:

After accepting the statutory audit of M/s All in One Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may adversely affect and result in your inability to obtain sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences and your response to the limitations imposed by the management on your scope.

**Answer:** ROSA chart**Question 11:**

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.

**Answer:**

Reporting requirements, Manner of qualification and disclosure to be made in the auditor's report in line with AS 1, "Disclosure of Accounting Policies":

In the case of a company, members should qualify their audit reports in case:

- (a) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013 have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the FS, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.

- Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed 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.
- 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.
- In making a qualification/disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification/disclosure in respect of items which, in his judgment, are not material.
- 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.

Question 13:

When should an auditor make a disclaimer opinion in his Audit Report?

 **Answer:** Refer chart**Question 14:**

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?

 **Answer:** Refer SA 705**Question 15:**

M/s Sun Moon & Associates are the statutory auditors of Venus Ltd. for the FY 2021-22. 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.

 **Answer:** Communicate with TCWG

SA 706

EOM PARA & OM PARA IN
INDEPENDENT AR

Question 1:

Enumerate certain important matters which can be included in “Emphasis of Matter Paragraph” in an Auditor’s Report.

 **Answer:** Explains

Question 2:

Give examples of Emphasis of Matters which may have an adverse effect on the functioning of the company as well as those which may not affect the functioning of the company.

 **Answer:** LACS

Question 3:

 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 2020-21. 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 31.03.2021. 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

 **Answer:**

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:

Emphasis of Matter:

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 not modified in respect of this matter.

Question 4:

Compare and Explain the following: Audit Qualification and Emphasis of Matter.

Answer:

- **SA 705** "Modifications to the Opinion in the Independent Auditor's Report" deals with the provisions relating to Audit Qualification. **Audit Qualifications** are given when auditor is having reservations on some of the items out of the financial statements.
- It is issued under following circumstances:
 1. Financial statements are **materially misstated** which in the auditor's judgments are **not pervasive**.
 2. Auditor is **unable to obtain SAAE** which in the auditor judgment are not pervasive
- As per 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" EOM is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed in FS and are fundamental to users' for understanding of FS.
- EOM is used when there is an uncertainty relating to future outcome of exceptional litigation, regulatory action, etc; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the FS in advance of its effective date.

Question 5:

In respect of the audit of BDS Ltd., the statutory auditor of the company noticed some matters. The statutory auditor wants to draw the user's attention towards such matters, though his opinion is not modified in respect of such matters. Draft the relevant paragraphs of the audit report for the following matters

- (1) The company has a plan to **resume its construction activities** with respect to one of its thermal power projects, The activity of such power plant was suspended in the FY 2018-19. The thermal power project comprises of the plant and equipment amounting to \$ 5.95 crores and capital work in progress of t 147.50 crores.
- (2) The FS of 5 branches are included in the Standalone FS of BDS Ltd. whose FS reflect total assets of \$ 90 crores as on 31.03.2023 and total revenue from operations of \$ 40 crores for the year ended on that date. The FS of these branches have been audited by the branch auditors.

Answer:

- Emphasis of Matter Para and Other Matter Para in Audit Report:

Emphasis of Matter

- We draw attention to the following note of the standalone financial statements:

Note 27 regarding the plans of the Company to resume construction/developmental activities of a thermal power project.

- The carrying amounts related to the project as on 31st March, 2023 comprise of plant and equipment of R 5.95 crores and capital work in progress of \$ 147.50 crores.
- Our opinion is not modified in respect of this matter.

Other Matter

- We did not audit the FS of 5 branches included in the Standalone FS of the company whose FS reflect total assets of 7 90 crores as on 31.03.2023 and total revenue from operations of R 40 crores for the year ended on that date.
- The FS of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion insofar as it relates to the amounts and disclosures included in respect of these branches, is based solely on the report of the branch auditors.
- Our opinion is not modified in respect of this matter.

Question 6:

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material. You are required to advise, whether AKB Associates should report Observations 1 and 2 in its audit report? If so, under which heading should it be reported?

 **Answer:**

Observation 1:

- **Facts of the case:**
- **Relevant provisions:** As per SA 706, "Emphasis of Matter Paragraph & Other Matter

Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgment is of such importance that it is fundamental to users' understanding of the financials.

- **Reporting requirements:** The auditor shall report about the consequences of the flood which affected the Company's warehouse under EOM.

Observation 2:

- **Facts of the case:**
- **Relevant provisions:** As per SA 705, "Modification to Opinion in the Independent Auditor's Report", where the auditor is unable to obtain sufficient and appropriate audit evidence and where such matter is material but not pervasive, the auditor shall issue a qualified opinion.
- **Reporting requirements:** In accordance with SA 705, the auditor is required to issue a qualified opinion.

SA 710

COMPARATIVE INFO-
CORRESPONDING FIGURES

Question 1:

When corresponding figures are presented, the auditor shall not refer to the corresponding figures except in some circumstances. the auditor's opinion shall not refer to the corresponding figures

 **Answer:** Q.3

Question 2:

NG Ltd. appointed CA N as the statutory auditor for the F.Y. 2023-24. Previous year's auditor gave a qualified opinion on the comparative Financial Statements for the Year ended 31.03.2023. What will reporting responsibility casted on CA N when he forms an opinion and prepares audit report on the Comparative Financial Statements for the F.Y. 2023-24?

 **Answer:** Matters to be stated in OM

Question 3:

The nature of the comparative information that is presented in an entity's FS depends on the requirements of the AFRF. 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.

 **Answer:** Difference between

SA 299

RESPONSIBILITY OF JOINT AUDITOR

Question 1:

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 joint auditors.

 **Answer:** Discussion among joint Auditors

Question 2:

The practice of appointing CA as joint auditor is quite widespread in big companies and corporations. Explain stating the advantages of the audit

 **Answer:** Advantages

Question 3:

A joint auditor is not bound by the views of majority. Comment

 **Answer:** Reporting

Question 4:

For which work joint auditors are jointly and severally responsible

 **Answer:** Responsibility of JA

SA 600

USING THE WORK OF
ANOTHER AUDITOR

Question 1:

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.

 **Answer:** It is not an encroachment of another auditor's domain

Question 2:

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.

 **Answer:** Whole SA 600

TOPIC 8 : BRANCH AUDITOR - REFER LAW

TOPIC 9: REPORTING UNDER LAW - REFER LAW

CARO 2020

Question 1:

As an auditor, how would you deal with the following: L pvt. Ltd. Which has an outstanding loss of more than Rs. 100 lakhs from financial institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies Auditor Report Order (CARO) is not applicable.

Answer:

Contention of L Pvt. Ltd is not correct as borrowing from financial institution exceeds Rs. 1 Cr., and auditor is required to report the period and amount of default in repayment of dues under Para 3 (viii) of CARO 2020.

Question 2:

A Pvt. Ltd. Company reports the following position as on 31st March 2019:

- Paid up capital: 60 Lacs
- Revaluation reserves: 20 Lacs
- Capital Reserves: 22 Lacs
- P & LA /C(Dr. balance): 4 Lacs
- The management of the company contends that CARO, 2020 is not applicable to it.

Answer:

CARO is not applicable as paid up capital and reserves does not exceed Rs. 1 Cr. (60 Lacs + 20 Lacs + 22 Lacs - 4 Lacs).

Question 3:

Under CARO 2020, how as a statutory auditor would you comment on the following: X Pvt. Ltd. Is a subsidiary of a listed entity. The management of the company believes that since X Pvt. Ltd. is a private company and satisfies all condition under CARO 2016, reporting under CARO is not applicable.

Answer:

CARO is applicable as extension is not available to a private company which is a subsidiary or holding of a public company.

Question 4:

E-Tech Pvt. Ltd., which has an aggregate outstanding loan of 20 lakhs from Banks and 30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The Company holds that it being a private limited company, the Companies (Auditor's Report Order, 2020 is not applicable)

 **Answer:**

CARO, 2020 will not be applicable on it as outstanding loan from banks and financial institution in aggregate does not exceed 1 Cr.

Question 5:

XLtd. closed its manufacturing operations and sold all its property, plant and equipment relating to manufacturing operations during the current financial year. However, it intends to continue its operations as a trading company. In respect of other fixed assets, the company carried out a physical verification as at the end of current financial year and found a material discrepancy to the tune of 1 lac, which was written off and is disclosed separately in the profit and loss account. Kindly incorporate the above in your audit report.

 **Answer:**

The property, plant and equipment have been physically verified by the management at reasonable intervals; material discrepancies were noticed on such verification and the same have been properly dealt with in the books of account.

Question 6:

Under CARO, 2020, as a statutory auditor, how would you report: NSP Limited has its factory building, appearing as property, plant and equipment in its financial statements in the name of one of its directors who was overlooking the manufacturing activities.

 **Answer:** Report under Clause (1)(c) of Para 3 of the CARO, 2020.**Question 7:**

ABC Ltd. owns a piece of Land and Building situated at IP road, Mumbai which was purchased before 30 years. The title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company.

As the statutory auditor of the company, what are the audit procedures to be followed and what is the reporting under CARO, 2020

 **Answer:** Refer under Clause (1) (c) of Para 3 of the CARO.

Question 8:

The Property, Plant and Equipment of Amir Ltd. included ₹ 25.75 crores of earth removing machines of out-dated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern in view of CARO, 2020 on matters specified above?

 **Answer:** Report under Clause (1)(b) of Para 3 of the CARO, 2020

Question 9:

As the statutory auditor of B Ltd. to whom CARO, 2020 is applicable, how would you report in the following situations: Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

 **Answer:**

Procedure of physical verification followed by management is not reasonable and hence the auditor should point out the inadequacies in physical verification procedures, under Para 3(ii) of CARO, 2020.

Question 10:

Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company. Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said Order:

- One of the Plant and Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from 4 crore to 4.45 crore.
- During the year under consideration, cash credit limit of 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Account. You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO, 2020

 **Answer:** Auditor is required to report the amount of change of 45 lakh in accordance with Clause (1)(d) of Para 3 of CARO, 2020. (ii) Reporting required under Clause (ii)(b) of Para 3.

Question 11:

Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for 10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited and the details of submission of quarterly stock statement are as follows:

Period of Qtr	Stock value as per books	Stock value as per statement submitted to ABC Bank
Q1	11.5	14
Q2	14.75	17
Q3	11.5	14
Q4	15.25	15.25

The management of Jam Private Limited did not disclose the above variations in Notes to accounts forming part of financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date and further they are of the view that stock statement furnished to bank is only a formality and computed arbitrarily only for the purpose of securing higher drawing power and hence statutory auditors need not be bothered. Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal and discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 and CARO,

 **Answer:**

The variations need to be disclosed in the notes to accounts and also reported under CARO 2020.

Question 12:

In the course of audit of Y Ltd., as the auditor of the company you observe the following: The company has advanced a loan to a firm in which a director was interested at a rate lower than the prevailing market rate as well as there was no agreement on terms of repayment. How auditor will report in CARO, 2020?

 **Answer:**

Reporting required under Para 3(iii) of CARO, 2020. Auditor should also ensure compliance of disclosure requirements of AS 18 and perform procedures as prescribed under SA 550.

Question 13:

H Ltd. granted unsecured loan of 1 crore @ 15% p.a. to two of its subsidiaries during the current financial year. Before the year end both the companies repaid the loan. The management of H Ltd. is of the opinion that since no balance is outstanding as at the end of financial year, these loans are not required to be reported in CARO, 2020. Comment and draft a suitable report.

 **Answer:**

Draft Report: "The Company has granted loan of 1 Crore @ 15% p.a. to 2 of its subsidiaries during the current Financial Year. The maximum amount involved during the year was 1 crore and the year-end balance of such loans was Nil"

Question 14:

As a company auditor you noticed that there is an intercorporate loan granted by the company. State the reporting requirements.

 **Answer:**

Reporting required under Para 3 (iii) &(iv) of CARO, 2020.

Question 15:

During the course of the audit of M/S CT Ltd, it has noticed that Rs. 2 lakh of employee contribution and Rs. 9.5 Lakh of employer contribution towards ESIC have been accounted in the books in the respective heads. Whereas it is found that only Rs. 4 lakh have been deposited with the ESIC dept during the year. The Finance Manager informed that auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial improves. Comment as a statutory auditor.

 **Answer:** Reporting required under Para 3(vii)(a) of CARO, 2020.**Question 16:**

Is the company regular in depositing undisputed statutory dues including Provident Fund, Employees State Insurance, Income Tax, Sales Tax, Wealth Tax, Customs duty, Excise duty, Value added Tax, Cess and any other statutory dues with the appropriate authorities and if not, the extent of arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable shall be indicated by the auditor.

 **Answer:** Reporting required under Para 3(vii)(a) of CARO, 2020.

Question 17:

Big and Small Ltd. received a show cause notice from GST department intending to levy a demand of 25 lakhs in December 2022. The company replied to the above notice in January 2023 contending that it is not liable for the levy. No further action was initiated by the GST department upto the finalization of the audit for the year ended on 31st March, 2023. As the auditor of the company, what is your role in this?

 **Answer:** Reporting required under Para 3(vii) of CARO, 2020.

Question 18:

As an auditor, how will you report under CARO in each of the following situation:

1. Since more than seven months, payment of electricity bills to company established under statute is outstanding.
2. The company had imported goods 5 years back and were placed in bonded warehouse till the end of financial year under Audit. The company has not paid import duty as goods have not been removed from such warehouse. The company has also not paid rent and interest expenditure payable on the amount of customs duty.
3. The company has received income tax assessment order along with demand notice from Assessing Officer. The company has not paid dues payable as the same is not acceptable to the company. The company has neither preferred appeal against the order nor an application for rectification of mistake has been made. The company has just merely represented to the Assessing Officer.
4. The company in view of voluminous pay-roll data consistently follows the method of making lump sum deposit of estimated amount of ESI collections and adjust the excess or deficit against next following months' deposit and the difference of the said amount always remains insignificant.

 **Answer:**

1. Reporting not required as dues has arisen on account of contract of supply of goods or services between the parties
2. Reporting not required for customs duty as it is not yet due; Interest and rent that are required to be incurred u/s 61 of the Customs Act, 1962 would come under other statutory dues and the auditor would have to examine and comment upon the regularity of the company in depositing such interest and rent.
3. Auditor is required to check whether time limit for filing the appeal or application for rectification of mistake has expired or not and report accordingly.
4. Reporting not required

Question 19:

R Ltd. as on 31st March 2023 defaulted in the repayment of interest and principal due to a financial institution. The due date was 28th Feb. 2023. However, the defaulted amount was paid on 5th April 2023. The company's management is of the opinion that since the default is set right before the audit completion these need not be reported in CARO, 2020. Comment & draft a suitable report.

 **Answer:**

Draft Report: "The company has defaulted in repayment of principal and interest to the financial institution amounted to, that become due on XX. Also the period of default is xx days".

Question 20:

Under CARO how, as a statutory auditor how would you comment on the following: A Term Loan was obtained from a bank for 75 lakhs for acquiring R&D equipment, out of which 12 lakhs were used to buy a car for use of the concerned director, who was overlooking the R&D activities

 **Answer:**

As per requirement of Para 3(ix) of CARO, 2020, auditor is required to report the fact that out of the term loan obtained for R & D equipment, 12 Lacs was not utilized for the purpose of acquiring the R &D equipment.

Question 21:

As a Statutory Auditor, how would you deal with the following: LM Ltd. had obtained a Term Loan of 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in shortterm deposits.

 **Answer:**

Auditor is required to report the fact that the pending utilisation of term loan, the funds are temporarily invested in short term deposits, in his audit report as per requirement of Para 3(ix) of CARO

Question 22:

During the financial year ended on 31.03.2023, LM Private Limited had borrowed from a Nationalized Bank, a term loan of 120 lakhs consisting of 100 lakhs for purchase of a machinery for the new plant and 20 lakhs for erection expenses. As on the date of 31st March 2023, the total of capital and free reserves of the Company was 50 lakhs and

turnover for the year 2022-23 was 750 lakhs. The Bank paid * 100 lakhs to the vendor of the Company for the supply of machinery on 31.12.2022. The machinery had reached the yard of the Company. On 28.02.2023, the Company had drawn the balance of loan viz. * 20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31.03.2023, in this respect.

 **Answer:**

As per requirement of Para 3(ix) of CARO, 2020, auditor is required to report the fact that our the term loan obtained for achinery purchase and erection, 20 Lacs was not utilized for the purpose of erection of machinery.

Question 23:

Gautam Limited had borrowed 1,000 crore from XYZ Bank, the principal of which was repayable after 5 years and interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5th instalment of interest payment and principal which was due on June 30, 2022. On Dec. 31, 2022, Gautam Limited approached XY bank and MNO bank to restructure the existing liability. As a result, the existing principal and outstanding and overdue interest was restructured into a new loan amounting to 1,100 crore The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist and the new loan has maturity after 5 years.

 **Answer:** Report under ix of para 3

Question 24:

ABC Pvt. Ltd. is a manufacturer of jewellery. A senior employee of the Company informed you that the Company does not properly disclose the purity of gold used on the jewellery.

 **Answer:**

From the view point of reporting on frauds under CARO, 2020, there is no implication for misstatement in the financial statements. Hence, no reporting is necessary for improper disclosure of purity of gold on the jewellery.

Question 25:

What are the reporting requirements in the audit report under the Companies Act, 2013/CARO,2020 for the following situations?

(a) A fraud has been committed against the company by an officer of the company.

- (b) A fraud has been committed against the company by a vendor of the company.
- (c) The company has committed a major fraud on its customer and the case is pending in the court.
- (d) A fraud has been reported in the cost audit report but not noticed by statutory auditors in his audit



Refer Sec. 143(12) read with Rule 13 of Companies (Audit & Auditor's) Rules, 2014 and Para 3(xi) of CARO, 2020.

Question 26:

In the course of audit of MM Ltd., your audit team has identified the following matter: All amount of 4 Lakh per month for the marketing services rendered is paid to M/s. MG Associates, a partnership firm in which Director of MM Ltd. is also a managing partner, with a profit sharing ratio of 30%. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by 1.50 Lakh per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts. Give your comments.



Answer: Refer Para 3(xiii) of CARO, 2020

Question 27:

You are appointed as the Auditor of XMP Pvt. Ltd. for financial year 2022-23 after the resignation of RS & Co. Chartered Accountants, as statutory auditor of the company. RS & Co., had certain concerns on the accounting matters of the company, leading to change of auditors. All compliance u/s 139 & 140 are made by the company with regard to resignation appointment. During the course of audit, it came to your notice that a survey has been conducted on December 7, 2022 by the Income Tax Department and department has unearthed unrecorded sales 5 lakhs which had been made in cash in different dates during the year 2021-22 XMP Pvt. Ltd. purchased from such collections and these transactions are not recorded. Company surrendered and disclosed these transactions before the assessing officer and paid taxes thereon. However, company has not recorded those transactions in books of account even after surrender before Income Tax authorities. Comment.



Answer: Report as per CARO clause (xviii) of para 3

9

SPECIAL FEATURES OF AUDIT OF
DIFFERENT TYPES OF ENTITIES

PART 1 - DIFFERENT ENTITIES

Question 1:

CA Akash Virmani is auditor of a partnership firm consisting of 4 partners. During the year, one of the partners has retired and another partner has joined the next day. Discuss, any one point, which shall be considered by you to ensure that financial statements of firm are not misstated due to change of constitution of firm.

 Answer:

Considerations in case of change in constitution of firm:

- Auditor shall consider provisions of retirement deed/partnership deed for date of retiring and joining of partners. It should be ensured that profits are appropriately distributed up to date of retirement
- Further, profits after retirement should have been distributed among partners as per terms of new partnership deed.

Question 2:

What are the advantages of the audit of the accounts of partnership firm.

 Answer: Advantages of Audit of Partnership Firms

Question 3:

Mention important points which auditors will consider while conducting audit of accounts of a partnership firm.

Or

There are certain points which are required to consider specially in the audit of accounts of a partnership. Discuss any three points briefly.

 Answer: Points to be considered in Audit of Partnership Firms

Question 4:

Tomo Construction Engineering LLP approached CA K to understand various returns to be maintained and filed by them, Guide/Discuss the various returns to be maintained and filed by them.

 **Answer:** Returns to be maintained and filed by an LLP.

Question 5:

Ban I.L.P is formed during the year 2023-24. They are not sure about the type of books of account to be maintained. What are the books of account that the LIP is required to maintain?

 **Answer:** Books of account to be maintained by LLP

Question 6:

Mention the special point to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges INR 500 per month from a student for their lodging / boarding.

 **Answer:** Point to be examined in audit of a Charitable Institution.

Question 7:

In the case of audit of a charitable institution, what attentions should be paid by auditor regarding audit of expenditure items?

OR

CA B is appointed as the auditor of a Public Charitable Trust. Guide him the focus area of attention relating to the vouching and verification of expenditure of charitable institution.

 **Answer:** Audit of Expenditure items in case of Charitable Institution

Question 8:

How will you vouch/verify the following: Investments income in the case of charitable institution.

 **Answer:** Investment Income in the case of Charitable Institution.

Question 9:

How will you vouch/verify the following: Investments income in the case of charitable institution.

 **Answer:** Investment Income in the case of Charitable Institution.

Question 10:

CA A is appointed as the auditor of a charitable Institutions. Discuss the audit procedure undertaken by him while auditing the Subscription and Donation received by the charitable institution.

 **Answer:** Audit Procedure in audit of Subscriptions & donations.

Question 11:

M/s T & Co. Chartered Accountants, a partnership firm, is appointed as an auditor of Treatment Hospital run by Smile Foundation, a charitable trust. Over and above the receipts of treatment of patients. During the year trust has received donations from various donors to treat COVID-19 patients and also incurred some capital expenditure for further development of the hospital. On some of the investment income, income tax has been deducted. What are the special points to be considered by M/s T & Co. while auditing such transactions of Treatment Hospital?

 **Answer:**

Audit of Charitable trust:

- (a) Donations
- (b) Capital Expenditure
- (c) Tax deducted on Investment Income

Question 12:

You are auditor of a school operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases. Discuss, how, you as an auditor, would proceed to verify the same?

 **Answer:**

Audit procedure in case of a School w.r.t. Fees Concessions:

- Fees concessions have to be under proper authority of school management. Auditor would verify internal controls in this regard.
- Besides, detailed checking of few cases needs to be undertaken to ensure genuineness of fees concessions and proper management approvals

Question 13:

Mention the eight Important points which an auditor will consider while conducting the audit of educational institutions. Or

What are the special steps involved in conducting the audit of an Educational Institution?

 **Answer:** Points in audit of Educational Institutions (School).

Question 14:

GSR & Co. has been appointed as an auditor of Tagore School. Engagement team wants to verify Fees from students in detail. Advise the audit procedure to be followed by the engagement team.

 **Answer:** Audit procedure for verify fee from students.

Question 15:

You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying assets and Liabilities of VJM Schools.

 **Answer:** Verifying Assets & Liabilities of an Educational Institution.

Question 16:

Explain and also state the role of auditor with respect to the following in case of a school:

- (i) The fees from the students.
- (ii) Other Receipts/Grants & Donations.

 **Answer:**

Role of Auditor with respect to audit of School:

- (i) Fee from Students
- (ii) Other receipts/Grants & Donations

Question 17:

A muti-speciality hospital has come up in your city. You are appointed as auditor for first year. Discuss, any four, broad areas to be kept in mind while conducting audit of accounts of such a newly opened multi-speciality hospital.

Or

The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital?

Or

Mention any 8 special points which you as an auditor would look into while auditing the books of account of Hospital.

Or

You have been appointed auditor of M/s. Divine Children Hospital. Discuss any four important points that would attract your attention while audit.

 **Answer:** Points in Audit of books of account of Hospital.

Question 18:

You have been appointed as internal auditor of 'City Club' in Delhi. The receipts of the club were 50 lakhs during the previous year ending 2023-24. You are required to mention special points of consideration while auditing such receipts of the club.

Or

State the points which merit consideration in the audit of a CLUB w.r.t its members.



Points which merit consideration in the audit of a CLUB w.r.t its members.

Question 19:

Cine Screen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets?



Answer: Verification points in receipts from sale of tickets.

Question 20:

M/s PQ & Co., Chartered Accountants have been appointed as statutory auditor of CBD Multiplex Cinema Ltd. The audit team started the audit and verified the ledger and other books of account for the FY 2023-24. However, one of the team members is of the view that the internal control mechanism of the company should also be verified. Can you guide the audit team about the areas that will be covered in verifying the internal control mechanism?



Answer: Internal control mechanism of a multiplex.

Question 21:

As an auditor, how will you verify the hire purchase transaction in the case of an entity engaged in the business of hire purchase?



Answer: Verification of Hire-purchase transactions.

Question 22:

Define the different types of lease agreements as per Accounting Standard/Ind-AS.



Answer: Different Types of Lease Agreements.

Question 23:

Explain and also state the role of auditor with respect to the following in case of a hotel:

- Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined.

(ii) The inventories in any hotel are both readily portable and saleable. Areas where large quantities of inventory are held should be kept locked.

 **Answer:** (i) Internal control (ii) Inventories

Question 24:

You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2023-24. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages?

 **Answer:** Verification of inventories in the nature of food and beverages.

Question 25:

Explain and also state the role of auditor with respect to the following in case of a hotel:

- (i) Inventories
- (ii) Travel agents & shops.

 **Answer:**

- Verification of Inventories
- Verification of Travel agents & shops

Question 26:

As an auditor, explain the areas of consideration while auditing the element of ROOM SALES during the audit of a 5-Star Hotel.

 **Answer:** Areas of consideration while auditing ROOM SALES during the audit of a Hotel.

Question 27:

An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

 **Answer:**

- Audit of Donation Receipts.
- Remittance of Donations to Different NGOS.

Question 28:

You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?

Or

While planning the audit of an NGO, the auditor may focus on Knowledge of the NGO's work, Its mission and vision, Updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO.

 **Answer:** Points to be concentrated while planning an audit of an NGO.

Question 29:

As an Auditor of NGO, how do you check/verify atleast four receipts of income during the year?

 **Answer:** Examination of Receipts of Income of NGO.

Question 30:

The audit programme of NGO should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted. Explain.

 **Answer:** Audit programme of NGO.

PART 2 - AUDIT OF CO-OPERATIVE SOCIETIES

Question 1:

A society has been formed by pan India employees of a public sector bank. The purpose of society is to promote savings habits of members and to grant loan to them up to a small specified amount. Small savings are promoted amongst members by way of compulsory contribution from monthly salary. Identify type of society and also discuss nature of books of accounts to be maintained by such a society.

 **Answer:** Maintenance of books

Question 2:

Discuss, In what circumstances, Central Registrar can hold an inquiry into working and financial condition of a multi-state cooperative society.

 **Answer:** Circumstances when inquiry may be held or ordered

Question 3:

Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of multi-state co-operative society. Explain stating also the persons who are not eligible for appointment as auditors of a multi-state co-operative society.

 **Answer:** Qualifications of Auditors of Multi-State Co-operative Societies.

Question 4:

Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002.

 **Answer:**

Qualifications of Auditors of Multi-State Co-operative Societies.

Question 5:

Central Govt. hold 55% of the paid-up share Capital in Kisan Credit Co-operative Society, which is Incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co-operative Society Act.

 **Answer:** Circumstances requiring Special Audit.

Question 6:

As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-state co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account. Explain

 **Answer:** Auditor's Duties on Reporting of accounts and financial statements.

Question 7:

You are appointed as an auditor of co-operative society. State the special features of the co operative audit to be borne in mind by the auditor, concerning:

- (i) Audit classification of society.
- (ii) Discussion of draft audit report with the managing committee.

 **Answer:**

Audit of Co-operative Society:

- (1) Audit classification of society.
- (2) Discussion of draft audit report with managing committee.

Question 8:

No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such Inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.

 **Answer:** Inspection of Multi-State Co-operative societies u/s 79.

Question 9:

CA, Z, a Chartered Accountant is the Senior manager of a Multi State Co-operative society in Mumbai. He is proposed to be appointed as an auditor of the said Multi-State Co-operative society. Analyse the provisions of the Multi-State Co-operative Societies Act, 2002 and comment on validity of proposed appointment.

 **Answer:** Appointment of Auditor in co-operative Society.

PART 3 - (A) GOVERNMENT AUDIT

Question 1:

It is the duty of Comptroller and Auditor General of India to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it. Discuss, in above context, what is understood by "Consolidated Fund of India"? What is its importance?

Answer:

Consolidated Fund of India and its importance:

- Consolidated Fund of India consists of all the revenue received from direct and indirect taxes, all the loans taken by the Govt. of India and all the amount of repayment of loans received by the Govt. of India.
- Its importance lies in the fact that all government expenditure is incurred from this fund. No moneys out of the Consolidated Fund of India shall be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution.

Question 2:

Define Government Audit and explain its objectives.

Answer: Government Audit and its objectives.

Question 3:

Explain in detail the duties of Comptroller and General of India.

Answer: Government Audit and its objectives.

Question 4:

Discuss the power of C&AG in Government audit.

Answer: Powers of C & AG in connection with the performance of his duties

Question 5:

The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit

and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. Explain.

 **Answer:** C & AG responsibility for compiling the accounts of the Union and State;

Question 6:

Write basis standards set for Expenditure Audit of Government.

 **Answer:** Basic Standards for audit of government expenditure.

Question 7:

Audit against the propriety seeks to ensure that expenditure confirms to certain principles. Explain.

 **Answer:** Principles of Propriety Audit.

Question 8:

Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain.

 **Answer:** Audit against Rules and orders.

Question 9:

The auditor of a Govt Company has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority. Explain.

 **Answer:** Audit of Sanctions

Question 10:

"Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while audit against propriety.

 **Answer:** Exceptions to the rule of audit against propriety:

Question 11:

PQR Ltd., a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in the infructuous expenditure. Considering the above case, explain the type of expenditure audit to be performed to curb the situation.

Answer: Propriety audit:

Question 12:

Audit against rules and orders aims to ensure that expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. These rules, regulations and orders against which regularity audit is conducted fall under various categories. Explain.

 **Answer:** Audit against rules and orders.

Question 13:

SK & Co, a Chartered Accountant firm has been appointed an auditor of Metro Rail project in City A. Since the project is on large scale it involves a high volume of resources (financial, human and physical resources). The appointing authority C&AG requires an objective examination of the financial and operational performance of the Metro Rail project. Explain the nature and scope of audit that SK & Co will undertake.

 **Answer:** Efficiency cum performance audit.

Question 14:

The audit of receipts of government is not as old as audit of expenditure but with the rapid growth of public enterprises audit of receipts tax or non-tax has come to stay. Discuss audit of receipts with respect to Government Audit.

 **Answer:** Audit of Receipts.

Question 15:

In case of Government entities, audit of accounts of stores and inventories has been developed as a part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG.

 **Answer:** Audit of Accounts of Stores and Inventories in Government Companies.

PART 3 - (B) AUDIT OF LOCAL BODIES**Question 1:**

Explain the different types of revenue grants which local bodies may receive.

 **Answer:** Different types of revenue grants

Question 2:

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. Explain stating Important objectives of audit of such bodies.

 **Answer:** Important objectives of local body's audit.

Question 3:

CA Sevak is appointed as an auditor of a Municipal Corporation of a big smart city. He wants to verify various expenditures of the Municipality. Define the term "Municipality" and state what are the heads under which expenditures incurred by the Municipalities and Corporations can be broadly classified?

 **Answer:**

Meaning of Municipality: Heads under which expenditures incurred by the Municipalities and Corporations can be broadly classified.

10

AUDIT OF BANKS

Question 1:

There are different types of banks prevailing in India. Explain giving examples of such banks.

 **Answer:** Different types of banking institutions prevailing in India are as follows.

Question 2:

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. Explain.

 **Answer:** RBI – Regulating Body.

Question 3:

List out any four points which highlight peculiarities involved in banking operations.

 **Answer:** Peculiarities involved in banking operations.

Question 4:

Your firm of auditors, SRG & Co, has been appointed as Statutory Central Auditors of Reliable Bank Explain the reporting requirements of the Statutory Central Auditors (SCAs) In addition to their main audit report.

 **Answer:**

Reporting requirements of the Statutory Central Auditors (SCAs) in addition to their main audit report.

Question 5:

The financial statements of a bank are prepared in a specified format. Discuss legal provisions in this regard as applicable to financial statements of a nationalized bank.

 **Answer:** Form and Content of F.S.

Question 6:

In the case of a nationalised bank, the auditor is required to make a report to the Central Government. The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor's report in the case of a nationalised bank. Explain what would the auditor state in his report.

 **Answer:** Auditor's Report in case of Nationalised Banks.

Question 7:

"If an accounting professional, whether in the course of internal or external audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of excess power or smells any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action". Analyse and explain the above RBI Circular regarding liability of accounting and auditing profession.

 **Answer:** Reporting of Fraud to RBI.

Question 8:

Ranjana Ceramic Private Limited is sanctioned a cash credit facility of ₹ 100 Lacs from a branch of LMO Bank. Besides, branch has also sanctioned a one-time bank guarantee of ₹10 lacs on behalf of the company in favour of a statutory authority. Discuss, what type of credit facilities have been sanctioned by branch of LMO bank to the company along with probable purpose for each of credit facility.

 **Answer:**

Classification of Advances.

Cash credit facility sanctioned by bank to company is in nature of funded credit facility.

Its purpose is to meet working capital requirements of business.

Bank guarantee sanctioned to the company is in nature of non-funded credit facility.

Its probable purpose could be requirement of a guarantee by a statutory authority in exchange of company fulfilling some statutory obligations.

Question 9:

In case of a Bank, explain the meaning of Funded loans. Also give examples.

 **Answer:** Funded Loans

Question 10:

Distinguish between Primary Security and Collateral Security with reference to audit of Banks. Also give examples of most common types of securities accepted by the Banks.

 **Answer:** Primary Security and Collateral Security.

Question 11:

Mr. A approaches a bank for financial assistance for his upcoming project. The bank branch manager, after verifying the proposal, is agreeable to financial Mr. A, but asks for the security of be offered to the bank. Discuss the nature of securities required to be offered to the bank.

 **Answer:** Nature of Securities to be offered.

Question 12:

Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien. Explain with specific reference to Audit of Banks.

OR

Explain hypothecation and assignment as the modes of creation of security with respect to advance granted by a bank.

 **Answer:** Modes of creating securities.

Question 13:

Explain pledge and set off as the modes of creation of security with respect to advance granted by a bank.

 **Answer:** Pledge and set-Off.

Question 14:

There are different provisioning requirements as regards to categories of NPA such as sub-standards assets. Doubtful assets and loss assets. Explain in detail.

 **Answer:** Provisioning Requirements of NPA.

Question 15:

During course of audit of branch of a nationalized bank, you find that system has generated a report marking ten term loan accounts as SMA. Discuss, meaning of SMA accounts and significance of such a classification.

OR

CA. Puranjay is appointed as statutory branch auditor of two branches of a nationalized bank for year 2023-24. While verifying advances of one semi-urban branch, he noticed

substantial number of accounts categorized as SMA (Special Mention Accounts). In this context, explain the nature and significance of SMA

 **Answer:** Special Mention Accounts (SMA)

Question 16:

Account of a borrower availing cash credit facility from branch of a bank has become “Out of order.” Discuss the term “Out of order”.

 **Answer:** Out of Order in relation to Classification of Advances.

Question 17:

“Ramjilal & Co. had been allotted the branch audit of a nationalised bank for the year ended 31st March, 2024. In the audit planning, the partner of Ramjilal & Co. observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose.” Now be needs your assistance on the following points so as to incorporate them in the audit plan:

- (i) For determine of NPA norms for agricultural advances.
- (ii) For accounts where there is erosion in the value of security/frauds committed by the borrowers.

 **Answer:**

- (i) NPA Norms for agricultural advances.
- (ii) NPA Norms where there is erosion in the value of security/frauds committed by the borrowers.

Question 18:

Explain “Advances under Consortium” in the context of Prudential Norms on Income Recognition, Asset Classification and provisioning pertaining to Advances.

 **Answer:** Advances under Consortium.

Question 19:

N Ltd. has been sanctioned a Cash Credit Facility by XYZ Bank Ltd. for ₹ 1 crore and drawing power as per the Stock Statements furnished for the last quarter is ₹ 80 Lakh. Outstanding balance in the account is ₹ 75 lakh. Interest charged to the account is ₹ 3.5 lakh and total credit into the account for the quarter is ₹ 2.5 Lakh. As an auditor how will you report this account in your report.

 **Answer:** Conclusion : Auditor should report the account as non- performing advance in the report

Question 20:

Explain the categories of Agricultural Advances in case of Banks and related NPA norms.

OR

When is an agricultural advance considered as non-performing as per the RBI guidelines?

 **Answer:** NPA Norms for Agricultural Advances.

Question 21:

CARD Ltd. is into the banking business and handles large amount of loans and advances of different kinds. Non-performing assets are on the rise since last two quarters. The management is concerned with correct provisioning for the same. CA R is appointed to check whether correct provisioning of NPA's is being made by the bank or not. What are the aspects that will be verified by CA R for this purpose?

 **Answer:**

Aspects to be verified by CA R to check correct provisioning of NPAs:

- (a) For audit of Provisions, the auditors should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- (b) The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets.
- (c) The auditor may verify the loan classification on a sample basis.
- (d) The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.

Question 22:

When are following considered as non performing as per the RBI guidelines:

- (i) Government guaranteed advances
- (ii) Advances to staff

 **Answer:** Classification of Advances as NPA

Question 23:

CA P is conducting stock audit of a borrower availing cash credit facility of ₹ 100 Lacs from branch of a bank. The cash credit facility is against security of paid stocks and debtors up to 90 days. Margin stipulated is 25% for stock and 40% for debtors.

Followings further information is available as on 31.12.23

Value of stocks	₹ 125 lacs
Value of stocks (fully damaged) included in above	5 lacs
Value of debtors	50 lacs
Value of debtors exceeding 90 days included in above	10 lacs
Value of creditors for goods	50 lacs

Is Drawing Power computed by CA P for ₹ 82.50 lacs proper?

Answer:

Computation of Drawing Power:

Value of stocks as on 31.12.23	125 lacs
Less: value of damaged stocks	5 lacs
	120 lacs
Less: creditors for goods as on 31.12.23	50 lacs
Value of Paid stocks	70.00 lacs
Less: Margin @ 25%	17.50 lacs
Drawing power (A)	52.50 lacs
Value of debtors as on 31.12.23	50 lacs
Less: debtors exceeding 90 days	10 lacs
	40 lacs
Less: Margin @40%	16 lacs
Drawing Power (B)	24 lacs
Drawing Power (A+B)	76.50 lacs

Conclusion: Drawing power calculated by CA P is not proper. Drawing Power comes to ₹76.50 lacs.

Question 24:

In a bank, all accounts should be kept within the drawing power and the sanctioned limit. The accounts which exceed the sanctioned limit or drawing power should be brought to the notice of the management regularly. Analyse the following points to be considered in the computation of drawing power in case of bank audit.

- (i) Bank's Duties
- (ii) Auditor's concern
- (iii) Computation of DP
- (iv) Stock audit

Answer: Drawing Power

Question 25:

Compute the Drawing Power for Cash Credit A/c of S Limited for the month of March 2023 with following information: (Amount in ₹)

Stock	50,000
Debtors	45,000
(including Debtor of ₹5,000 for an invoice dated 17.11.2022)	
Sundry creditors	15,000
Sanctioned Limit	45,000
Margin on stock is 20% and on debtors is 50%.	

Note: Debtors older than 3 months are ineligible for calculation of DP.


Answer:
Computation of Drawing Power

	Particulars of Current Assets		Drawing power (₹)
(A) Stock			
	Stock at realisable value	50,000	
	Less: Unpaid Stock		
	Creditors	15,000	
	Paid for Stocks	35,000	
	Less: Margin @20%	7,000	28,000
(B) Debtors			
	Total debtors	45,000	
	Less: Ineligible debtors	5,000	
		40,000	
	Less: Margin @ 50%	20,000	20,000
	Total eligible amount	48,000	
	Drawing Power (Cannot exceed sanctioned limit)		45,000

Question 26:

A Ltd. has availed Cash Credit facilities against Stock and Book Debt. Term Loan for machineries and Bank Guarantee from Big Bank Ltd. A Ltd. furnishes stock statements and age wise list of debtors to Big Bank Ltd. on regular basis. Concurrent Auditors of Big Bank Ltd. mentioned about wrong calculation of Drawing Power by the Bank Branch along with sanctioned limit, and balances overdrawn due to wrong calculation of Drawing Power (DP) in the monthly report. Explain the meaning of drawing power and how it differs from sanctioned limit? What is to be ensured while computing Drawing Power (DP)?

**Answer:****Drawing Power**

- (a) Meaning
- (b) Drawing Power vs. Sanctioned Limit
- (c) Computation of DP

Question 27:

TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹ 4.00 crore. The letter sanctioning the above credit facility stipulates margin 25% on stocks and @ 40% on eligible book debts up to 90 days.

While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹ 5 crore (Including ₹ 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna). Debtors outstanding as on 30.6.23 are ₹ 3 crore (including ₹ 50 lacs outstanding for last 6 months). Trade creditors outstanding as on date are ₹ 2 crore. He calculates DP as on 30.6.23 for ₹ 3.30 crore. Is he correct?

Justify with your workings. What does drawing power calculated by you signify to the borrower company?

**Answer:****Computation of Drawing Power:** The calculation of DP is as under:

	₹
Value of stocks as on 30.6.23	5.00 crore
Less: value of damaged stocks	1.00 crore
Value of stocks considered as on 30.6.23	4.00 crore
Less: Trade creditors	2.00 crore
Paid stocks	2.00 crore
Less: Margin @ 25%	0.50 crore
Drawing power for stocks [A]	1.50 crore
Value of Trade debtors	3.00 crore
Less: Debtors outstanding for more than 90 days	0.50 crore
	2.50 crore
Less: Margin @ 40%	1.00 crore
Drawing power for Book debts [B]	1.50 crore
Total drawing power [A+ B]	3.00 crore

Accountant's DP calculation is not correct. The drawing power of ₹ 3.00 crore signifies that company can utilize funds to the tune of ₹ 3.00 crore only against sanctioned cash credit limit of ₹ 4.00 crore.

Question 28:

Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about, among other points, the amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet, Explain.

**Answer:**

Auditor's considerations while obtaining evidence in carrying out audit of advances.

Question 29:

The auditor can obtain sufficient appropriate audit evidence about advances by study and valuation of internal controls relating to advances. Explain in the context of Audit of Banks.

**Answer:** Evidences in respect of Advances**Question 30:**

"The Auditor should examine the efficacy of various internal controls over advances, to determine the nature, timing and extent of his substantive procedures." Discuss briefly.

OR

The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the Internal controls over advances.

**Answer:** Aspects of Internal Control in the area of loans and advances.**Question 31:**

You are verifying interest on deposits paid by branch of a nationalized bank. Discuss, any two "analytical procedures", to verify interest on deposits paid by branch.

**Answer:** "Analytical procedures", to verify interest of deposits.

Question 32:

Write a short note on reversal of income under bank audit.

Or

In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.

Analyse and explain.

 **Answer:** Reversal of Income

Question 33:

CA. Puran Jay is appointed as statutory branch auditor of two branches of a nationalized bank for year 23-24. While verifying Interest income of a mid-corporate branch of an urban centre having advances consisting of only cash credit limits for large borrowers, It was noticed that advances of ₹300 crores were outstanding as on balance sheet date carrying average interest rate @ 8% p.a. One articled clerk in audit team makes quick back of the envelope calculations of interest income of ₹ 24 crores on advances. However, schedule of profit & loss a/c shows interest income on advances for ₹10 crores. Discuss any two probable reasons for such variation.

 **Answer:**

The probable reasons for difference in interest calculation could be due to following:

- (i) Cash credit accounts, by their very nature, are running accounts and their utilization depends upon needs of business. Further, interest on cash credit account is charged on the extent of funds utilized by the borrower. It could be possible that all cash credit limits were not fully utilized during the year which resulted in lower interest income.
- (ii) Some large accounts may have been sanctioned during later part of the year resulting in lower Interest income on advances for whole year.

Question 34:

In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount. Explain the Audit Approach and Procedures regarding following points in the above context:

- (i) RBI's Directions
- (ii) Materiality
- (iii) Revenue Certainty
- (iv) Revenue Uncertainty

 **Answer:**

Audit Approach and Procedures:

- (i) RBI's Directions
- (ii) Materiality
- (iii) Revenue Certainty
- (iv) Revenue Uncertainty

Question 35:

In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense.

 **Answer:** Verification of Interest Expenditure.

Question 36:

Discuss outline of audit approach including audit procedures while auditing "provisions and contingencies in financial statements of a bank.

Or

You are appointed as statutory audit of DEF Bank Limited for the year 2023-24. As an auditor how will you verify provision created by DEF Bank Limited?

 **Answer:** Audit Procedure for Verification of Provisions and Contingencies

Question 37:

Explain the following in the context of Bank audit:

- (a) For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses.
- (b) For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.

 **Answer:**

- (a) Evaluation of system of internal control relating to expenses
- (b) Audit of Provisions and contingencies

Question 38:

As an Auditor of XYZ Bank Limited, how would you assess the Risk of Fraud including Money Laundering in line with SA 240?

 **Answer:** Assessing Risk of Fraud & money laundering.

Question 39:

“The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference”. Explain.

 **Answer:**

Engagement Team Discussions

Engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

Benefits of discussion:

- Specific emphasis should be provided to susceptibility of bank's F.S. to material misstatement due to fraud, that enables the ET to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- Enables EP to delegate the work to experienced ET members, and to determine the procedures to be followed when fraud is identified.
- EP may review the need to involve specialists to address the issues relating to fraud.

Matters to be discussed:

- (a) Errors that may be more likely to occur;
- (b) Errors which have been identified in prior years;
- (c) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- (d) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- (e) Need to maintain professional skepticism throughout the audit engagement;
- (f) Need to alert for information or other conditions that indicates that a material misstatement may have occurred.

Question 40:

Mr. Piyush, the Bank Manager develops controls to aid in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

OR

What are the general requirements of an effective Risk Management system in Banks?

 **Answer:** Understanding the Risk Management Process

Question 41:

Discuss importance of implementation of KYC norms by a bank from perspective of an auditor of bank.

 **Answer:** Importance of implementation of KYC norms.

11

ETHICS AND TERMS OF
AUDIT ENGAGEMENTS

Question 1:

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

 **Answer:** Principles based approach vs rules based approach

Question 2:

Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants related to an audit of financial statements. Discuss with reference to those fundamental principles of professional ethics.

 **Answer:** 5 fundamental principles

Question 3:

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

 **Answer:** Professional Behaviour

Question 4:

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

 **Answer:** Integrity.

Question 5:

Independence of mind and independence in appearance are interlinked perspectives of independence of auditors.

 **Answer:** Independence in mind vs Appearance

Question 6:

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

 **Answer:**

He should take steps to eliminate the threat by selling shares immediately before accepting appointment. Holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence.

Question 7:

A Chartered accountant receives about 40% of his total audit fees from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client. What are such types of threats referred to

 **Answer:**

Undue dependence on fees of a client constitutes a threat as there is fear of losing the client. Such threats are referred to as self-interest threats.

Question 8:

CA Murli Madhavan provides accounting and book keeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO. Identify and discuss what kind of threat to independence may be involved in accepting such an engagement.

 **Answer:**

In this case, Chartered Accountant is already rendering accounting and book keeping services to an NGO. If he accepts audit, he would be involved in reviewing own work. Therefore, the same constitutes "self-review" threat.

Question 9:

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain

 **Answer:** Familiarity threat

Question 10:

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. State the guiding principles in this regard.

 **Answer:** Safeguards to independence

Question 11:

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

 **Answer:** 5 threats to independence

Question 12:

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

 **Answer:**

Engagement letter includes reference to expected form and content of audit report. It merely states that auditor would provide opinion in this form. However, engagement letter also includes statement that the form and content of report may need to be amended in the light of audit findings. Therefore, if in light of audit findings, auditor needs to give a modified opinion, he shall do so.

Question 13:

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



Answer:
If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

Question 14:

R & Co, a firm of Chartered Accountants have not revised the terms of engagement and obtained confirmation from the clients for last 5 years despite change in business and professional environment.



Answer: Recurring Audit.

Question 15:

“An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so.” Discuss.



Question 16:

CA S is requested to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present?



Question 17:

On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide not to send a new audit engagement letter or other written agreement each period. Explain the factors an auditor considers to be appropriate to revise the terms of the audit engagement or to remind the entity of existing terms.



Question 18:

CA P is appointed as an auditor of XYZ Limited for the FY 2022-23. The management of XYZ Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and few new products have been introduced

by the company Can CA P agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in terms of engagement?

 **Answer:** Reasonable justification

Question 19:

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

 **Answer:** Recurring audit

Question 20:

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

 **Answer:** Reasonable justification

Question 21:

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

 **Answer:**

Auditors have relied only upon management representation letter regarding treatment of certain tax matters under appeal by the company. No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors. It shows lack of "professional skepticism" on part of auditors.

Question 22:

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

 **Answer:** Benefits of professional ethics

Question 23:

The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statement to be materially misstated, Discuss any four examples of professional skepticism.

 **Answer:** When to apply

Question 24:

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

 **Answer:**

Integrity of principal owners has to be considered before accepting an audit engagement in accordance with SA 220 .

In the instant case, there have been raids of NIA on suspected links with terror outfits which is a criminal activity. Further, raids by Enforcement Directorate also point towards money laundering. Therefore, proposed offer should not be accepted.

Question 25:

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

 **Answer:**

SQC 1 requires that before accepting an engagement, competence (including capabilities, time and resources) to perform engagement have to be considered. In the given case, the

proposed engagements involve use of technology and data analytics. The firm has no prior experience of audits in emerging “fin- tech” sector. The firm does not have trained personnel to carry out these audits. Hence, offer for these audits should not be accepted.

Question 26:

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

 **Answer:** Ethical requirements under “Elements of System of quality control” in SQC 1.

Question 27:

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

 **Answer:** “Leadership responsibilities for quality on audits” under SA 220.

Question 28:

The firms system of quality control should include policies and procedures addressing each element

 **Answer:** “Only head points of SQC 1

Question 29:

As per SA 220, the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. While taking responsibility for the overall quality on each audit engagement, analyse and explain the emphasis of the actions of the engagement partner and appropriate messages to the other members of the engagement team. Also define engagement partner.

 **Answer:** Leadership as per SA 220

Question 30:

The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

 **Answer:** Monitoring as per SQC 1