Star Rating

On the basis of Maximum marks from a chapter	☆☆☆☆☆
On the basis of Questions included every year from a chapter	☆☆☆☆☆
On the basis of Compulsory questions from a chapter	☆☆☆☆☆

CHAPTER

1A

Auditing Standards, Statements and Guidance Notes

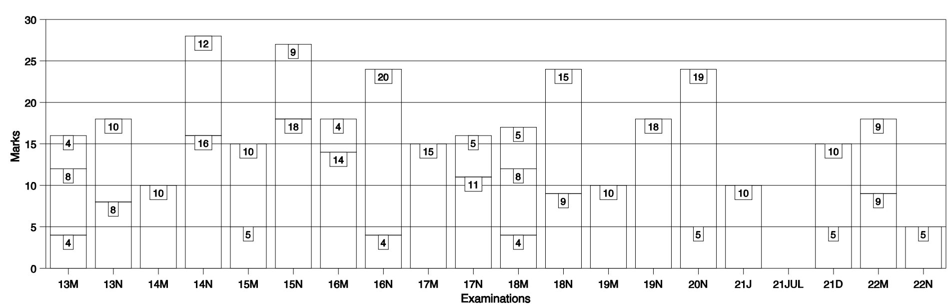
THIS CHAPTER COMPRISES OF

☞ Auditing and Assurance Standards Board-Scope and Functions: Setting up of AASB; Scope and Functions of AASB; Scope of SAs; Procedure for Issuing SAs; Compliance with the SAs; Linkage between SAs and Disciplinary Proceedings ☞ Framework of Standards and Guidance Notes on Related Services ☞ Quality Control and Engagement Standards: Structure of SAs ☞ Guidance Notes.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

☐ Objective ☐ Short Notes ☐ Distinguish ☐ Descriptive ☐ Practical



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SHORT NOTES

2013 - May [7] Write short note on the following:
(c) Corresponding figures. (4 marks)

Answer :

Corresponding Figures:

As per SA - 710, "Comparative Information- Corresponding Figures and Comparative Financial statements", corresponding figures means: comparative information where amounts and other disclosures for the preceding period are included as part of the current period financial statements and are intended to be read in relation to the amounts and other disclosures relating to the current period. These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship with the current period figures.

Auditors Responsibilities in Respect of Corresponding Figures:

As per SA 710 "Comparatives Information-Corresponding figures, and Comparative Financial Statements", the auditors responsibilities in respect of corresponding figures are as follows:

1. The auditor should obtain sufficient appropriate audit evidence that the corresponding figures meet the requirements of the relevant financial reporting framework. The extent of audit procedure performed on the corresponding figures is significantly less than that for the audit of current period figures and is ordinarily limited to ensuring that the corresponding figures have been correctly reported and are appropriately classified. This involves the auditor assessing whether:

(a) accounting policies used for corresponding figures are consistent with those of the current period or whether appropriate adjustments and/or disclosures have been made and

(b) corresponding figures agree with the amounts and other disclosures presented in the prior period or whether appropriate adjustments and/or disclosures have been made.

2. When the financial statements of the prior period have been audited by another auditor, the incoming auditor should assess whether the corresponding figures meet the conditions specified above.
3. When the financial statements of the prior period have not been audited, the incoming auditor nonetheless should assess whether the corresponding figures meet the conditions specified above.
4. If the auditor becomes aware of a possible material misstatement in the corresponding figures when performing the current period audit, the auditor should perform such additional procedures as are appropriate in the circumstances.

—— Space to write important points for revision ——

2016 - Nov [7] Write short note on the following:

(e) Objectives of compilation engagement. (4 marks)

Answer:

The objective of a compilation engagement is for the accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarize financial information. This ordinarily entails reducing detailed data to a manageable and understandable form without a requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the accountant to express any assurance on the financial information. However, users of the complied financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.

A compilation engagement would ordinarily include the preparation of financial statements (which may or may not be a complete set of financial statements) but may also include the collection, classification and summarization of other financial information.

DISTINGUISH BETWEEN

2018 - May [6] (d) (i) Self-interest threat from self-review threat in an Assurance Engagement. (4 marks)

Answer:

Self review threats, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement or when a member of the audit team was previously a director or Senior employee of the client. Instances where such threats come into play are :

(i) When an auditor having recently been a director or senior officer of the company; and

(ii) When auditors perform services that are themselves subject matters of audit.

—— Space to write important points for revision ——

DESCRIPTIVE QUESTION

2013 - May [3] (b) In audit plan for T Ltd., as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements. (4 marks)

Answer :

According to SA 450 "Evaluation of Misstatements Identified during the Audit", misstatements may result from

1. An inaccuracy in collecting or processing data by which the financial statements are prepared.
2. An omission of an amount which should have been disclosed.
3. An accounting estimate incorrect due to overlooking or clear misinterpretation of facts.
4. Judgements of management concerning accounting estimates that the auditor considers unreasonable.

5. The selection and application of accounting policies that the auditor considers inappropriate.

2013 - May [3] (d) R & Co., a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement. (4 marks)

Answer:

SA- 210 on "Agreeing the Terms of Audit Engagements", the auditor may decide not to send a new audit engagement letter or other written agreement each period.

However, the following factors may make it appropriate to revise the terms of audit engagement or to remind the entity of existing terms:

1. An indication that the entity misunderstands the objective and scope of the audit.
2. Any revised or special terms of the audit.
3. A recent change of senior management in the organisation structure.
4. A significant change in ownership of the enterprise.
5. A significant change in nature or size of the entity's business.
6. A change in legal or regulatory requirement.
7. A change in the financial reporting framework adopted in the preparation of the financial statements.
8. A change in reporting requirements.

—— Space to write important points for revision ——

2013 - Nov [2] (d) Mr. X was appointed as the auditor of M/s Easy go Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose. (4 marks)

Answer:

Use of Benchmark in determining materiality SA 320 on "Materiality in Planning and Performing an Audit", prescribes the use of Benchmarks in determining materiality for the financial statements as a whole.

Determining materiality involves the exercise of professional judgement. **Factors that may affect the identification of an appropriate benchmark include the following:**

(i) The elements of the financial statements (for example, assets, liabilities, equity revenue, expenses);

(ii) 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);

(iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

(iv) 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); and

(v) The relative volatility of the benchmark.

Space to write important points for revision

2013 - Nov [3] (c) In the audit of Hotel Great Stay Ltd. its auditor wants to use the analytical procedure as substantive procedure in respect of room rental income as well as payroll costs. Guide him as to how it can be done. (4 marks)

Answer:

According to provisions of **SA 520 on "Analytical Procedures"**, in some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

In case of Payroll cost - Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy.

In case of Room Rental Income of Hotel - Different types of analytical procedures provide different levels of assurance. It can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.

—— Space to write important points for revision ——

2014 - Nov [1] {C} (c) Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same. (5 marks)

Answer:

As per SA-450, "Evaluation of misstatements identified during the Audit", the Auditor has to consider the impact of identified mistakes/ misstatement on the audit. Whether on the basis of these identified misstatements the original audit programme needs modification.

There may be some mistakes which were identified and colleted during the audit process by the auditor but remain uncorrected, the auditor has to evaluate the impact of these uncorrected misstatement on the financial statements.

As per SA 320, "Materiality in Planning and performing an Audit," the aggregate of uncorrected misstatements comprises:

1. specific misstatements identified by the auditor including the net effect of uncorrected misstatements identified during the audit of previous periods; and
2. the auditors' best estimate of other misstatements which cannot be specifically identified (that is, projected errors).

The auditor have to determine whether uncorrected misstatements are material, individually or when considered together with other misstatements accumulated during the audit.

Impact of Misstatements: If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, or if auditor determines that the aggregate of uncorrected misstatements causes the financial information to be materially misstated, he should consider requesting the management to adjust the financial information or extending his audit procedures. In any event, the management may want to adjust the financial information for known misstatements. The adjustment of financial information may involve, for example, application of appropriate accounting principles, other adjustments in amounts, or the addition of appropriate disclosure of inadequately disclosed matters. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

Further:

- The auditor shall communicate with those charged with governance. Uncorrected misstatements and the effect that they, individually or in aggregate may have an opinion in the auditor's report.
- The auditor shall request a written representation from management and where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.

—— Space to write important points for revision ——

2014 - Nov [2] (c) Describe the principal methods of selection of samples. (4 marks)

Answer:

According to **SA 530 "Audit Sampling"**, the principal methods of selecting samples are the use of random selection, systematic selection, monetary unit sampling selection, haphazard selection and block selection.

Methods of sampling

1. **Random sampling:** This method of sampling is easy to operate types (a) simple Random or (b) stratified Random.
2. **Interval sampling:** samples following an interval will be selected types (a) Block sampling or (b) Cluster sampling
3. **Monetary unit sampling/value** weighted selection (i.e. selecting high value items for verification)
4. **Haphazard selection:** This is a Non-statistical method of sampling, by which auditor selects the samples by his own choice.
5. **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. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

2014 - Nov [3] (d) Discuss the Auditor's responsibility to provide access to his audit working papers to Regulators and third parties. (3 marks)

Answer:

Auditors responsibility to provide access to his audit working papers to regulators and third parties:

- Working papers are the property of the Auditor and the Auditor should adopt reasonable procedures for custody and confidentiality of his working papers.
- He should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirement of record retention.
- Working papers should be properly filed, in order to ensure that they are easily retrievable.
- In case of recurring audits, some working paper files may be classified as permanent file or current file.
- Working papers of the Auditor constitute his property and should not be provided to client. However, the Auditor may at his discretion, if considered appropriate, make portion of or extracts from his working papers available to the client.

Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by law for the time being in force.

SA 200 on "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of the information obtained and should not disclose any such information to any third party without specific authority or unless there is a legal or professional duty to disclose".

If there is a request to provide access by the regulator based on the legal requirement, the same has to be complied with after informing the client about the same.

Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements", provides that, unless otherwise specified by law or regulation, 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 engagements, the independence of the auditor or of his personnel.

As per SA 230, Audit Documentation serves a number of additional purposes, including the enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Therefore, it is auditor's responsibility to provide access to his audit working papers to Regulators whereas it's at auditor's discretion, to make portions of or extract from his working paper to third parties.

—— Space to write important points for revision ——

2014 - Nov [4] (d) In the course of your audit you have come across a related party transaction which *prima facie* appears to be biased. How would you deal with this? (4 marks)

Answer:

As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the name of all known related parties and for this purpose, he may inspect records or documents that may provide information about related party relationships and transactions.

In this case, the auditor is finding a related party transaction which *prima facie* appears to be biased. So, the auditor is required to confirm the same. For identified significant related party transactions outside the entity's normal course of business, the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

(i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into engage in fraudulent financial reporting or to conceal misappropriation of assets,

(ii) The terms of the transactions are consistent with management's explanations; and

(iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Where the applicable financial reporting framework establishes related party requirements, the auditor shall obtain written representations from management and where appropriate, those charged with governance that they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and they have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

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2015 - May [1] {C} (c) When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization? (5 marks)

Answer:

In accordance with **SA 402 "Audit Considerations relating to an Entity Using a Service Organisation"**, a user entity may use a service organisation that in turn uses a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting.

Report on the description and design of controls at a service organisation (Called as Type 1 Report):

A report given by Service Auditor to user Entity's Auditor that comprises:

1. A description, prepared by Management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date, and
2. A report by the Service Auditor, with objective of conveying reasonable assurance that includes the Service Auditor's opinion on the description of the Service Organization's System, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

Report on the description, design and operating effectiveness of controls at a service organization (called as Type 2 Report)

A report given by Service Auditor to user Entity's Auditor that comprises:

1. A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and in some cases, their operating effectiveness throughout a specified period, and
2. A report by the Service Auditor with the objective of conveying reasonable assurance that includes:
   (i) The service Auditor's opinion on the description of the Service Organization's System, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives and the operating effectiveness of the controls, and
   (ii) A description of the Service Auditor's tests of the controls and the results thereof.

If the Type 1 or Type 2 report excludes the control at a sub-service organization and the services provided by the sub-service organization are relevant to the audit of the user entity's financial statements, the user auditor

is required to apply the requirements of the SA 402 in respect of the sub-service organization.
The nature and extent of work to be performed by the user auditor regarding the services provided by a sub-service organization depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

—— Space to write important points for revision ——

2015 - Nov [1] {C} (a) Mr. A, a practicing Chartered Accountant, has been appointed as an auditor of True Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit? (5 marks)

Answer:

Working papers are the material that auditors prepare or obtain and retain in connection with the performance of the audit. It may be in the form of data stored on paper, film, electronic media, or other media. They can also be used in Court as evidence.

Reasons in preparing Working Papers:

1. Basis for planning the audit.
2. Record the evidences accumulated and the results of the audit.
3. Data for determining the proper type of Audit Report.
4. Basis for review by supervisors and partners.

In this case, Mr. A, CA has been appointed as an Auditor of True Pvt. Ltd. The factors that influence the amount of working papers required to be maintained for the purpose of audit are :

Factors and Content of Working Papers: As per SA 230 'Audit Documentation', the amount of Audit working paper and content depend on the following factors:

1. The size and complexity of the entity.
2. The nature of the audit procedure to be performed.
3. The identified risk of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. The audit methodology and tool used.

These are the factors required to be maintained by Mr. A, CA for the purpose of his Audit.

—— Space to write important points for revision ——

2015 - Nov [1] {C} (c) "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." Discuss. (5 marks)

Answer:

SA 501"Audit Evidence - specific Considerations for Selected Items", requires from the auditor that when inventory is material to the financial statements, he shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable, to:

(a) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
(b) Observe the performance of management's count procedures;
(c) Inspect the inventory; and
(d) Perform test counts;

Attendance at physical inventory counting involves:

(a) Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
(b) Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
(c) Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

—— Space to write important points for revision ——

2015 - Nov [2] (c) The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, what are the relevant criteria which determine whether the data is reliable for the purposes of designing substantive analytical procedures? (4 marks)

Answer:

Analytical procedures is a substantive technique which can be used at:

- Initial planning stage of the audit.
- During the course of the detailed audit work.
- At or near the completion of the audit when reviewing the financial statements.
- These are the relevant criteria which determine whether the data is reliable for the purposes of designing substantive analytical procedures.

SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its sources and nature and is dependent on the circumstances under which it is obtained.

Reliability of Data to be compared:

- Sources of information available (e.g. It is more reliable if obtained from some independent source.)
- Relevance of the data available (budget should be realistic).
- Comparability of information available (entities should be realistic.)
- Control over preparation of information.

—— Space to write important points for revision ——

2015 - Nov [2] (d) JY & Co. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding 'related party transactions in the normal course of business'. Describe the steps to be followed. (4 marks)

Answer:

Identification of Related Parties:

As per SA 550 "Related Parties" the auditor shall remain alert, when inspecting records or documents with respect to arrangements or information indicating the existence of related party relationships or transactions, not previously identified or disclosed to the auditor.

The auditor shall inquire of management regarding:

(a) The identity of the entity's related parties, including changes from the prior period;

(b) The nature of the relationships between the entity and these related parties; and

(c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:

(a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;

(b) Authorise and approve significant transactions and arrangements with related parties; and (Ref: Para. A21)

(c) Authorise and approve significant transactions and arrangements outside the normal course of business.

During the audit, the auditor may inspect records documents that may provide information about related party relationship and transactions, for example

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and TCWG.
5. Records of the entity's investments and those of its pensions plans.
6. Contracts and agreements with key management or TCWG.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.

11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

Space to write important points for revision

2016 - May [1] {C} (a) Mr. Z who is appointed as 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 effects of using positive external confirmation request by Mr. Z. (5 marks)

Answer :

As per SA 505, "External Confirmation", following factors to be considered when designing confirmation request:

1. The assertions being addressed .
2. Specific identified risks of material misstatement, including fraud risks.
3. The layout and presentation of the confirmation request.
4. Prior experience on the audit or similar engagements.
5. The method of communication.
6. Management's authorisation or encouragement to the confirming parties to respond to the auditor.

Effects of using positive external confirmation request:

- Positive external confirmation request asks the confirming party to reply to the auditor in all cases.
- More reliable and authentic reply can be received.
- Reply or confirmation can be received even if replying party disagree with some points.

Space to write important points for revision

2016 - May [1] {C} (b) R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS

Ltd. R & M Co. seeks your guidance for identifying the indications of non compliance with Laws and Regulations. (5 marks)

Answer :

Indications of non Compliance with Laws and Regulations:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements by inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

Following are indicators:

- Investigation by regulatory organisation and government departments.
- Payment of fines or penalties.
- Payments for unspecified services or loan to consultant, related parties, employees or government employees.
- Purchase at price significantly above or below market price.
- Unusual payments towards legal and retainer ship fees.
- Unusual payment in cash.

—— Space to write important points for revision ——

2016 - May [2] (a) ENP Ltd. engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As an auditor of ENP Ltd., you would like to use the report of the actuary as an audit evidence. How would you evaluate the work of the actuary? (4 marks)

Answer:

Actuary work evaluation:

Actuary work evaluation:

As per AS-500 "Audit Evidence", the auditor should evaluate following:

- Evaluate the competence, capabilities and objectivity of that expert;
- obtain an understanding of the work of that expert;

- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert, discussion with that expert knowledge of expert's qualification etc.

Auditor should also evaluate:

- Relevance and reasonableness of expert's finding or conclusions, consistency with audit evidence etc;
- Expert's relevance and reasonableness of assumptions and methods etc.

2016 - Nov [1] {C} (a) Mr. Ram, an auditor, identified some events that cast significant doubt on the entity's ability to continue as a going concern. What are the additional procedures he should perform as per the related Standard on Auditing? (5 marks)

Answer:

Additional Audit Procedures when events or conditions are identified:
As per SA 570 (Revised) "Going Concern", when 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 through performing additional audit procedures, including consideration of mitigating factors.

These procedures shall include:

(i) **Management's Assessment:**
When management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

(ii) **Evaluating Future Plans:**
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. Evaluating management's plant's for future actions may include inquiries of management as to its plans for

future action, including, for example, its plans to liquidate assets, borrow money or restructure or delay expenditures, or increase capital.

(iii) **Analysing Financial Aspects:**
Analysing and discussing cash flow, profit and other relevant forecasts with management. Analysing and discussing the entity's latest available interim financial statements. Reading the terms of debentures and loan agreements and determining whether any have been breached. Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties. The prospective financial information for recent prior periods with historical results, and the prospective financial information for the current period with results achieved to date.

(iv) **Enquiring Legal Aspects:**
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.
Confirming the existence, legality and enforceability of such arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

—— Space to write important points for revision ——

2016 - Nov [1] {C} (b) Mr. Mohan, an auditor of KTEN Limited wants to use the work of an expert. With reference to the Standard on Auditing state the factors which suggest the need for detailed and written agreement between the auditor and the auditor's expert. (5 marks)

Answer:

As per SA 620, "Using the work of an Auditor's expert", some matters noted in paragraph 8 may affect the level of detail and formality of the agreement between of auditor and the auditor's expert, including whether it is appropriate that the agreement be in writing for example the following factors may suggest the need for more a detailed agreement than would otherwise be the case, or for the agreement to be set out in writing.

- The auditor's expert will have access to sensitive or confidential entity information.
- The respective roles or responsibility of the auditor and the auditor's expert are different from those normally expected.
- Multi-jurisdictional legal or regulatory requirements apply.
- The matter to which the auditor's expert's work relates is highly complex.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

—— Space to write important points for revision ——

2016 - Nov [1] {C} (c) With reference to the Standards on Auditing state the examples of accounting estimates that may have a high estimation uncertainty. (5 marks)

Answer:

Examples of Accounting Estimates that may have a High Estimation Uncertainty: As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures", the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.
- Fair value accounting estimates for which a highly specialised entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.

—— Space to write important points for revision ——

2016 - Nov [1] {C} (d) Is it appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it? Discuss. (5 marks)

Answer:

Auditor to make Inquiries regarding Management's own Assessment of Risk of Fraud and Controls:

As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", management accepts responsibility for the entity's internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity.

The auditor shall make inquiries of management regarding:

(a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;

(b) Management's process for identifying and responding to the risk of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions account balances, or disclosures for which a risk of fraud is likely to exist;

(c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

(d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior.

Space to write important points for revision

2017 - May [2] (c) The auditor should select sample items in such a way that the sample can be expected to be representative of the population. Comment. (5 marks)

Answer:

Selection of the sample:

As per SA 530, 'Audit Sampling' the auditor should select sample items in such a way that the sample can be expected to be representative of the population.

The principal methods of sampling are :

- Random selection
- Systematic selection
- Monetary units
- Haphazard selection
- Block selection

There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

1. **Statistical sampling:**
   - A method of Audit sampling wherein the auditor selects the sample randomly.
   - This is a method of audit testing which is more scientific than testing based entirely on the auditor's own judgement because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
   - Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, debtors' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
2. **Non-statistical sampling:**
   - A method of Audit Sampling where in the auditor selects sample size which is neither random selection nor based on use of theory of probability.
   - Under this method, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.
   - This method has been in common application for many years because of its simplicity in operation.

- Traditionally, the auditor on the basis of his personal experience will determine the size of the sample and express it in terms that number of pages or personal accounts in the purchases or sales ledger to be checked. For example, March, June & September may be selected in year one and different months would be selected in the next year. An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check. It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined.

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2017 - May [3] (a) Describe the principal method of design of the samples and its evaluation. (4 marks)

Answer:

Principal Method of Design of Samples

As per SA 530 "Audit Sampling", when designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.

In designing an audit sample, the auditor has to consider the following:

1. **Audit objectives:** Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn.
2. **Population:** The population is the entire set of data from which the auditor wishes to sample in order to reach a conclusion. The auditor determines that the population from which he draws the sample is appropriate for the specific audit objective. Population must be sufficiently large. The system which produces the records to be tested must be sufficiently reliable. All items within a particular population must be homogeneous and must be identifiable and accessible.
3. **Confidence level:** The reliability referred to is unusually termed the confidence level. More precisely, in an auditing context, it is the

mathematical probability that the misstatement rate in the sample will not differ from the error rate in the population by more than a stated amount.

4. **Precision:** The precision may be defined with which we can describe the attributes of a given population.
5. **Evaluating Results of Audit Sampling:** The auditor shall evaluate:
   (i) The results of the sample; and
   (ii) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

   If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:
   - Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
   - Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance.

—— Space to write important points for revision ——

2017 - May [4] (a) Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from management fraud.

(6 marks)

Answer:

Duties and Responsibilities of an auditor in case of Material misstatement resulting from Management Fraud

Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an 'Intentional Act' by one more individuals among management, those charged with governance. The auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud". The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Various SAs state the requirements for the auditor to consider the risk of fraud in an audit of financial statements and the manner of dealing with the same:

1. **Paragraph 27 of SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment",** requires the auditor to consider the risk of fraud in determining which risks are significant risks.
2. **Paragraphs 22 and 23 of SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",** requires the auditor, *inter alia*, to communicate to those charged with governance (the Audit Committee/Board of Directors) when there is a non - compliance with laws and regulations, that come to the auditor's attention during the course of the audit, which he/she believes is intentional and material, without delay.
3. **SA 240, *"The Auditors responsibilities relating to fraud in an audit of financial statements", inter alia,* States the following:**

   Paragraph 5 - '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. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.'

   Paragraph 40 - 'If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities'.

   Paragraph 43 - 'If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances'.

Paragraph A66 - 'In some cases, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related legislation or regulation'.

Further, as per Sec. 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is one crore rupees or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than one crore rupees) within such time and in such manner is prescribed. Under Rule 13 of Companies Audit and Auditors Rules, 2014.

Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

Time and Manner of Reporting prescribed under Rules - Rule 13:

1. If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or

above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the CG.

2. The auditor shall report the matter to the CG as under:
   (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
   (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the CG within 15 days from the date of receipt of such reply or observations.
   (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the CG along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
   (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment Due or by Speed Post followed by an e-mail in confirmation of the same;
   (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contract telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
   (f) the report shall be in the form of a statements as specified in Form ADT-4.
3. In case of a fraud involving amount less than ₹ 1 Cr., the auditor shall report the matter to Audit Committee constituted u/s 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:
   a. Nature of Fraud with description;

   b. Approximate amount involved; and
   c. Parties involved.
4. The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:
   a. Nature of Fraud with description;
   b. Approximate Amount involved;
   c. Parties involved, if remedial action not taken; and
   d. Remedial actions taken.
5. The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively.

The auditor is also required to report as per Clause (xi) of 3rd Para of CARO, 2020,

(a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated;

(b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT- 4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

(c) whether the auditor has considered whistle- blower complaints, if any, received during the year by the company.

As per Para 4 of CARO 2020,

1. Where in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavorable or qualified, the auditor's report shall also state the basis for such unfavorable or qualified answer, as the case may be.
2. Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not- possible for him to give his opinion on the same.

Space to write important points for revision

2017 - Nov [3] (c) The auditor of XY & Co. Ltd. has intimated the management that certain misstatements identified during the course of audit need to be corrected. As an auditor, discuss the impact of such misstatements in case the management does not carry out the said corrections. (5 marks)

Answer:

- **As per SA - 450, "Evaluation of Misstatements identified during the audit",** if the auditor identifies any misstatements during the audit then he shall require to communicate such misstatement to TCWG or appropriate level of management.
- In the present case, the auditor of XY & Co. Ltd. has intimated the management that certain misstatements identified during the course of audit need to be corrected. If management does not carry out the said corrections then auditor shall require to evaluate the effect of uncorrected misstatements.
- The auditor prior to evaluating the effect of uncorrected misstatements, shall reassess materially determined in accordance with SA-320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
- The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate having regard to the size and nature of the misstatements and the effect of uncorrected misstatements related to prior periods on the relevant class of transactions account balances or disclosures and the financial statements as a whole.
- The auditor shall communicate with TCWG 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 with a request that uncorrected misstatements be corrected.
- 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.

- The auditor shall request a written representation from management and where appropriate, TCWG whether they believe the effect of uncorrected misstatements are immaterial, individually and in aggregate to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

Space to write important points for revision

2017 - Nov [4] (c) Discuss the points and indications to be noted while examining and evaluating the 'Going Concern' assumption for an entity.

(6 marks)

Answer:

SA 570 "Going Concern", requires that while planning a performing audit procedure and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements. In assessing such a risk, the auditor should examine the following indications:

(a) Financial Indications:

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects or renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawals of financial support by creditors..
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay trade payables on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.

- Inability to obtain financing for essential new product development or other essential investments.

(b) Operating Indications:

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

(c) Other Indications:

- Non-compliance with capital or other statutory requirements.
- 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.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or under insured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. **For example**, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

Space to write important points for revision

2018 - May [5] (e) Neverpermit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond?

(4 marks)

Answer:

- **SA 505, "External Confirmations"**, establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek confirmation from certain parties because of dispute with trade, receivables etc. The management for example, might make such a request on the grounds that due to a dispute with the particular trade receivable, the request for confirmation might aggravate the sensitive negotiations between the entity and the trade receivables.
- In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain trade receivable, the auditor should consider validity of grounds for such a request and access management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request.

- If the auditor of Never permit Ltd. agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding the matter. While considering the validity of request, in case of the auditor of Never permit Ltd. reaches at a conclusion that the same was not valid, he may appropriately modify the report.

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2018 - May [6] (d) (ii) Reasonable Assurance Engagement from Limited Assurance Engagement. (4 marks)

Answer:

- Reasonable assurance is the reduction in assurance engagement risk to an acceptably low level in circumstances of engagement as a basis of a positive form of expression practitioners conclusion.

- Limited assurance is the reduction of assurance engagement risks to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement, as a basis of a negative form.

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2018 - Nov [2] (d) State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes. (5 marks)

Answer:

The evaluative or review procedures before concluding as to relevance and reasonableness of Auditor's Expert work using for his audit purposes the auditor may perform:

1. Inquiries of the auditor's expert
2. Reviewing the auditor's experts working papers and reports
3. Corroborative procedures, such as:
   - Observing the auditor's expert's work;
   - Examining published data, such as statistical reports from reputable, authoritative sources;
   - Confirming relevant matters with third parties;
   - Performing detailed analytical procedures; and
   - Re-performing calculations.
4. Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
5. Discussing the auditor's expert's report with management.

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2018 - Nov [6] (c) A Review Report of an Auditor is negative in form in expression of conclusion-Explain. (4 marks)

Answer:

When the practitioner expresses an adverse conclusion on the financial statements, the practitioner shall, unless otherwise required by law or regulation use one of the following phases as appropriate;

(a) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse conclusion paragraph, the financial statements do not give a true and fair view (or do not present fairly, in all material aspects), in accordance with the applicable financial reporting framework", (for financial statements prepared using a fair presentation framework); or

(b) "Based on our review, due to the significance of the matter(s) described in the Basis of Adverse conclusion paragraph, the financial statements are not prepared, in all material aspects, in accordance with the applicable Financial Reporting Framework," (for financial statements prepared using a compliance framework.)

Space to write important points for revision

2020 - Nov [6] (b) In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls. (5 marks)

Answer:

In the given case, management of Quick Ltd has made intentional misstatements to deceive the users in order to meet market expectations. Auditor is suspecting such intentional behavior of the management and in such situations, SA 240 discusses how fraudulent financial reporting may be accomplished and also discusses techniques of committing fraud by management overriding controls.

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

Fraudulent financial reporting may be accomplished by the following:

(i) Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.

(ii) Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.

(iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

(i) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

(ii) Inappropriately adjusting assumptions and changing judgments used to estimate account balances.

(iii) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.

(iv) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.

(v) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

(vi) Altering records and terms related to significant and unusual transactions.

—— Space to write important points for revision ——

2021 - Dec [5] (a) Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures. (5 marks)

Answer:

The following are the factors that may assist Mr. Agarwal in determining whether external confirmation procedures:

(i) The confirming party's knowledge of the subject matter responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.

(ii) The ability or willingness of the intended confirming party to respond-for example, the confirming party:

- May not accept responsibility for responding to a confirmation request;
- May consider responding too costly or time consuming;
- May have concerns about the potential legal liability resulting from responding;
- May account for transactions in different currencies; or
- May operate in an environment where responding to confirmation requests is not a significant aspect of day to day operations;
- In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

(iii) The objectivity of the intended confirming party - if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

—— Space to write important points for revision ——

2022 - May [5] (c) CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s. Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS . M/s. Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is concerned with identification and assessment of the risks of material misstatement for accounting estimates.

Guide him with regard to the estimation making process adopted by management with reference to the relevant standard on Auditing.

(4 marks)

Answer:

As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", CA. Harry shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

The estimation making process adopted by the management including:

1. The method, including where applicable the model, used in making the accounting estimates.
2. Relevant controls.
3. Whether management has used an expert?
4. The assumption underlying the accounting estimates.
5. Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
6. Whether and, if so, how the management has assessed the effect of estimation uncertainty.

—— Space to write important points for revision ——

2022 - May [6] (b) You are the team leader of 10 members for an audit of a Multinational company. All the team members are concerned about Audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing. (5 marks)

Answer:

SA 230, Audit Documentation' provides evidence that the audit complies with SAs. However it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgement made, in an audit. Further, it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file.

The following are some examples of this:

1. The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
2. The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
3. An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirements to express a qualified opinion under the circumstances specified in the SAs.
4. In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
   (i) **For example,** there may be no single way in which the auditor's professional skepticism is documented, but the audit documentation may nevertheless provide evidence of the auditor's exercise of professional. Skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
   (ii) Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.

PRACTICAL QUESTIONS

2013 - May [3] (c) The auditor of H Ltd. wanted to obtain 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? (4 marks)

Answer:

As per **SA - 505, "External Confirmation"**, the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute as the request for confirmation might aggravate the sensitive negotiations between the Company and creditor.

In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain creditors, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same.

Present Case: If the auditor of H Ltd. agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding the matter. While considering the validity of request, in case the auditor of H Ltd. reaches at a conclusion that the same was not valid, he may appropriately modify the report.

—— Space to write important points for revision ——

2013 - Nov [1] {C} (b) G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of G Ltd. as to how he can obtain an understanding of how G Ltd. uses the services of the outsourced agency in its operations. (5 marks)

Answer:

According to SA 402 "Audit Considerations relating to an Entity Using A Service Organisation" the user auditor shall obtain an understanding of how a user entity uses the services of a service organization.

It shall include an understanding of :

1. The nature of services provided by the service organisation and the significance of such services to the user entity, including its effect on the internal control of user entity.
2. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation.
3. The degree of interaction between the activities of the service organization and those of user entity and
4. The nature of the relationship between the user entity and the service organization including the relevant contractual terms for the activities undertaken by the service organisation.

—— Space to write important points for revision ——

2013 - Nov [1] {C} (d) M/s Honest Limited has entered into a transaction on 5th March, 2013, near year-end, whereby it has agreed to pay ₹ 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but ₹ 60 lakhs is provided in books of account as on March 31, 2013.

Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach? (5 marks)

Answer:

SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" relates to any fraud can be committed by management overriding controls using such techniques as Recording Fictitious Journal Entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

Accordingly, the auditor would adopt the following approach:

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters some exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should:

1. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted.
2. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment in some cases.
3. If the auditor withdraws:
   (i) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
   (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Reporting Under Companies Act, 2013:

Sec. 143(12) of the Companies Act, 2013 read with Rule 13 of Companies (Audit & Auditors) Rules, 2014 requires that if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the audit committee within 2 days of his knowledge (as amount involved is less than ₹ 1 Cr.) mentioning the following:

(i) Nature of fraud with description;
(ii) Approximate amount involved; and
(iii) Parties involved etc.

Reporting Under CARO 2020

The auditor is also required to report as per Clause (xi) of paragraph 3 of CARO 2020, if there is any fraud on or by the company has been noticed during the year.

—— Space to write important points for revision ——

2014 - May [1] {C} (a) ABC Company files a law suit against Unlucky Company for ₹ 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation? (5 marks)

Answer :

As per **AS 29 "Provisions, Contingent liabilities and Contingent Assets",** a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

As per **SA 570 "Going Concern",** there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. 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 is one of the example of such event.

When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe 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 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.

Present Case:

ABC Company has filed a law suit against Unlucky Company for ₹ 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its financial statements. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of ₹ 5 crores by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.

—— Space to write important points for revision ——

2014 - May [1] {C} (d) During the course of audit of Star Limited the auditor received some of the confirmation of the balances of creditors outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of Sundry Creditors there are number of creditors of small balances except one, old outstanding of ₹ 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing. (5 marks)

Answer:

Auditor need to generate necessary audit evidences for the transactions contained in the financial statements mainly through vouching, verification or even external confirmation. The question relates to a case of external confirmation covered by SA 505-**"External confirmations".**

The identity of creditors are not available to confirm the credit balance as appearing in Financial statement. As it is also not a case of pending litigation so he should observe other possibilities as well as evidences. Auditor should examine the validity of the credit balance as shown in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transactions and should not rely entirely on the management representation.

But, if Auditor cannot verify the same by any means then he should include the matter by way of Qualification in his audit report to the members due to non availability of information.

Present Case:

The auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request. So, Auditor should state in his report about non availability of evidences about the creditor's balances outstanding.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

—— Space to write important points for revision ——

2014 - Nov [1] {C} (b) The Auditor of PQR Pvt. Ltd. having turnover of ₹ 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the Management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach? (5 marks)

Answer:

The physical verification of stock is the primary responsibility of the management. As per **SA-501**, **"Audit evidence - specific considerations for selected items",** the auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence and valuation of stock.

Present Case :

In the case of PQR Pvt. Ltd., the auditor has not been able to verify the existence and value of certain stock despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry.

As per **SA 580 "Written Representations"**, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence for other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. "Written Representations" cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.

If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter, which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not tenable.

—— Space to write important points for revision ——

2014 - Nov [3] (a) Big and Small Ltd. received a show cause notice in December 2013 from the Central Excise department intending to levy a sum of ₹ 25 lakhs. The Company replied to the above notice in January 2014 contending that it is not liable for the proposed levy. No further action was initiated by the Central Excise department up to the finalization of the audit for the year ended on 31st March, 2014. As the Auditor of the Company, how would you deal with this matter in your report? (3 marks)

Answer:

- **As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",** the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

- During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.
- Then the auditor shall discuss the matter with management and where appropriate, those charged with governance. If management or as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.
- In case, if the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.
- Again, **as per AS 29 "Provisions, Contingent liabilities and Contingent Assets**", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

  Present Case:

  Issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In so far as the Company has replied to the notice and no further correspondence was received from the Department. This show cause notice may be an alert or indication of non-compliance for the auditor. So auditor need to discuss with management and apply additional procedure. If the auditor concludes that there is non-compliance then provision for the same should be made as per AS 29. If the management does not accept the request the auditor should qualify the audit report accordingly or *vice versa.*

Space to write important points for revision

2014 - Nov [4] (b) You are appointed to compile financial statements of Z & Company (a partnership firm) for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing out the same, the partners of Z & Co., tell you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment. (4 marks)

Answer:

According to SRS 4410 "Compilation Engagements" if an accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other compiled financial information. If such amendments are not made and the financial statements are still considered to be misleading the accountant should withdraw from the engagement. Hence, in this case, there is a clear violation of SRS 4410.

Further, as per Guidance Note on Tax Audit under section 44AB of the Income Tax Act, 1961, the tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof. The tax auditor should also examine the basis adopted for ascertaining the cost and this basis should be consistently followed. It is very necessary for an auditor to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains.

Present Case:

Appointment was made to compile financial statements for tax audit purpose of Z & Co., a firm. It is Z & Co's duty to ensure that method followed for valuation of stock results in disclosure of correct profit and gains.

In this case the stock valuation was grossly understated. Consequently, disclosure of profit is also not correct. Hence, contention of the Z & Co., that you are not the conducting an audit, the said figures duly certified by the firm should be accepted is not correct.

2015 - May [1] {C} (a) As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please guide him. (5 marks)

Answer:

1. **Re-evaluation of the Materiality Concept:**
   As per SA 320, **"Materiality in Planning and Performing an Audit",** the Auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level(s) for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the Auditor to have determined a different amounts initially.
2. **Revision of materiality may happen 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 & its operations as result of further audit procedures.
3. If the Auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level(s) 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.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

—— Space to write important points for revision ——

2015 - May [1] {C} (d) In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are 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 audit report?

(5 marks)

Answer:

Audit Procedures for ensuring correctness of Opening Balance:

Audit Procedure for ensuring correctness of Opening Balances:

As per **SA 510 "Initial Audit Engagements-Opening Balances",** the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by-

1. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
2. Determining whether the opening balances reflect the application of appropriate accounting policies; and
3. By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

Being a new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. **For example**, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments, long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

Drafting Audit Report:

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further if the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements 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.

—— Space to write important points for revision ——

2015 - Nov [1] {C} (b) M/s. T K Projects Limited, a manufacturing company in the Steel industry was allegedly involved in some irregularity relating to allotment of coal blocks for which a complaint was lodged against the company by the government. The financial institutions stopped additional working capital finance which caused a financial crisis resulting in stoppage of production. The company incurred a massive loss during the year 2014-15. There were delays in salary and other payments. Certain key managerial personnel including GM Finance and certain other employees left the company. The company has no sound action plan to mitigate these situations. Guide the statutory auditor on how he should deal with this situation. (5 marks)

Answer:

As per SA 570, "Going Concern" an entity is viewed as continuing in business for the force able future. As per going concern assumption, an entity is expected to work for long time and it has no intention to shut down its operation for the force able future.

SA 570 on "Going Concern" requires the auditor to consider the appropriateness of the going concern assumption underlying the preparation of the financial statements which may no longer be appropriate.

But, there are many indicators which create doubt in continuation of business on going concern basis. These are when key business has been suspended or management is not in the position to come out from this worst situation or any legal proceeding is going against the company which create doubt for continuing its business etc.

As here, M/s. TK Projects Limited have following indicators which create doubt of its continuing business profile.

- Complaint lodged for irregularity relating to allotment of coal blocks.
- Financial institutions stopped additional working capital finance which caused a financial crisis result in stoppage of production.
- Company incurred heavy losses.
- Delay in other payments and salary payments.
- Certain key managerial personnel left the company.
- There is no sound action plan to mitigate these situation.

As per SA 570, when auditor comes to the knowledge of above mentioned indicators, he should mentioned in his report the following:

(i) Financial indicators which create doubt on going concern assumption.
(ii) Reasons.
(iii) Financial impact of such indicators.

Auditor should first communicate these to management and those charged with Governance. After receiving reply and recommendation from management, if auditor is not satisfied with the reply of management, he should report it in his report.

—— Space to write important points for revision ——

2015 - Nov [2] (a) In the course of the statutory audit of Z Ltd., its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of the internal auditor in respect of physical verification of fixed assets. How should an evaluation be carried out of this specific work done by the internal auditor? (4 marks)

Answer:

Using Specific Work of the Internal Auditors

As per SA 610, "Using the Work of the Internal Auditors",

In order for the external auditor to use specific work of the internal auditors, the external auditor shall evaluate and perform audit procedures on that work to determine its adequacy for the external auditor's purposes.

The nature, timing and extent of the audit procedures performed on specific work of the internal auditors will depend on the external auditor's assessment of the risk of material misstatement, the evaluation of the internal audit function, and the evaluation of the specific work of the internal auditors.

Such audit procedures may include:

- Examination of items already examined by the internal auditors;
- Examination of other similar items; and
- Observation of procedures performed by the internal auditors.

To determine the adequacy of specific work performed by the internal auditors for the external auditor's purposes, the external auditor shall evaluate whether:

(a) The work was performed by internal auditor having adequate technical training and proficiency;

(b) The work was properly supervised, reviewed and documented;

(c) Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;

(d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and

(e) Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

—— Space to write important points for revision ——

2016 - May [4] (b) During the course of audit of M/s CT Ltd. for the financial year 2014-15, it has noticed that ₹ 2.00 lakhs of employee contribution and ₹ 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that ₹ 4.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2015. The Finance Manager informed the 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 position improves.

Comment as a statutory auditor. (4 marks)

Answer:

Non-Compliance of Laws and Regulations and Reporting Requirements:
As per statutory provision of Companies Act, all companies are required to submit its government dues on time to comply with statutory requirements. All expenses and dues are required to be accounted correctly and dues to be paid for government dues to claim it as deduction from income as expenses.

As per **SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement",** it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor 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. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

As here M/s CT Ltd. has not paid full amount ESIC which are government dues and contended that it will pay it with interest when financial position improves is not acceptable reason. Auditor has to report separately on this and auditor is required to qualify his report.

2017 - Nov [1] {C} (b) You have been appointed statutory auditor of a company for the financial year ended 31st March, 2017 in place of the retiring auditor. During the course of audit, you observe that a fraud had been committed by a general manager who retired in March 2017. While going into further details, it was found that the fraud was going on since last 2-3 years and the total amount misappropriated was likely to exceed ₹ 100 lakhs. As statutory auditor, what would be your reporting responsibilities to the government? (5 marks)

Answer:

- **As per Sec. 143(12) of the Companies Act, 2013, read with Rule 13(1) of the Companies (Audit and Auditors) Rules, 2014,** it has been prescribed that, if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 cr. or above, is being or has been committed against the company by its officers or employees, the auditor, shall report the matter to the Central Government.
- **The manner of reporting the matter to the Central Government is as follows:**
  (a) The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty five days;
  (b) On receipt of such reply or observations, the auditor shall forward his report and reply or observations of the Board or Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
  (c) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or Audit Committee for which he has not received any reply or observations;
  (d) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment due or by Speed Post followed by an e-mail in confirmation of the same;

(e) The report shall be on the letter- head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his membership number; and

(f) The report shall be in the form of a statement as specified in form ADT - 4.

- In this case, it was found that the fraud was going on since last two to three years and total amount misappropriated was likely to exceed One hundred lakh rupees in the company. So as a statutory auditor of the company the above procedure shall be followed.

—— Space to write important points for revision ——

2018 - May [1] {C} (c) Y & Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the Auditors have applied the concept of materiality for the Financial Statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard. (5 marks)

Answer:

- In the instant case, Y & Co., Charted Accountants as an auditor of the company has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of as they come across in the course of audit that certain machinery had been imported for production of new product.
- AS per SA 320, "Materiality in Planning and Performing an Audit', while establishing the overall audit strategy. The auditor shall determine materiality for the financial statement as a whole. They should set a benchmark on the basis of which he performs their audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the 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. The auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

- The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
- If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.
- Thus, Y & Co., Chartered Accountants can re-evaluate the materiality concepts after considering the necessity of such revision.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (a) You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ₹ 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ₹ 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report. (5 marks)

Answer:

Provision: Related Party Disclosures:

Para. 25 of Ind AS 24 provides exemption to Government-related entities for making disclosure of Related Party Transactions. As per this para.
A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and out standing balances, including commitments, with:
(a) A Government that has control, joint control or significant influence over the reporting entity; and
(b) Another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

As per Para. 26, if a reporting entity applies the exemption in paragraph 25 above, it shall disclose the following about the transactions and related outstanding balances related to referred to in para. 25:
(a) The name of the Government and the nature of its relationship with the reporting entity (i.e. control, joint control, or significant influence);
(b) The following information is sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
  (i) The nature of and amount of each individually significant transaction; and
  (ii) For other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 21.

Present Case:
In this case, Power Supply Corporation Ltd. is a Government Company, which has procured spares for transmitters for ₹ 850 crores from abroad through a corporation by name Procurement and Supply India Ltd. which is also owned and controlled by Government of India. As per Indian AS 24 Power Supply Corporation Ltd. and Procurement and Supply India Ltd. becomes the Related parties as they are owned or controlled by the Government. So adequate disclosure required for transaction between them as per Ind AS 24.

However, para. 25 of Ind AS 24, specifically exempt from disclosure requirement of para 18 in relation to related party transactions and outstanding balances with other entity that is a related party because the same government has control, joint control and the other entity.

The contention of management tenable, it is exempted to make disclosure as per para 25. However, Power Supply Corporation Ltd. is taking exemption benefit here then it shall required to make adequate disclosure as provided in para 26, as above.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (c) M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter. (5 marks)

Answer:

Provision:

As per SA 570 on "Going Concern", it is the responsibility of the auditor to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about entity's ability to continue as a going concern. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

Present Case:

In this case, M/s. Airlift Ltd. has occurred financial loss and reduction in sales due to stiff competition and frequent break down in its own aircrafts. The management is not sure as it can continue in future or not, the study of which is in process. The management is feels that it is uncertainty about going concern.

The auditor should ask management for its adequate disclosure in the financial statement and include the same in his report. However, if the management fails to make adequate disclosure, the auditor should express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised). But, if the result of the appropriate assumption used in the preparation of financial statements is material and pervasive as to make the financial statements misleading, the auditor should express an adverse opinion and in the Basis for Qualified (Adverse) opinion section of the auditor's report, state that a material uncertainty exists that may cost significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (d) There are certain circumstances in which Emphasis of Matter in Auditor's Report is mandated to be included. Explain this statement in the light of mandatory requirements of matters that are to be emphasised in Auditor's Report when the Audit Report is on Financial Statements prepared in accordance with Special Purpose Framework.

(5 marks)

Answer:

SA 706 contain specific requirements for the auditor to include Emphasis of matter paragraph in the Auditor's report in certain circumstances.

These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.

- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report.
- The following are the example of circumstances where the auditor may consider to include Emphasis of matter paragraph.
- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event occurs between the date of the financial statements and the date of auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statement.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Space to write important points for revision

2019 - May [1] {C} (a) You are engaged by M/s Active Ltd. to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state. The company in its vision document descripted various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you, while determining the nature, timing and extent of examination procedure to be applied in the review of the same? (5 marks)

Answer:

Examination Procedures: As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:

(i) the knowledge obtained during any previous engagements;

(ii) management's competence regarding the preparation of prospective financial information;

(iii) the likelihood of material misstatement;

(iv) the extent to which the prospective financial information is affected by the management's judgment;

(v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;

(vi) the stability of entity's business; and

(vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

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2019 - May [2] (a) CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay. (5 marks)

Answer:

- As per SA 620. Using the work of an Auditor's Expert, the auditor shall evaluate the adequacy of the auditors's expert's work for the auditor's purposes, including.
  (a) The relevance and reasonableness of that expert's finding and conclusions and their consistency with other audit evidence.
  (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and.
  (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance completeness and accuracy of that source data.

- If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall.
  (a) Agree with that expert on the nature and extent of further work to be performed by that expert, or.
  (b) Perform further audit procedures appropriate to the circumstances.

—— Space to write important points for revision ——

2019 - Nov [1] {C} (a) Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing. (5 marks)

Answer:

SA 580 'written representations' discusses the use of written representations Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

(i) About the appropriateness of the measurement processes, including related assumptions and mode is, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.

(ii) That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.

(iii) That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.

(iv) That no Subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

- **Here,** Mr. L while conducting the audit of ABC Ltd. observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statement. Mr. L is guided with the above mentioned points for the purpose of obtaining written representation from the management to determine whether the assumptions and estimates used are reasonable.

—— Space to write important points for revision ——

2019 - Nov [1] {C} (b) LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March, 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report. While regarding other information, LMP Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates with examples of 'Amounts" or "other items" that may be included in the "other information" with reference to SA 720. (5 marks)

Answer:

SA 720, The Auditor's Responsibility in Relation to other Information provides following examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts :

- Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues and purchases and operating expenses.
- Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- Liquidity and capital resource information such as cash, cash equivalents and marketable securities; dividends and debt, capital lease and minority interest obligations.

- Capital expenditures by segment or division.
- Amounts involved in, and related financial effects of, off balance sheet arrangements.
- Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders's equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilation to the financial statements.

Other Items:

- Explanations of critical accounting estimates and related assumptions
- Identification of related parties and descriptions of transactions with them.
- Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- Descriptions of the nature of off-balance sheet arrangements.
- Descriptions of gaurantees, indemnifications, contractual obligations, litigation or environmental liability cases and other contingencies, including management's quantative assessments of the entity's related exposures.
- Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.
- Management's quantitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- General descriptions of the business environment and outlook.
- Overview of strategy.
- Descriptions of trends in market prices of key commodities or raw materials.
- Contrasts of supply, demand and regulatory circumstances between geographic regions.

- Explanations of specific factors influencing the entity's profitability in specific segments.

2019 - Nov [1] {C} (c) MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1. (4 marks)

Answer:

MB & Associates is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client.

The firm is looking to work with only selected clients to adhere to the Quality Control Standards. As per the requirements of SQC1, following matters to be considered with regard to the integrity of a client :

(i) The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

(ii) The nature of the client's operations, including its business practices.

(iii) Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

(iv) Whether the client is aggressively concerned with maintaining the firms's fees as low as possible.

(v) Indications of an appropriate limitation in the scope of work.

(vi) Indications that the client might be involved in money laundering or other criminal activities.

(vii) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

—— Space to write important points for revision ——

2019 - Nov [5] (c) Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'? (4 marks)

Answer:

As per SA 510, Initial Audit Engagements - Opening Balances, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's statement of Profit and Loss;

(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(c) Performing one or more of the following:
  - (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
  - (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.

In this case, Mr. X shall require to perform above mentioned audit procedures if he wants to be satisfied about the sufficiency and appropriateness of balances to ensure that they are free from misstatements.

If Mr. X after following above procedures is not satisfied with the correctness of opening balances he shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

If the auditor concludes that such misstatements exist in the current period's financial statements, he shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450.

—— Space to write important points for revision ——

2020 - Nov [1] {C} (a) 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 JK 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.

In the light of the above facts:

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.

(5 marks)

(b) You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company need to stock various non- perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores).

Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view ? (5 marks)

(c) GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y. 2019-20. The audit team has completed the audit and is in the process of preparing audit report. Management of the company has also prepared draft annual report. Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue.

Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting. (4 marks)

Answer:

(a) **As per SA 501 "Audit Evidence- Specific Considerations for Selected Items"**, when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor, JK Associates, shall perform the following procedures:

(a) Attendance at physical inventory counting, unless impracticable, to:
   - (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
   - (ii) Observe the performance of management's count procedures;
   - (iii) Inspect the inventory; and
   - (iv) Perform test counts; and

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

In addition to above, auditor shall also 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 to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded 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.

(b) As per SA 560 "Subsequent Events", the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required in above paragraph so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.

Being the auditor of PQR Ltd, to ensure that all subsequent events are considered so that financial statements for the year ending 31.03.2020 represent true and fair view, 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:

(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

(c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

(d) Reading the entity's latest subsequent interim financial statements, if any.

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

(c) As per SA 720, "The Auditor's Responsibility in Relation to Other Information", Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", i f the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

(i) Agrees to make the correction, the auditor shall determine that the correction has been made; or

(ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

Space to write important points for revision

2020 - Nov [2] (a) Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business. (5 marks)

Answer:

As per SA 550 "Related Parties", examples of transactions outside the entity's normalcourse of business may include:

1. Complex equity transactions, such as corporate restructurings or acquisitions.
2. Transactions with offshore entities in jurisdictions with weak corporate laws.
3. The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
4. Sales transactions with unusually large discounts or returns.
5. Transactions with circular arrangements, for example, sales with a commitment to repurchase.
6. Transactions under contracts whose terms are changed before expiry.

—— Space to write important points for revision ——

2021 - Jan [1] {C} (a) M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y. 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period.

Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC). (5 marks)

Answer:

(a) As per Standard on Quality Control (SQC) 1 **"Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".**

(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:
  (a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
  (b) Allegations of non-compliance with the firm's system of quality control.

(ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

(iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

(iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.

(v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

—— Space to write important points for revision ——

2021 - Jan [1] {C} (b) GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 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.

(5 marks)

Answer:

(b) As per SA 501- "Audit Evidence-Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

(i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.

(ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

(iii) The allocation of assets and costs among segments.

(iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

—— Space to write important points for revision ——

2021 - Dec [1] {C} (a) M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA. Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA. Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.

Guide CA. Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. (5 marks)

Answer:

→ In this Case, CA Kumar, who is one of the partners of audit firm observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. He is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation. So, as per SA 240. The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists incentives / pressures, opportunities and attitudes/rationalization.

(i) Incentives/Pressures:

→ Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

→ Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following :

→ Known or anticipated future employee layoffs.

→ Recent or anticipated changes to employee compensation or benefit plans.

→ Promotions, compensations, or other rewards inconsistent with expectations.

(ii) **Opportunities:**

→ Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

→ Large amounts of cash on hand or processed.

→ Inventory items that are small in size, of high value, or in high demand.

→ Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
→ Fixed assets which are small in size, marketable, or lacking observable identification of ownership.
→ Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:
→ Inadequate segregation of duties or independent checks.
→ Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
→ Inadequate management oversight of employees responsible for assets, for example, Inadequate supervision or monitoring of remote locations.
→ Inadequate job applicant screening of employees with access to assets.
→ Inadequate record keeping with respect to assets.
→ Inadequate system of authorization and approval of transactions (for example, in purchasing).
→ Inadequate physical safeguards over cash, investment, inventory, or fixed assets.
→ Lack of complete and timely reconciliations of assets.
→ Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
→ Lack of mandatory vacations for employees performing key control functions.
→ Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
→ Inadequate access controls over automated records, including controls over and review of computer systems event logs.

(iii) **Attitudes/Rationalizations:**

→ Disregard for the need for monitoring or reducing risks related to misappropriations of assets.

→ Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
→ Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
→ Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
→ Tolerance of petty theft.

—— Space to write important points for revision ——

2021 - Dec [1] {C} (b) In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions and process related data. As an auditor, what would be your considerations regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.
Discuss with reference to relevant Standard on Auditing. (5 marks)

Answer:

→ **As per SA 402**, Service provided by a service organization are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information systems including related business processes, relevant to financial reporting. Although most controls at the service organization are likely to rebate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organization's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:
(a) The classes of transactions in the user entity's operations that are significant to the user entity's financial statements;

(b) The procedures, within both Information Technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(c) The related accounting records, either in electronic or manual form supporting information and specific accounts in the user entity's financial statements that are used to initiate, records, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;

(d) How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;

(e) The financial reporting process used to prepare the user entity's financial statements, including significant accounting estimates and disclosures; and.

(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

→ The nature and extent of work to be performed by the user auditor regarding the services provided by a service organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

—— Space to write important points for revision ——

2022 - May [1] {C} (b) JKL Limited is engaged in the business of Construction and real estate having various projects across states. M/s YT & Co. Chartered Accountants have been appointed as Statutory Auditors. Audit Team from M/s YT & Co. for audit of JKL Limited comprises of CA Z Engagement Partner, CA Q, a paid assistant and 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is managing partner. The engagement team discussed that SA 315 and SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could-result from the JKL Limited's related party relationship and transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant standard on Auditing. (5 marks)

Answer:

As per SA 550 "Related Parties", the engagement team discussion that SA 315 and SA 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.

Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

1. The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
2. An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
3. The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special - purpose entities for off-balance sheet transactions, or an inadequate information system).
4. The records or documents that may indicate the existence of related party relationships or transactions.
5. The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.

6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
   (a) how special-purpose entities controlled by management might be used to facilitate earnings management.
   (b) how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

—— Space to write important points for revision ——

2022 - May [1] {C} (c) Beta Hotel operates in an automated environment and uses application softwares for front desk, Guest reservations Restaurant and kitchen and orders and billing for which CA Anil has been appointed as an auditor. Guide CA Anil the various key aspects that needs to be considered by him while understanding of the automated environment of the Company in accordance with SA 315. Is he required to document the same? If yes, illustrate by giving one example. (4 marks)

Answer:

The following are the key aspects aspect that needs to be considered by CA Anil while understanding of the automated environment of the company in accordance with SA 315.

1. The applications that are being used by the company;
2. Details of the IT infrastructure components for each of the application;
3. The organization structure and governance;
4. The policies, procedures and processes followed;
5. IT risks and controls.

CA Anil is required to document the understanding of a company's automated environment as per SA 230.

The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server And storage
SAP ECC / HANA	Integrated application software	Oracle 19 C	HP - UX	LAN, WAN	HP Server and NAS
REVS	Front desk, Guest Reservation	MS - SQL Server 2018	Windows 2016 server	In - house developed	HP Server Internal HDD
KOTS	Restaurant and Kitchen orders	MS - SQL Server 2018	Windows 2016 Server	In - house developed	HP Server Internal HDD
BILLSYS	Billing	Oracle 12 C	Windows 2016 Server	Packaged Software	HP Server Internal HDD

—— Space to write important points for revision ——

2022 - Nov [1] {C} (b) During the audit of Star Ltd. a company engaged in the production of paper, the auditor received certain confirmation for 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 small balances except one which is an old outstanding of ₹ 20 lakhs for which no confirmation was received. Comment with respect to Standards of Auditing relating to the confirmation process and how to deal the non-receipt of confirmation. (5 marks)

Table Showing Marks of Compulsory Questions										
Year	18 M	18 N	19 M	19 N	20 N	21 J	21 J	21 D	22 M	22 N
Practical	5	15		14	14	10		10	9	5
Total	5	15		14	14	10		10	9	5