

CHAPTER	Nature, Objective and Scope of Audit
1	





This Chapter Covers: Study's Chapter: 1

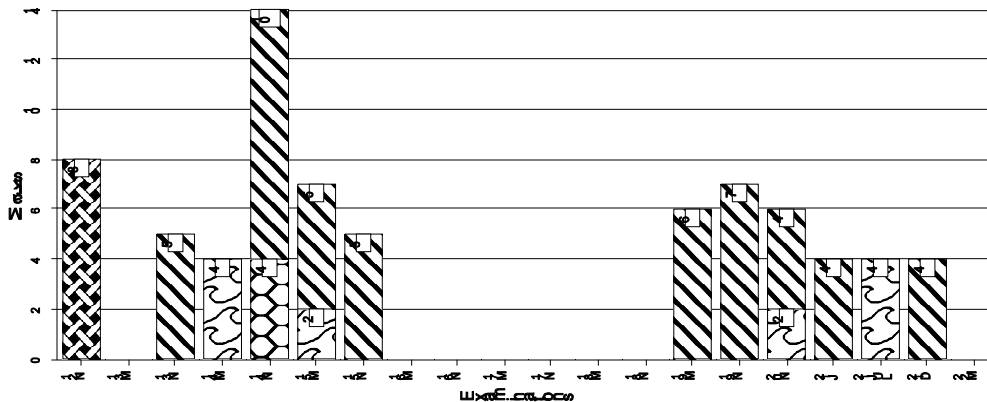
Chapter Comprises: *Meaning and Definition of Auditing* ✎ *Objectives of Audit* ✎ *Scope of Audit* ✎ *Types of Audit* ✎ *Inherent Limitations of Audit* ✎ *Relationship of Auditing with other disciplines* ✎ *Standard Setting Process* ✎ *Elements of a System of Quality Control* ✎ *Preconditions for an Audit* ✎ *Agreement of Audit Engagement Terms* ✎ *Recurring Audit.*

THE GRAPH **Trend Analysis**

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

Legend

-  Objective
-  Short Notes
-  Distinguish
-  Descriptive
-  Practical



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TIME MANAGER	 <i>Plan and Manage your Time</i>						
Time	<i>First In-depth learning</i>	<i>Instant Revision (in hours)</i>		<i>Periodic Revision (in hours)</i>				
	i.e.....	Next day i.e....	After 7 days i.e. on	After 30 days i.e. on	After 60 days i.e. on	After 90 days i.e. on	Fix as per your need.	
 Day 1 Day 2 Day 8 Day 30 Day 60 Day 90		
1. Budgeted	16	4.00	3.12	2.20	1.35	1.35		
2. Actual								
3. Variance (1-2)								

QUICK LOOK	 <i>Weightage Analysis</i>	
Repeatedly Asked Questions	Common Answered Questions	Must Try Question	
		5.1, 8.1, 8.7, 12.1, 13.1, 13.2	

1 ***Meaning and Definition of Auditing***

Q.1.1	2010 - May [1] (ii)	Objective
State with reasons (in short) whether the following statement is True or False: The auditor compares entries in the books of accounts with vouchers and if two agrees, his work is done. (2 marks)		

Answer:

False :

The totaling of entries in the books with vouchers shows fairness of financials statements. But auditor has to determine reliability of annual statement of accounts alongwith the truth and fairness.

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2

Objective of Audit

Q.2.1	2015 - May [2] (viii)	Objective
State with reasons (in short) whether the following statement is correct or incorrect: The basic objective of audit does not change with reference to nature, size or form of an entity. (2 marks)		

Answer:

Correct:

The meaning and nature of audit does not change with the nature or size of entity, audit is examination of true and fair view of statement of any entity irrespective of its size and legal structure as defined in definition of audit.

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3

Scope of Audit

Q.3.1	2021 - July [1] {C} (c)	Objective
State with reasons whether the following statement is correct or incorrect. Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur. (2 marks)		

Answer:

Incorrect:

SA 315 “Identifying and Assessing the Risk of Material Misstatements through understanding the Entity and its Environment” defines the term assertion as, “Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.”

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4

Types of Audit

Q.4.1	2011 - Nov [6] (b)	Descriptive
Discuss the types of audits required under law.		(5 marks)

Answer:

Legally audit is not compulsory for all the types of business organisation or institution. Thus it may be divided in two broad categories:

1. Statutory/Mandatory Audit
2. Voluntary/Independent Audit

1. Statutory Audit: It is an audit which is conducted under the control of law as under:

Enterprise	Governing Statute
Companies	Companies Act, 2013
Co-operative Societies	Multi state Co-operative Societies Act
Banking Co's	Banking Regulation Act, 1949, Banking Laws (Amendment) Act, 2017
Insurance Co's	Insurance Act and Companies Act
Electricity Co's	The Electricity Act, 2003
Public Charitable Trust	Indian Trust Act and also state enactments

2. Voluntary Audit : It is a purely optional audit and at the discretion of the governing body. Examples of enterprises of voluntary natures are individuals, private trust, partnership firm etc.

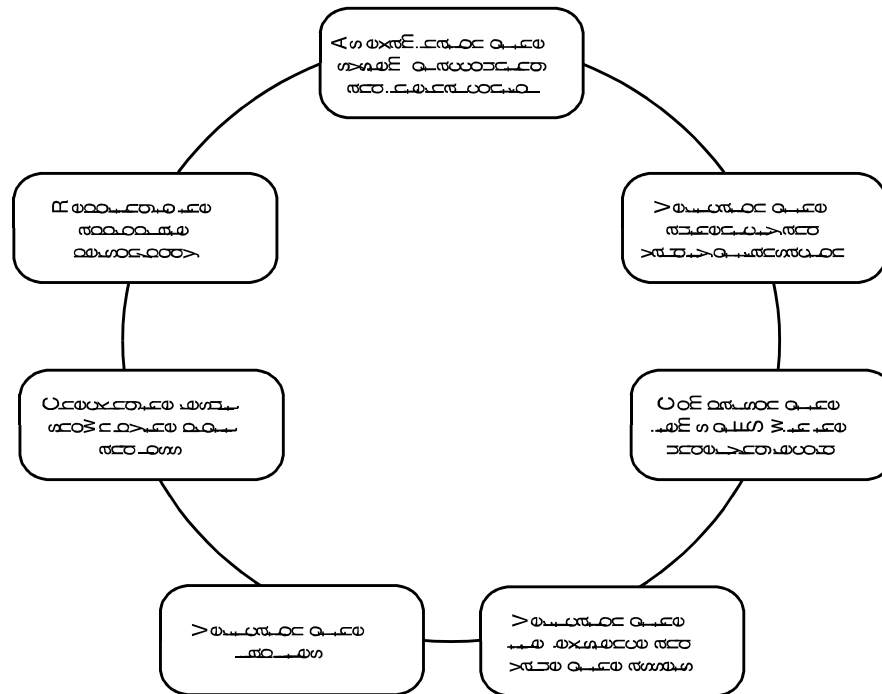
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Advantages of Audit of Financial Statements

Q.5.1	RTP	Descriptive
<p>The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain.</p>		

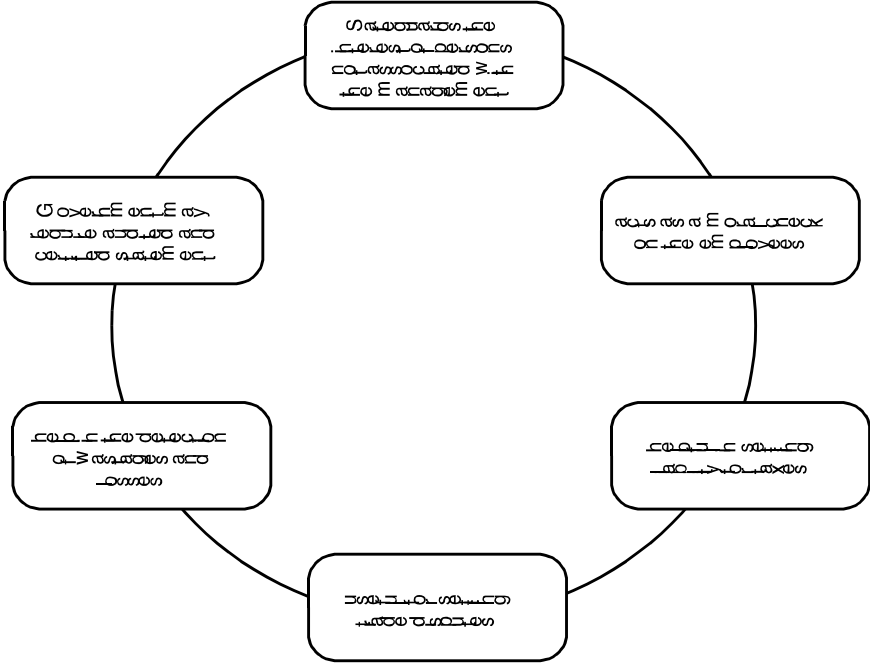
Answer:

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious



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utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below:



- (a) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
- (b) It acts as a moral check on the employees from committing defalcations or embezzlement.
- (c) Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.
- (d) These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.

- (e) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
- (f) Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
- (g) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.
- (h) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.
- (i) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

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6

Inherent Limitations of Audit

Q.6.1	2011 - May [3] (a)	Descriptive
Discuss limitations of audit.		(8 marks)

Answer:

Inherent limitations of Audit:

As per **SA-200, Overall Objectives of the Independent Auditor and the conduct of Audit in accordance with standards of auditing**, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor

to form that opinion.

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

The inherent limitations of an audit arise from:		
1.	The Nature of Financial Reporting	The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures.
2.	Non Co-operation by Management	There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

3.	Fraud may involve sophisticated and carefully organised schemes designed to conceal it	Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
4.	Timeliness of Financial Reporting and the Balance between Benefit and Cost	The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit, Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.
5.	Risk of failure of Internal Control	Any system of internal check/control may become ineffective due to collusion among employees for doing fraud and fraud committed by top management itself.

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6.	Management's Fraud	Risk of auditor not detecting a material misstatement resulting from management's fraud is greater than that of an employee's fraud because those charged with governance and management are often in a position that assumes their integrity and enables them to override the internal control procedures. For example- if a director of a company orders verbally the assistant not to record the sales made to particular party and to show the goods, sold as inventory, he is overriding the internally established procedure (internal control).
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7	<i>Relationship of Auditing with other Disciplines</i>
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Q.7.1	2013 - Nov [1] {C} (b)	Descriptive
<p>Discuss the following: The discipline of behavioural science is closely linked with the subject of auditing. (5 marks)</p>		

Answer:
 Auditing is very much a discipline which involves review of various assertions both financial as well as non financial as regards his truthfulness. So audit can be performed in a better way only if the person also possesses a good knowledge about other disciplines.
 The discipline of behavioural science is closely linked with subject of auditing. While carrying out audit activity an auditor is required to obtain information and explanations from the client's staff and he has also to interact with the client's staff in analysing the financial figures. So, the knowledge of human behaviour is very essential for an auditor. Thus knowledge of dealing with human being is indeed very essential for an auditor in order to discharge his duties.

Q.7.2	2014 - Nov [1] {C} (c)	Descriptive
Discuss the following: Indicate the factors which make it appropriate for an auditor to send a new Engagement Letter for a recurring audit. (5 marks)		

Answer:

Factors what make it appropriate for an auditor to send a new Engagement Letter for a recurring audit

- Any indication that entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the Entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

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8

Elements of a System of Quality Control

Q.8.1	2015 - May [1] {C} (a), RTP	Descriptive
Advantages of Independent Audit. (5 marks)		

Answer:

Independent Audit		
1.	Meaning	Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.

2.	Nature	Independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence, which are imposed by law.
3.	Visibility	Independence of the auditor should not only exist, but should also appear to so exist to all reasonable persons. The relationship maintained by the auditor shall be such that no reasonable man can doubt his objectivity and integrity. There is a collective aspect of independence that is important to the accounting professional as a whole.

The advantages of an Independent Audit are :

1.	Protection of interest	It safeguards the financial interest of persons who are not associated with the management of the organization whether they are partners or shareholders.
2.	Moral check	It acts as a moral check on the employees from committing defalcations.
3.	Tax liability	Audited statements of account are helpful in settling liability for taxes.
4.	Credit negotiation	Financiers and bankers use audited financial statements in evaluating the credit worthiness of individuals in negotiating loans.
5.	Trade dispute settlement	Audited statements are useful in settling the trade disputes for higher wages, or bonus, etc.
6.	Control over inefficiency	It helps in detection of wastages and losses and also helps in recommending ways to correct it.
7.	Funds-in-trust	It is an agency, which ensures that persons acting for others have properly accounted for the amounts collected by them.

8.	Arbitration	It is helpful in settling disputes by arbitration.
9.	Appraisal	Audit reviews the existence and operations of various controls in the organization and reports in adequacies, weaknesses, etc in them. Management can take suitable action based on the reports.
10.	Assistance to government	Government may require audited and certified statements before it gives assistance or issues a license for a particular trade.

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Q.8.2	2019 - May [3] (c)	Descriptive
“Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors.” Explain.		(3 marks)

Answer:

Independence of Mind and independence in appearance are interlinked perspective of Independence of auditors.

Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.

Independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence, which are imposed by law.

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

Independence is :

- **Independence of Mind:**

The state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity and exercise objectivity and professional skepticism ; and.

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• **Independence in Appearance :**

The avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised.

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Q.8.3	2019 - Nov [2] (a)	Descriptive
The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statement to be materially misstated. Discuss any four example of professional skepticism.		(4 marks)

Answer:

The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

The following are the examples that professional skepticism includes being alert to,

- (i) Audit evidence that contradicts other audit evidence obtained.
- (ii) Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- (iii) Conditions that may indicate possible fraud.
- (iv) Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
- (v) Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risk of:
- (vi) Overlooking unusual circumstances.
- (vii) Over generalising when drawing conclusions from audit observations.
- (viii) Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

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Q.8.4	2019 - Nov [5] (c)	Descriptive
Briefly explain the policies and procedures of assembling the final audit file on a timely basis after the date of auditor's report under SQC-1.		(3 marks)

Answer:

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

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- SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than 7 years from the date of the auditor's report, or, if later, the date of the group auditor's report.

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Q.8.5	2021 - Jan [2] (a)	Descriptive
Explain the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements in accordance with Code of Ethics issued by ICAI.		(4 marks)

Answer:

Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the Institute of Chartered Accountants of India. The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles;

1. Integrity;
2. Objectivity;
3. Professional competence and due care;
4. Confidentiality; and
5. Professional behaviour.

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Q.8.6	2021 - July [1] {C} (d)	Objective
State with reasons whether the following statement is correct or incorrect. There is a very thin difference between advocacy threats and intimidation threats to an auditor while performing his duty.		(2 marks)

Answer:**Incorrect:**

Advocacy threats occur: When a professional accountant promotes a position or opinion to the point that subsequently objectivity may be compromised.

Intimidation threats occur: When auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles or pressure to inappropriately reduce work in response to reduced audit fees.

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Q.8.7	RTP	Short Notes
Write short note on Independence of an Auditor.		

Answer:

Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.

Independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence, which are imposed by law.

Independence of the auditor should not only exist, but should also appear to so exist to all reasonable persons. The relationship maintained by the auditor shall be such that no reasonable man can doubt his objectivity and integrity. There is a collective aspect of independence that is important to the accounting professional as a whole.

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9	<i>Preconditions for an Audit</i>
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Q.9.1	2021 - Dec [2] (a)	Descriptive
CA S is requested to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present? (4 marks)		

Answer:

- **As per SA 210 “Agreeing The Terms of Audit Engagements”** preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and where appropriate, those charged with governance to the premise on which an audit is conducted.
- **In order to establish whether the preconditions for an audit are present, the auditor shall:**
 - (a) Determine whether the financial reporting framework is acceptable; and
 - (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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Q.10.1	2019 - May [2] (c)	Descriptive
CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which informations, he should obtain before accepting an engagement?		(3 marks)

Answer:

SQC 1 requires the firm to obtain information before accepting an engagement. Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate :

1. The integrity of the principal owners, key management and those charged with governance of the entity:
2. Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources:
3. Whether the firm and the engagement team can comply with relevant ethical requirements: and.
4. Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

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Q.10.2	2020 - Nov [1] {C} (a)	Objective
Examine with reasons whether the following statements are correct or incorrect. Even if law or regulation prescribes sufficient details of the terms of the audit engagement the auditor should record them in a written agreement. <div style="text-align: right;">(2 marks)</div>		

Answer:**Correct:**

Law or regulation prescribes sufficient details of terms of the audit engagement, but as per SA 210. The auditor should record them in written agreement.

— Space to write important points for revision —

Q.11.1	2014 - Nov [1] {C} (c)	Descriptive
Discuss the following: Indicate the factors which make it appropriate for an auditor to send a new Engagement Letter for a recurring audit. (5 marks)		

Answer:

As per SA - 210 i.e. "Agreeing the terms of Audit Engagement, In case of recurring audit, the auditor should consider:

1. Whether circumstances require the terms of engagement to be revised, and
2. Whether there is a need to remind the check of the existing terms of engagement.

In following circumstances the auditor may think it appropriate to send a new engagement letter to client:

1. Any indication that the client misunderstood the objective and scope of audit
2. Any revised and special terms of the engagement
3. Any recent change in board of directors, and senior managements.
4. New legal requirements, or pronouncements of the Institute of Chartered Accountants of India (ICAI)
5. Significant change in client's business.

Change in terms of engagement :

1. If a change is related to information that is incorrect or otherwise unsatisfactory the auditor should not agree to changed terms of engagement.
2. If the auditor is unable to agree to change the engagement then he should withdraw from it.

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Q.11.2	2015 - Nov [1] {C}	Descriptive
<p>Discuss the following:</p> <p>(c) 'P' an auditor decides not to send a new audit engagement letter to G Ltd. every year. Whether he is right in his approach? State the circumstances where sending new engagement letter, would be appropriate. (5 marks)</p>		

Answer:

As per **SA-210, Agreeing the terms of Audit Engagements**, the auditor shall assess whether circumstances require the terms of audit engagement to be revised and whether there is a need to remind the entity of the existing terms.

- It is not necessary to issue audit engagement letter each year for repetitive audit. Here 'P' an auditor decides not to send a new engagement letter to G Ltd. every year. So, the approach of the auditor is correct and appropriate.
- **The following are the circumstances where issue of the fresh engagement letter becomes mandatory:**
 - (i) When it appears that the client has misunderstood the objective and scope of audit. In such case issue of engagement letter becomes necessary.
 - (ii) Where there has been change in management, board or ownership, so that it is felt that it is pertinent to remind them of the engagement terms again.
 - (iii) Where any revision by way of addition, deletion or modifications had been contemplated in the engagement letter originally issued.
 - (iv) Where significant changes had occurred in nature, volume of the business transactions of the client which warrant the scope and terms of engagement to be altered to be in tune with them.
 - (v) Where there has been necessity to modify audit approach to be in line with the pronouncements of ICAI, the Companies Act and the like.

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Q.12.1	2009 - Nov [8] (a), RTP	Descriptive
<p>X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.</p> <p>Offer your comments in this regard.</p>		(5 marks)

Answer:

A letter of engagement refers to a letter written by the auditor to his client in order to avoid any misunderstanding between them as to the scope and objective of an audit.

Change in terms of engagement.

In the following circumstances the auditor may think it appropriate to send a new engagement letter to client.

1. Any indication that the client misunderstood the objective and scope of audit.
2. Any revised and special terms of engagement.
3. Any recent change in board of directors and senior management.
4. New legal requirements or pronouncement of ICAI.
5. Significant change in clients business

It should be kept in mind that

1. When the terms of engagement change both the auditor and the client should agree an new terms.
2. The auditor should not agree to change in terms where there is no reasonable justification for doing so.

Thus, as per the case in question, the auditor should not agree to change the terms of engagement as the auditor was unable to obtain sufficient evidence regarding receivable.

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13**Miscellaneous****Auditing Vs. Investigation****Q.13.1****2012 - Nov [4] (b), RTP****Distinguish Between**

Distinguish between Auditing and Investigation.

(8 marks)

Answer:

Both involve a systematic and critical examination of the available evidence, yet these are quite distinct from each other which is as follows:

S. No.	Basis of Difference	Auditing	Investigation
1.	Meaning	Auditing relates to the independent examination of financial information of any entity, when such an examination is conducted with a view to express an opinion.	Investigation relates to systematic, critical and special examination of the records of the business for a specific purpose.
2.	Scope	Audit covers all factual assertions in the financial statements to ascertain their truth and fairness.	Scope is limited as regards the period or area to be covered.
3.	Object	The object of an audit is to critically examine the financial statements and report on the truth & fairness of assertions.	Investigation aims at ascertaining certain facts such as fraud, tax liability, value of shares etc.
4.	Coverage	Auditing is a routine exercise for generally an accounting year.	Investigation may spread over a period longer than one year.

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5. Purpose	To enhance the degree of confidence of intended users in the financial statements.	To establish a fact or assessing a particular situation.
6. Appointment	Auditor may be appointed by the owners or shareholders.	Investigator may be appointed by the owners or management or even third parties.
7. Procedure	The audit is conducted in accordance with the Generally Accepted Auditing Procedure.	Investigation involves an extended auditing procedure.
8. Approach	Auditor is skeptical and not suspicious.	Investigator starts his work with suspicion & collects evidence to either confirm or dispel that suspicion.
9. Evidence	Audit evidence is persuasive.	Investigator relies on conclusive.
10. Extent of checking	Test checking or sample checking is allowed.	In investigation particularly to detect frauds, test checking may not be advisable. It may be necessary to check 100%.
11. Report	Auditor reports to the owners e.g. shareholders.	Investigator reports to the person on whose behalf he has undertaken the investigation.

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Fundamental Accounting Assumption**Q.13.2****2014 - May [2] (ii), RTP****Objective**

State with reasons (in short) whether the following statement is correct or incorrect.

Specific disclosure is required of the fundamental accounting assumptions followed in the financial statements. (2 marks)

Answer:**Incorrect:**

As per AS - 1 Disclosure of Accounting Policies, if the company or firm does not follow the fundamental accounting assumptions viz., going concern, accrual, consistency then disclosures in the financial statements are required. If they follow the fundamental accounting assumptions then disclosures are not required.

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Error of Commission**Q.13.3****2014 - May [2] (v)****Objective**

State with reasons (in short) whether the following statements are correct or incorrect.

'Errors of commission' is where a transaction has been omitted either wholly or partially. (2 marks)

Answer:**Incorrect:**

When wrong amount is entered either in the subsidiary books or in ledger accounts or when totals are wrongly made or when a wrong account is involved or when amount is posted on the wrong side, it is a case of error of commission.

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6.44**Scanner CA Inter Gr. II Paper - 6 (New Syllabus)****Self Revealing Errors****Q.13.4****2014 - Nov [7] (b)****Short Notes**

Write short note on the Self-revealing errors and four illustrations thereof.
(4 marks)

Answer:

Self revealing errors: These are such errors the existence of which becomes apparent in the process of compilation of accounts.

A few illustrations of such errors are given hereunder, showing how they become apparent.

1.	Omission to post a part of a journal entry to the ledger.	Trial balance does not tally.
2.	Wrong totaling of the Purchase Register.	Control Account (e.g., the Sundry Creditors Account) balances and the aggregate of the balances in the personal ledger will disagree.
3.	A failure to record in the cash book amounts paid into or withdrawn from the bank.	Bank reconciliation statement will show up error.
4.	A mistake in recording amount received from X in the account of Y.	Statements of account of parties will reveal mistake.

From the above, it is clear that certain apparent errors balance almost automatically by double entry accounting procedure and by following established practices that lie within the accounting system but not being generally considered to be a part of it, like bank reconciliation or sending monthly statements of account for confirmation.

— Space to write important points for revision —

Q.13.5	2020 - Nov [2] (a)	Descriptive
Describe the guiding principles which the auditor should take into account which serves as the safeguards to eliminate the threats to independence. (4 marks)		

Answer:

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard:

1. Planning	The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.
2. Confidentiality	The auditor should not disclose any information /data of his client, unless there is legal obligation or professional duty to disclose.
3. Work performed by others	When auditor delegate work to assistants or uses work performed by other auditors and experts, he continues to be responsible for forming and expressing his opinion on the financial information.
4. Accounting & Internal System Control	The auditor should Gain an understanding of the accounting system & Internal control.
5. Audit Evidence	The auditor should obtain sufficient & appropriate audit Evidence as per SA – 500.
6. Integrity, objectivity & Independence	The auditor should maintain integrity, objectivity & independency towards his work & not disclose any information to others. So maintain Independency & Integrity.

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7. Documentation	After obtaining Audit Evidence as per SA 500 then proper Documentation is Required.
8. Skills & Competence	The auditor must have knowledge about financing, accounting, Law or others and he should be competent person.
9. Audit Reporting	The auditor should review and draw conclusion from the available audit evidence and after that reporting of the same to appropriate authority.

— Space to write important points for revision —

MULTIPLE CHOICE QUESTION**1*****Meaning and Definition of Auditing***

1. Audit is _____ examination of financial information.
 - (a) Dependent
 - (b) Independent
 - (c) Inter dependent
 - (d) Intra dependent
2. The Objective of an audit is to _____.
 - (a) Find errors
 - (b) Give report on any fraud
 - (c) Express an opinion on the financial statement
 - (d) Any of them
3. Audit is an independent examination of _____ information of any entity.
 - (a) Statutory
 - (b) Financial
 - (c) Financial as well as non financial
 - (d) All of them

4. Audit is an independent examination of financial information of any entity.
 - (a) that entity must be profit oriented
 - (b) that may profit oriented or not
 - (c) irrespective of its size or legal form
 - (d) (b) and (c)
5. Audit ensure that the entries in the books are
 - (a) adequately supported by sufficient documents
 - (b) adequately supported by sufficient evidence
 - (c) adequately supported by vouchers
 - (d) adequately supported by sufficient and appropriate evidence.
6. The word "Auditing" has been derived from Latin word
 - (a) Auditro
 - (b) Audiere
 - (c) Auditstro
 - (d) Audiherence
7. 'Auditing' word has been derived from Latin word "Audiere" which means
 - (a) to check
 - (b) to verify
 - (c) to hear
 - (d) to comply.

8. Overall Objectives of the Independent Auditor describe under.
 - (a) SA - 200
 - (b) SA - 205
 - (c) SA - 500
 - (d) SA - 700
9. Objective of the auditor
 - (a) To obtain reasonable assurance
 - (b) To report on the financial statements and communicate as required by the Sas.

- (c) To ensure the financial statement as a whole are free from material misstatement
- (d) All of them.

10. Audit should be organised to cover adequately _____ of the enterprise relevant to the financial statements being audited.
 - (a) some aspects
 - (b) only financial aspects
 - (c) non financial aspects
 - (d) all aspects.
11. Auditor assesses the reliability and sufficiency of the information contained in the accounting records and other source data by:
 - (a) making a study and evaluation of accounting systems and internal control
 - (b) carrying out other tests, enquiries, and verification as appropriate in a particular circumstances
 - (c) (a) or (b)
 - (d) (a) and (b).
12. Aspects to be covered in Audit
 - (a) An examination of system of accounting and internal control
 - (b) Verification of the authenticity and validity of transaction including all assets and liabilities
 - (c) Checking the result shown by the financial statement and report it to the appropriate body
 - (d) All of them.
13. Audit of a corporate body, auditor should confirming the compliances of
 - (a) Management's requirements
 - (b) Non Statutory requirements
 - (c) Statutory requirements
 - (d) None of them.

14. Audit is _____ for all types of business organisation or institution.
 - (a) Legally obligatory
 - (b) Not legally obligatory
 - (c) Voluntary
 - (d) None of them
15. Organisations which require audit under law.
 - (a) Companies governed by the Companies Act.
 - (b) Banking Companies
 - (c) Statutory bodies required by their regulators or by Specific Act
 - (d) All of them
16. Exception of voluntary category of audit
 - (a) Proprietary entities
 - (b) HUF entities
 - (c) Companies form under companies law
 - (d) Partnership firms.
17. An audit that is taken up between two annual audits is called
 - (a) Statutory Audit
 - (b) Voluntary Audit
 - (c) Interim Audit
 - (d) Internal Audit
18. When the auditor's staff is engaged continuously in checking the accounts of the client throughout the financial period/whole year is called
 - (a) Statutory Audit
 - (b) Interim Audit
 - (c) Concurrent Audit
 - (d) Continuous Audit
19. A comprehensive, continuous and systematic examination of all transactions by a person other than those involved in operation is called.
 - (a) Statutory Audit
 - (b) Interim Audit
 - (c) Concurrent Audit
 - (d) Continuous Audit

20. Concurrent Audit ensure
- (a) Accuracy
 - (b) authenticity and due compliance
 - (c) procedures and guidelines
 - (d) all of them.
21. _____ is a management process tool towards the establishment of sound internal functions and effective control systems.
- (a) Statutory Audit
 - (b) Internal Audit
 - (c) Interim Audit
 - (d) Concurrent Audit
22. Audit which commences after the books has been closed at the end of the accounting period and thereafter is carried on continuously until completed.
- (a) Continuous Audit
 - (b) Internal Audit
 - (c) Final or Annual Audit
 - (d) Concurrent Audit

23. Advantages of audit excludes
- (a) It safeguards the financial interest of person who are associated
 - (b) It safeguards the financial interest of person who are not associated
 - (c) It acts as a moral check on the employees.
 - (d) It helps in the detection of wastages and losses.
24. Audit of financial statement is beneficial:
- (a) For settlement of accounts at the time of admission or death of partners
 - (b) Help in detection of wastages and losses
 - (c) Help in settlement of liabilities for taxes
 - (d) All of them.

6***Inherent Limitations of Audit***

25. The auditor is not expected to, and cannot, reduce audit risk to zero because there are some inherent limitation of an audit. This statement is stated under.
- (a) SA 200 (b) SA 300
(c) SA 500 (d) SA 700
26. Some practical and legal limitations on the auditor's ability to obtain audit evidence includes:
- (a) An Audit is not an official investigation into alleged wrong doing
(b) Fraud may involve sophisticated and carefully organised scheme
(c) Possibility that management or other may not provide, intentionally or unintentionally, the complete information relevant for preparation and presentation of financial statement
(d) Any of them.

7***Relationship of Auditing with other Disciplines***

27. Auditing involves review of various assertion _____, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same.
- (a) financial terms
(b) non financial terms
(c) both financial and non financial term
(d) None of them

8***Standard Setting Process***

28. International Federation of Accountants (IFAC) was set up in _____.
- (a) 1970 (b) 1977
(c) 1987 (d) 1997

29. International Federation of Accountants was set up with a view to
- (a) establish uniform accounting rules and regulation
 - (b) establish uniform accounting standards
 - (c) bringing same accounting methods and procedure for all countries
 - (d) bringing harmony in the profession of accountancy on an international scale.
30. ICAI is a member of
- (a) IFAC
 - (b) IAASB
 - (c) IMF
 - (d) SEBI
31. _____ apply in the audit of historical financial information.
- (a) Standards on Auditing (SAs)
 - (b) Standards on Review Engagements (SREs)
 - (c) Standards on Assurance Engagements (SAEs)
 - (d) Standards on Related Services
32. _____ apply in the review of historical financial information
- (a) Standards on Auditing (SAs)
 - (b) Standards on Review Engagements (SREs)
 - (c) Standards on Assurance Engagements (SAEs)
 - (d) Standards on Related Services
33. _____ apply to engagements to apply agreed upon procedures to information and other related services engagements such as compilation engagements.
- (a) Standards on Auditing (SAs)
 - (b) Standards on Review Engagements (SREs)
 - (c) Standards on Assurance Engagements (SAEs)
 - (d) Standards on Related Services
34. _____ apply in assurance engagements, dealing with subject matters other than historical financial information
- (a) Standards on Auditing (SAs)
 - (b) Standards on Review Engagements (SREs)
 - (c) Standards on Assurance Engagements (SAEs)
 - (d) Standards on Related Services

35. Guidance Notes are _____ in nature.
- (a) Mandatory
 - (b) Recommendatory
 - (c) Statutory
 - (d) All of them.

9***Qualities of an auditor***

36. "An auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true". Stated by
- (a) Justice Kindley in Federal General Bank Case
 - (b) Justice Lindley in London Federal Bank Case
 - (c) Justice Lindley in London and General Bank Case
 - (d) None of them.

10***Elements of a system of quality control***

37. Quality Control System of a firm should include policies and procedures of
- (a) Ethical requirements
 - (b) Engagement performance
 - (c) Leadership responsibilities for quality
 - (d) All of them.
38. "As per SA - Engaged partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned".
- (a) SA 200
 - (b) SA 220
 - (c) SA 300
 - (d) SA 320

39. Which of the fundamental principles of professional ethics relevant to the auditor when conducting an audit.
- (a) Integrity and objectivity
 - (b) Confidentiality and professional behaviour
 - (c) Professional competence and due care
 - (d) All of them.
40. _____ refers to an attitude that includes a questioning mind. While conducting the audit.
- (a) Professional misconduct
 - (b) Professional behaviour
 - (c) Professional Skepticism
 - (d) Professional ethics

41. "Agreeing the Terms of Audit Engagements", preconditions for an audit may be defined as the use by management is defined under
- (a) SA 200
 - (b) SA 210
 - (c) SA 220
 - (d) SA 300

42. Audit engagement letter is sent by _____ to his _____.
- (a) Client, auditor
 - (b) Shareholder, auditor
 - (c) Auditor, Client
 - (d) Auditor, government

43. ICAI has issued SA 210 “Agreeing the Terms of Audit engagement” in the interest of
- (a) both the auditor and the client
 - (b) both the auditor and government
 - (c) only auditor
 - (d) only client
44. Letter of engagement is issued so that
- (a) Possibility of understanding increases to a great extent
 - (b) Possibility of understanding reduces to a great extent
 - (c) Possibility of mis-understanding is reduced to great extent
 - (d) None of them.
45. The appointment of the auditor in partnership firm is normally government by
- (a) Partners
 - (b) Management of the firm
 - (c) Partnership Deed
 - (d) Governing Council.
46. According to SA 210 “Agreeing the Terms of Audit Engagement” the auditor shall agree the terms of audit engagement with _____ as appropriate.
- (a) Management or those charge with governance (TCWG)
 - (b) Management or shareholders
 - (c) Management or auditor
 - (d) Auditor or those charge with governance.
47. The agreed terms of the audit engagement shall include:
- (a) The objective and scope of the audit of the financial statement
 - (b) The responsibilities of auditor and management
 - (c) Identification of the applicable financial reporting framework for the preparation of the financial statements.
 - (d) All of above.

48. In case of recurring audit of a firm by the same auditor
- requires fresh letter of engagement
 - requires revised letter of engagement
 - does not requires any letter of engagement
 - does not requires any letter of engagement until and unless there is any type of change
49. Factor(s) that may make it appropriate to revise the terms of the audit engagement are :
- Any indication that the entity misunderstands the objective and scope of the audit
 - A resent change of senior management or change in ownership
 - A change in legal or regulatory requirement
 - Any of them.

50. If management or TCWG impose limitation on the scope such that auditor believes limitation would result in auditor disclaiming an opinion
- the auditor shall accept such a limited engagement
 - the auditor shall not accept such a limited engagement
 - the audit quit his assignment
 - any of them.

Answer

1.	(b)	2.	(c)	3.	(b)	4.	(d)	5.	(d)
6.	(b)	7.	(c)	8.	(a)	9.	(d)	10.	(d)

11.	(d)	12.	(d)	13.	(c)	14.	(b)	15.	(d)
16.	(c)	17.	(c)	18.	(d)	19.	(c)	20.	(d)
21.	(d)	22.	(c)	23.	(a)	24.	(d)	25.	(a)
26.	(d)	27.	(c)	28.	(b)	29.	(d)	30.	(a)
31.	(a)	32.	(b)	33.	(d)	34.	(c)	35.	(b)
36.	(c)	37.	(d)	38.	(b)	39.	(d)	40.	(c)
41.	(b)	42.	(c)	43.	(a)	44.	(c)	45.	(c)
46.	(a)	47.	(d)	48.	(d)	49.	(d)	50.	(b)

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