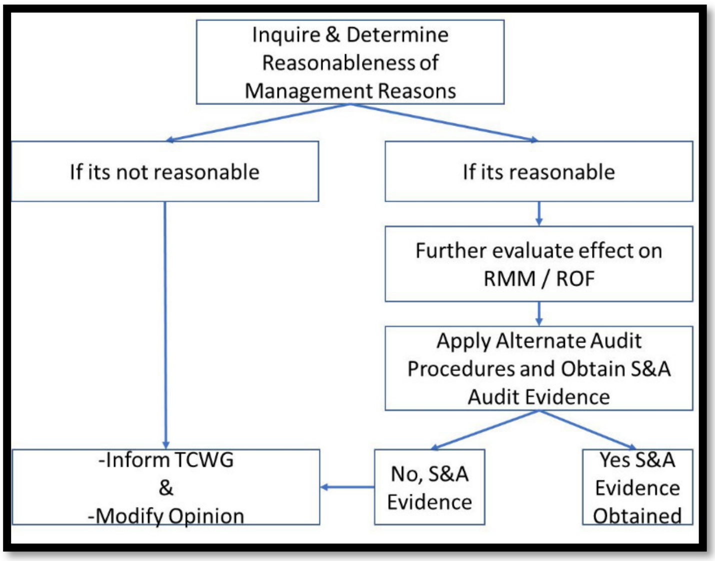
	Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: ➢ The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; ➢ The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions; ➢ A very low exception rate is expected; and ➢ The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

QNO 505.11	**External Confirmation- Management refuse**	**New Course -- (S17M/N20E)**
	While conducting the audit of Jay Kay Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables but the management refused the auditor to send confi1 SA 505 Management refuse to sent External Confirmation to Particular groups of Debtors Confirmation request. **Required, How would the auditor proceed?**	
Answer	➢ **Inquiry** **If management refuses to allow the auditor** to send a confirmation request, the auditor shall **Inquire as to management's reasons** for the refusal, and seek audit evidence as to their validity and reasonableness; ➢ **Evaluate** **Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and** ➢ **Alternative audit procedures** **Perform alternative audit procedures** designed to obtain relevant and reliable audit evidence. ➢ **Auditor conclusion** ∇ **If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures,** • **the auditor shall communicate with those charged with governance in accordance with SA 260.**	

- **The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.**



TRUE AND FALSE

TNO- SA 505- 1	
	Audit evidence obtained from external confirmation is always reliable. State true or false with reason:
Answer	**Incorrect**
	The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

TNO-SA-505-2	
	External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only.
Answer	**Incorrect**
	External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".

TNO-SA-505-3	
	R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability.
Answer	**Hint Answer for Nov 20 Exam** **Correct** **Electronic responses are risky** Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect.
	Author's Note: This is hint answer as per SA 505. This point was not covered in any of ICAI's material before . So it was totally a new question. **Some questions of Nov 20 IPCC old course paper were weird and new. These were not at all expected, so this paper was harsh on students.**

Part 6 -- [SA 510] INITIAL AUDIT ENGAGEMENTS OPENING BALANCES

QNO 510.01	Objective with respect to Opening Balances	(S17M/S20M)
	Discuss the objective of Auditor with respect to Opening balances – in conducting an initial audit engagement. **OR** **M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2020- 21-. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510?**	

Answer

- **Objective**

  In conducting an initial audit engagement, **the objective of the auditor with respect to opening balances** is to obtain sufficient appropriate audit evidence about whether:

  - Opening balances contain **misstatements that materially affect** the current period's financial statements; and
  - Appropriate **accounting policies reflected in the opening balances** have been consistently applied in the current period's financial statements or **changes thereto are properly accounted for and adequately presented and disclosed** in accordance with the applicable financial reporting framework.

QNO 510.03	Audit Procedures for Opening Balance	Old Course -- (M17E/N17R/N18M/N19M/M19R) New Course -- N18E/N19M/S20M)
	M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? **OR** **Discuss with reference to SA 510, "Initial Audit Engagement – Opening Balances", the procedures the auditor should undertake in respect of opening balances for a new audit engagement.** **OR** **Explain Audit Procedures in respect of Opening Balances for a New Audit Engagements with reference to relevant SA.**	

Answer

- **Applicability**
  - This Standard on Auditing (SA) deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.
    - The financial statements for the prior period were **not audited**; or
    - The financial statements for the prior period were **audited by a predecessor auditor.**

- **Audit Procedures**
  - The auditor shall **read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening** balances, including disclosures.
  - 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:
    - 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**;
    - Determining whether the opening balances reflect **the application of appropriate accounting policies; and**
    - Performing one or more of the following:
      - 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;

	o Evaluating whether **audit procedures performed in the current period provide evidence relevant to the opening balances;** or o Performing **specific audit procedures**_to obtain evidence regarding the opening balances. ➢ ***Conclusion*** From the above, it is quite clear that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.

TRUE AND FALSE

TNO- SA 510-1	
	An auditor is not concerned with consistency of accounting policies relating to opening balances. State true or false with reason:
Answer	**Incorrect**
	In conducting an initial audit engagement, one of the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

TNO- SA 510-3	
	If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report
Answer	**Incorrect:**
	If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

Part 7 -- [SA 550] RELATED PARTIES

QNO 550.02	Situation when RPT will lead to higher RMM	(M20R/S20M)
	The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.	

Answer

- RPT **in normal course doesn't lead to higher RMM**
  Many related party transactions are in the **normal course of business.** In such circumstances, they may carry **no higher risk of material misstatement** of the financial statements than similar transactions with unrelated parties.

- **Situation when RPT will lead to higher RMM**
  However, **the nature of related party relationships and transactions may,** in some circumstances, **give rise to higher risks of material misstatement** of the financial statements than transactions with unrelated parties.
  For example:
  - They are not conducted **at normal market prices, terms & conditions.**
    - **E.g.** Goods purchased at double the market price from MDs son proprietor firm or goods sold to brother of MD at triple the market price)
  - Transactions are conducted through **complex related party relationships & structures.**
    - (Indian Co pays Technical Consultancy Fees -- USA Sub pays Management Consultancy -- UK Sub pays Dividend -- Canada Holding Co where MD is having major stake)
  - **Where** there are **no appropriate employees** / register / software (systems) to identify, authorize, record, summaries and disclose related party transactions which may lead to non-compliance of AS 18.
    - (**E.g.** Delhi based Company indirectly holds controlling stake in Australian company through its subsidiaries in Mumbai and Chennai, but this thing is not disclosed in financial statement as per AS 18, because of lack of expertise in staff managing related party transactions (Non-CA / CS / CWA)

QNO 550.03	Responsibility of Auditor	(M19R/N20R)
	There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements. Analyse and explain stating the responsibility of auditor in this regard.	

Answer

- **Presentation in Financial Statement**
  AS 18 / Ind AS 24 deals with Related Party, such standards generally provide accounting & disclosure treatment, In India they provide only disclosure treatment
  There are specific **accounting and disclosure requirements** for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

- **Risk Assessment & Further Audit Procedures**
  - **Auditor's Responsibility to Assess RMM (Including ROF) and Perform Further Audit Procedures**
    The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.
    In addition, it is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

- **Conclusion**

	The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions: ∀ Achieve a true and fair presentation; or ∀ Are not misleading (for compliance frameworks). ➢ **Problems / Issues** ∀ **Inherent Limitations of Audit & It increases in context of RPT** 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. **In the context of related parties,** the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following: • Management may be **unaware of the existence** of all related party relationships. • Related party relationships may present a **greater opportunity for Collusion.** • Concealment **or Manipulation** by management. *(Collusion – Transferring profits to Dubai / Concealment → Stolen stock shown as sale to subsidiary in Mauritius / Manipulation → Gave loan to RP to purchase goods & boost own sales)* ➢ **Solution** ∀ **Importance of Professional Skepticism** Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for **undisclosed related party relationships and transactions.** ∀ **Matter of SA 550** The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

QNO 550.04	**Records or Documents which can provide details of related party relationships or related party transactions**	**(N21R)**
	The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples.	
Answer	During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, **For Example**: 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 those charged with governance. 5. Records of the entity's investments and those of its pension plans. 6. Contracts and agreements with key management or those charged with governance. 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 e.g, prospectuses)	

TRUE AND FALSE

TNO- SA 550-1	
	All entities that are under common control by a state (i.e., national, regional or local government) are considered related party.
Answer	**Incorrect**
	Entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another

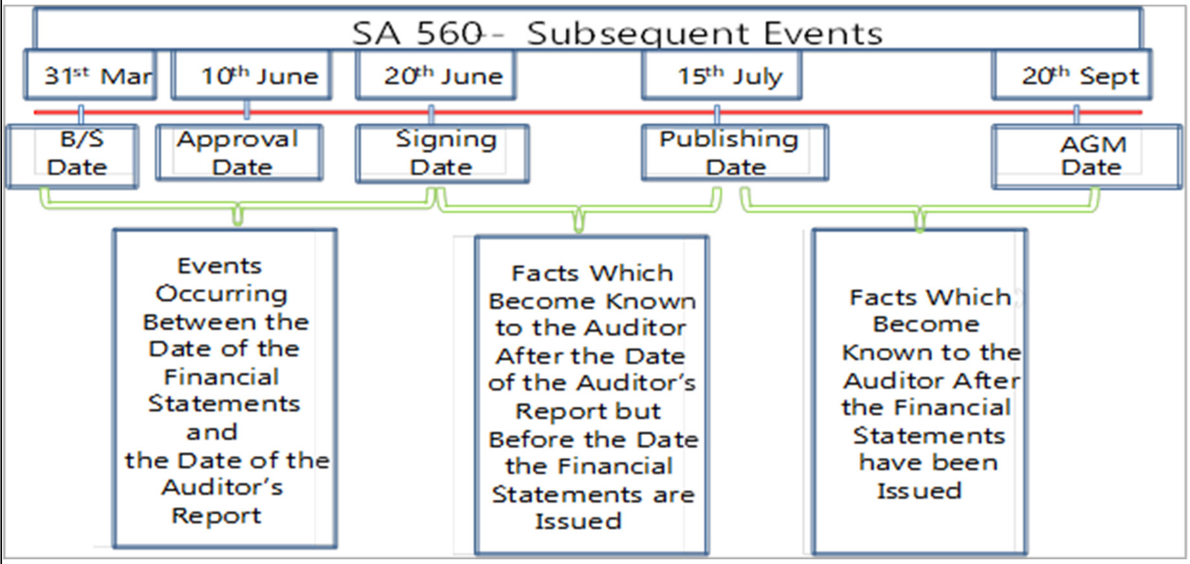
Part 8 -- [SA 560] SUBSEQUENT EVENTS

QNO 560.01	Subsequent Event- Meaning	Old Course -- (P16N/M17M) New Course – Relevant, Concept Covered in New Course SM
	Explain the meaning of the term subsequent events as used in the SA 560.	

Answer

Meaning of Subsequent Events:

SA 560 on "Subsequent Events" defines the term "subsequent events" as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report., "subsequent events" also refer to significant events which occurred up to the date of report of the auditor of that component. Thus, subsequent events are those events which occur after the date of the balance sheet till the audit report is signed by the auditor.



QNO 560.02	Subsequent Event Definition by FRFs (In General) & SA 560	(N21R)
	SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Explain those events and also define subsequent events	

Answer

SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

(a) Those that provide evidence of conditions that existed at the date of the financial statements; and

(b) Those that provide evidence of conditions that arose after the date of the financial statements.

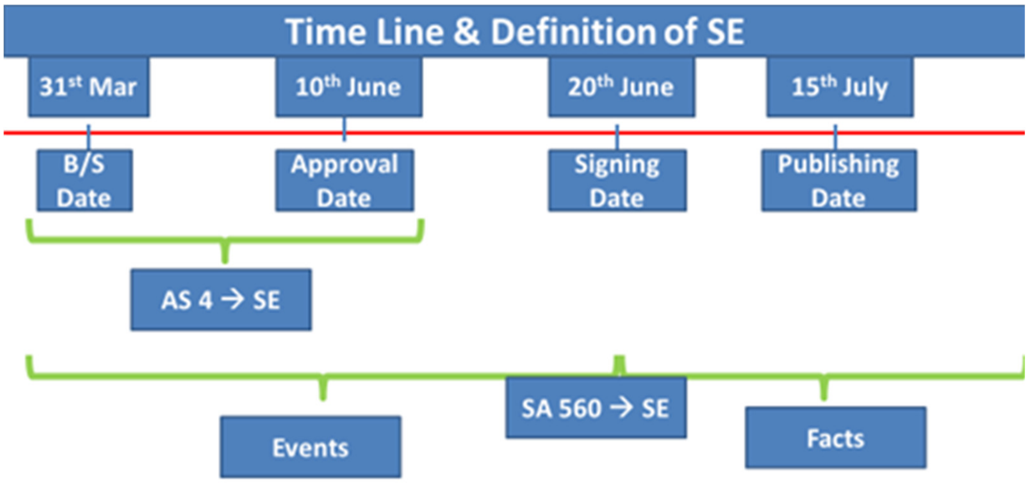
SA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.

Subsequent events refer to events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

QNO 560.03	Auditor Responsibility - Events occurring between the date of the financial statements and the date of the auditor's report	Old Course -- (P16M/ M16R/ N19M) New Course -- (N17R/M19R/N19M)

	The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. Explain. **OR** **Indicate briefly the procedures to identify subsequent events requiring adjustment of or disclosure in the financial statements.** **OR** **The auditors should consider the effect of subsequent events on the financial statement and on auditor's report– Comment according to SA 560.**

Answer



- **Duty of Auditor**
  - **Auditor should examine whether all adjusting events should be identified**
    The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that **all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.** The auditor shall perform the procedures 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.**
  - **No need to check again is some areas are checked in regular audit procedures**
    The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
  - **Nature and extent depends on risk assessment**
    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:
- **Audit Procedures**

  Understanding procedures, controls set by Mgt / Inquiry with Mgt, TCWG / Reading minutes / Latest subsequent interim financial statements/ / Read latest budgets, cash flow forecasts and other management reports for periods after the date of the FST / oral or written inquiries concerning litigation and claims

Detailed Text

- Obtaining an understanding of **any procedures management has established** to ensure that subsequent events are identified.
- *Inquiring* of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- *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.**
- Reading the entity's latest **subsequent interim financial statements,** if any.

- Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims

➢ **Adjusting Event**

If auditor identifies event requiring adjustment / see whether it is adjusted or disclosed in FST / if not then modify the report.

Detailed Text

- When, as a result of the procedures performed as explained 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. .If such events have not been considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

➢ **Written Representations**

The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

QNO 560.06	**Auditor's Obligation - Facts which become known to the auditor after the date of the auditor's report but before the date the financial statements are issued**	**Old Course -- (M20R) New Course -- (M20R/S20M)**
	"The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation."	
Answer	➢ The auditor has **no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report.** However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, **may have caused the auditor to amend the auditor's report, the auditor shall:** - **Discuss the matter with management** and, where appropriate, those charged with governance. - Determine **whether the financial statements need amendment** and, if so, - **Inquire how management intends to address** the matter in the financial statements.	

Part 9 -- [SA 570] GOING CONCERN

QNO 570.01	Objectives of Auditor Regarding Going Concern	(M19R/N19R/M21R)
	On the basis of which assumption, the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern. **OR** **When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern.**	
Answer	➢ *Going Concern Basis of Accounting* ∀ Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. ➢ **The objectives of the auditor are:** ∀ To conclude, based on the audit evidence obtained, **whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern;** and ∀ To 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; ∀ To determine the **implications for the auditor's report.**	

QNO 570.02	Objectives / Responsibilities of Auditor with respect to Going Concern and implication of inherent limitations on going concern evaluation	(M21R)
	As described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. Explain stating the auditor's responsibilities with regard to going concern.	
Answer	Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either (i) intends to liquidate the entity or to cease operations, (ii) or has no realistic alternative but to do so. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. The objectives of the auditor regarding Going Concern are: (1) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; (2) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and (3) To report in accordance with this SA.	

QNO 570.03	Events & Conditions Creating Significant Doubt	Old Course -- (P16M/M16M/N16R/N18R/N20E) New Course -- (N21R)
	Explain with reference to the relevant Standard on Auditing - Appropriateness of going concern assumption **OR** **"Operating Conditions" that may cast doubt about going concern assumption.** **OR** **Give six examples of operating Conditions that may cast doubt about going concern assumption.**	

Answer

- **Appropriateness of Going Concern Assumption:**
  - As per SA 570 "Going Concern", in some enterprises, for example, those where the funding arrangements are guaranteed by the Central Government, going concern risks may arise, but are not limited to, situations where such type of entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatisation.
  - Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern may include situations where such type of entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by such an entity.
  - However, the auditor should consider the risk that the going concern assumption may no longer be appropriate.
  - The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.
    - **Financial**

      (In sequence of falling business)
      - Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
      - Negative operating cash flows indicated by historical or prospective financial statements.
      - Arrears or discontinuance of dividends.
      - Net liability or net current liability position.
      - Adverse key financial ratios.

      (Borrowing Related Points)
      - Inability to comply with the terms of loan agreements.

        (Maintaining Stock Levels, Margin Money)
      - Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.

        (Kingfisher Airlines)
      - Inability to obtain financing for essential new product development or other essential investments.

        (Satyam, Banks refused to give new loans)

      (Creditor Related Points)
      - Inability to pay creditors on due dates.
      - Indications of withdrawal of financial support by creditors.

        (No extension from creditors)
      - Change from credit to cash-on-delivery transactions with suppliers.
    - **Operating**
      - Management intentions to liquidate the entity or to cease operations.

        (E.g. Start-up's)
      - Loss of key management without replacement.
      - Shortages of important supplies.

        *(**E.g.**Power Generating Plants)*
      - Labour difficulties.
      - Loss of a major market, key customer(s), franchise, license, or principal supplier(s).

	○ Emergence of a highly successful competitor. *(**E.g**.Milk Butter Vs Peanut Butter)* • **Other** ○ Uninsured or underinsured catastrophes when they occur. **(Law related matters)** ○ Non-compliance with capital or other statutory requirements. *(**E.g.** CAR in Banks)* ○ Changes in law or regulation or government policy expected to adversely affect the entity. ○ 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. ▽ 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. ▽ The risk assessment procedures help the auditor to determine whether management's use of the going concern assumption is likely to be an important issue and its impact on planning the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans and resolution of any identified going concern issues.

QNO 570.05	**Going Concern Assumption Invalid – Reporting** **#Unique**	**Old Course -- (P16M)** **New Course -- (S20M)**
	M/s ANS & Associates has been appointed as the statutory auditors of MNO Ltd. The company has been suffering losses due to the emergence of highly successful competitor, thereby leading to negative net worth. Also, the sales head, key management personnel, of the company left the company due to health issues. When CA Amar, the engagement partner discussed the scenario with the management of the company, he did not get any satisfactory reply from the management. What is the responsibility of M/s ANS & Associates with regard to SA 570? **OR** **TT Ltd. has suffered recurring losses due to steep fall in production and has negative net worth. Its production head, an expert, has also left the company. Reply of the management is inadequate to these developments and there is no sound action plan to mitigate these situations. Comment.**	
Answer	➢ As per SA 570, one of the objectives of the auditor regarding going concern is to obtain sufficient and appropriate audit evidence regarding the same and to conclude on the appropriateness of the management's use of the going concern basis of accounting in the preparation of the financial statements. ➢ Further it also contains the list of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern which are: ▽ Financial indicator- Negative net worth ▽ Operating indicator- Loss of key management and emergence of highly successful competitor. ➢ In the present case, MNO Ltd. has negative net worth on account of emergence of highly successful competitor and the sales head of the company has also left the company. Also, CA Amar did not get any satisfactory reply when he discussed the going concern matter with the management. ➢ Thus, from the above facts, it appears that MNO Ltd. is not going concern. If the management of MNO Ltd. has used the going concern basis of accounting, the auditor should first ask the management to adjust the financial statements. ➢ If the management of MNO Ltd. does not agree with the same, CA Amar shall consider the impact on his audit report.	

QNO 570.07	Additional Procedures	Old Course -- (P16M) New Course – Relevant, Concept Covered in New Course SM
	Procedures to be performed by the auditor in expressing opinion on 'going concern' assumption.	

Answer

- **Compulsory**
  - **Management's Assessment if not prepared yet**
    Where management has not yet performed an assessment of the entity's ability to continue as a going concern, **requesting management to make its assessment.**
  - **Future Plan**
    Evaluating management's plans for future actions *(Introducing new products, cost cutting, sale of assets, sale of investments, issue of shares, taking new loans etc.)* in relation to its going concern assessment, whether the outcome of these plans is **likely to improve the situation.**
    *(**E.g.** Will such funds be sufficient to carry on business)* ***and whether management's plans are feasible in the circumstances.*** *(Can they pull off such big changes in given short span)*
  - **Cash flow & forecast**
    Where the entity has prepared a cash flow forecast, and **analysis of the forecast is a significant factor** in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
    - Evaluating the **reliability of the underlying data generated** to prepare the forecast; and
    - Determining whether there is **adequate support for the assumptions** underlying the forecast.
  - **Events**
    Considering whether **any additional facts or information have become available** since the date on which management made its assessment.
  - **Written Representation**
    Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.
- **Optional if required**
  Audit procedures that are relevant to the requirement **may include the following:**
  - **Future Action Plans of Third Parties & Management**
    (In Sequence of Power)
    - Obtaining and reviewing **reports of regulatory actions.**
    - **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.
    - **Reading minutes** of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
    - Determining the **adequacy of support for any planned disposals of assets.**
    - Reading the **terms of debentures and loan agreements** and determining whether any have been breached.
    - Evaluating the **entity's plans to deal with unfilled customer orders.** *(When there is shortage of raw material)*
  - **Cash flow, forecast & interim financial statements**
    - **Analyzing and discussing cash flow, profit** and other relevant forecasts with management.
    - Analyzing and discussing the entity's **latest available interim financial statements.**
  - **Subsequent Events**
    - Performing audit procedures regarding **subsequent events to identify those that either mitigate or otherwise affect** the entity's ability to continue as a going concern.
  - **Written Representation of Third Parties**
    - Confirming the **existence, legality and enforceability of arrangements** to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

	• Confirming the **existence, terms and adequacy of borrowing facilities.**
	Author's Note **Here in this answer two types of points are mentioned, one ccompulsory and another optional . Prefer compulsory one .**

QNO 570.10	Implication on Audit Report depending on adequacy of disclosure of material uncertainty in notes to accounts	(N21R)
	While doing audit of ABC Pvt Ltd, on the basis of sufficient and appropriate evidence, auditor comes to a conclusion that use of the Going Concern Basis of Accounting is appropriate, but a material uncertainty exists. Discuss the implications for auditor's report if: (a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements (b) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements	
Answer	**Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists** The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance. (a) **Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements** If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor 's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern." (b) **Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements** If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall: (i) Express a **qualified opinion or adverse opinion**, as appropriate, in accordance with SA 705 (Revised); and (ii) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.	

QNO 570.15	Preliminary Assessment by Management Regarding Going Concern	(M21R)
	When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor has determined that management of XYZ Ltd has already performed a preliminary assessment of the entity's ability to continue as a going concern. Explain how would auditor of XYZ Ltd proceed in the above case. Also explain how would the auditor proceed if such an assessment has not yet been performed by the management.	
Answer	When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and: (i) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or (ii) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.	

QNO 570.18	Management's Ability to make judgement about going concern #Unique	(N20E)
	Management's assessment of the entity's ability to continue as a going concern involves making a judgement about inherently uncertain future outcomes of events or conditions. What are relevant factors to that judgement?	
Answer	Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment: • The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information. • The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions. • Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.	

TRUE AND FALSE

TNO- SA 570-1	
	As per SA 570, the objective of the Auditor is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of consistency assumption in the preparation and presentation of the financial statements. True or false
Answer	**Incorrect**
	As per the objectives given in SA 570 "Going Concern", the auditor is required to obtain sufficient appropriate audit evidence about the appropriateness of management's use of going concern assumption in the preparation and presentation of the financial statements.

TNO- SA 570-2	
	An auditor has nothing to do with prudence or profitability of a company.
Answer	**Incorrect**
	Companies Act, 2013 requires the company auditor to go beyond the functions of reporting and express an opinion about the propriety or prudence of certain transactions. Also, the auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Therefore, it would not be correct to say that an auditor has nothing to do with prudence or profitability of a company because it may impact the going concern.

TNO- SA 570-3	
	The auditor shall disclaim an opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
Answer	**Incorrect**
	The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Part 10 -- [SA 580] WRITTEN REPRESENTATIONS

QNO 580.01	Management Representation-	Old Course -- (P16M/N16E) New Course – Relevant, Concept Covered in New Course SM
	Briefly explain Management Representation.	

Answer

- **Definition**
  A written statement by management provided to the auditor to **confirm certain matters or to support other audit evidence.**
  For example –
  *To **confirm things** which were committed at the start of the audit (preparation of financial statements, inform about all frauds & errors during the audit etc.) or to **support / corroborate other audit evidences** said orally during the audit (Scrap value is Rs 2 lakhs only.*

- **Enhances Quality of Information from Management**
  Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

- **Excludes**
  - Written representations in this context **do not include financial statements, the assertions therein, or supporting books and records.**
  - For purposes of this SA, references to "management" should be read as "management and, where appropriate, those charged with governance."

- **Types**
  There are two types of written representations: -
  - Written Representations about Management's Responsibilities (Compulsory)
  - Other Written Representations

- **Not a substitute of regular audit procedure**
  - Although **written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.**
  - Furthermore, the fact that management has provided reliable written representations **does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.**
  - It makes it absolutely clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

- **Example**
  A representation by management as to the quantity, existence and cost of inventories is no substitute for adopting *normal audit procedures regarding verification and valuation of inventories**. 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.*

QNO 580.05	Written Representation - not substitute to audit evidence and Objective of Written Representation	Old Course -- (P16M/M18R/M19M/M20R) New Course -- (S17M/N19R/S20M/M20R/N20E)
	Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Discuss. **OR** **The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of Kapor Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter.** **Required Discuss how would you deal as an auditor.**	

	OR **Auditor of AAS Ltd. was unable to confirm the existence and valuation of imported goods lying with the transporter and accepted a certificate from the management without obtaining other audit evidence. Comment** **OR** **Explain clearly objective of the auditor regarding written representation.** **OR** **Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation.**

Answer

- **Audit Evidence**
  Audit evidence is **all the information used by the auditor in arriving at the conclusions** on which the audit opinion is based.

- **Written representations**
  - **Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence** on their own about any of the matters with which they deal.
  - Furthermore, the **fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence** that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.
  - **Written representations are necessary information** that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, **written representations are audit evidence**.
  - Written representations are **requested from those responsible for the preparation and presentation of the financial statements**.

- **The objectives of the auditor regarding written representation (Write Only When Specifically Asked)**
  - The objectives of the auditor are:
    - **To obtain written representations**
      To obtain written representations from management. Also, that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
    - **To support other evidence**
      To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and
    - **To respond appropriately**
      To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

Author's Note

- **Write this extra point in case of second question**
  Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company.
- **Write this extra point in case of third question**
  Mere possession of a certificate does not absolve the auditor from his liability. He should not seek or accept certificates when subject matter is such that it is capable of verification from internal and/or external evidences.

  In the instant case, the inventory of imported material lying with the transporter can be easily verified with purchase order, invoice, bill of entry, custom document, payment of F.C. etc. Therefore, the auditor in this instant case has not used available evidences. He should not have rested with the

	certificate obtained from the management and could have evaluated other evidences. He may be held liable for negligence and professional misjudgment.

QNO 580.07	Written Representation – Quick completion of Audit	Old Course -- (P16M) New Course – Relevant, Concept Covered in New Course SM
	The management of Ankita Limited suggested for quick completion of the statutory audit that it would give its representation about the receivables in terms of their recoverability. The management also acknowledged to the auditors that the management would give their representation after scrutinizing all accounts diligently and they own responsibility for any errors in these respects. It wanted auditors to complete the audit checking all other important areas except receivables. The auditor certified the account clearly indicating in his report the fact of reliance he placed on representation of the management. Comment.	

Answer

- **Management Representation:**
  - According to SA 580 "Written Representations", the management representation cannot substitute other audit evidence that the auditor could reasonably expect to be available to the auditor.
  - The audit evidences available for checking receivables- say, invoices, debt acknowledgement documents, receipts, statement of accounts, confirmations etc., are available evidences which auditor is duty bound to verify.
  - In the given case, the management of Ankita Limited wants the auditor to carry out audit on all areas except on area of receivables. The management of the company also committed to give representation and further owned responsibility for any errors in these respects.
  - However, just because management had owned responsibility for the correctness of its evaluation of receivables, the auditor cannot shirk his responsibility. This is negligence on his part if he relies on the management representation without assessing the corroborative available evidences. There cannot be any restriction on scope of audit in case of statutory audit

QNO 580.09	WR (Refusal)	Old Course -- (P16M/N16M/N18R/N18M/M19M/N19E) New Course – Relevant, Concept Covered in New Course SM
	The Partner of Vansh and Vaibhav, Chartered Accountants, asked the management to provide statements from the creditors as part of audit evidence and also required written representation from the management but the management did not provide the requested written representations. Discuss how the auditor would proceed. **OR** **What do you mean by "Written Representations"? As an auditor, how you will deal if management does not provide requested written representations?** **OR** **The Partner of Ashish Surjeet and Company, Chartered Accountants, asked the management to provide statements from the creditors as part of audit evidence and also required written representation from the management but the management did not provide the requested written representations. Discuss how the auditor would proceed.** **OR** **Written representations are to be provided by the management to the auditor when requested. Comment.**	

Answer

- **Written Representations:**
  - As per SA 580, "Written Representation" is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.
  - These representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.
  - Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

	➢ **Requested Written Representations not provided by Management:** If management does not provide one or more of the requested written representations, the auditor shall- - Discuss the matter with management; - Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and - Take appropriate actions, including determining the possible effect on the opinion in the auditor's report. The auditor shall disclaim an opinion on the financial statements if management does not provide the written representations.

TRUE AND FALSE

TNO- SA 580-1	
	Written representation by management as to the quality of inventory is substitute for verification.
Answer	**Incorrect**
	Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying its quality for example, obsolete, damaged or ageing inventory. Written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

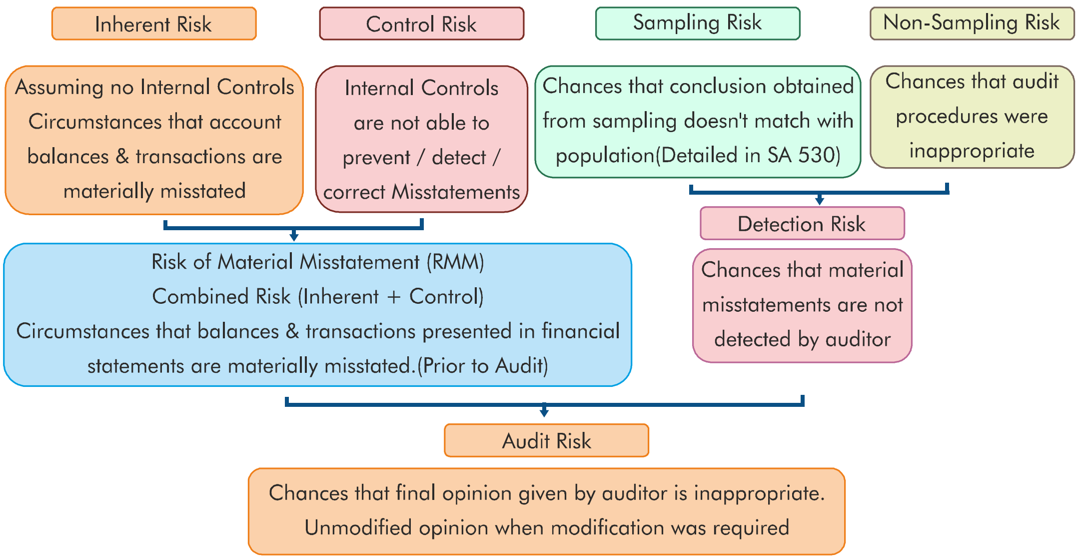
TNO- SA 580-2	
	Written representation can be a substitute for other audit evidence
Answer	**Incorrect**
	One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

TNO- SA 580-3	
	Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.
Answer	**Incorrect**
	One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

Part 1 -- [SA 315] IDENTIFYING AND ASSESSING RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING ENTITY AND ITS ENVIRONMENT

QNO 315.01	Audit Risk (All Components with Inter Relationships) -Master answer	Old Course -- (P16M) New Course -- (S17M)
	Audit Risk and inter-relationship of its components. **OR** **XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as readymade garments for all seasons, shoes, gift items, watches etc. There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis.** **Discuss the types of inherent, control and detection risks as perceived by the auditor.**	

Answer



➤ **Audit Risk:**

- An auditor's judgement as to what is sufficient and appropriate audit evidence is affected by the degree of risk of misstatement. Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is materially misstated.
  - **For example**,
    - o An auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated.
    - o Such risk may exist at overall level, while verifying various transactions and balance sheet items.
- As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the risks of material misstatement at the assertion level consist of two components:
  - Inherent risk and
  - control risk.
- Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.
- The **nature of each of these types of risk is discussed below-**
  - **Inherent risk:**
    It is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. External circumstances giving rise to business risks may also influence inherent risk.
    - o **For example**,

Technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement.

- **Control Risk:**
  - It is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
  - It is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements .
  - The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.
- **Detection Risk:**
  - It is the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
  - Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor.

Inter-relationship of Components of Audit Risk:

- Audit risk is a function of the risks of material misstatement and detection risk. The inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted.
- Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce on acceptable level of detection risk, thereby reducing audit risk to an acceptably low level.
- For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level.
  - **For example**,
    The greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

Author's Note

This is a master answer. Students are required to write the appropriate part as per the requirements of the question

QNO 315.02	**Factors for control risk assessment #Unique**	**New Course -- (N20E)**
	What factors are to be considered by an auditor while making control risk assessments?	

Auditor assesses control risk as Rely or Not rely on Controls. When making control risk assessments, consider:

- The control environment's influence over internal control. A control environment that supports the prevention, and detection and correction, of material misstatements allows greater confidence in the reliability of internal control and audit evidence generated within the entity. However, it does not guarantee the effectiveness of specific controls. We, therefore, test the operating effectiveness of controls over significant class of transactions (SCOTs) when we plan to take a controls reliance

	strategy. Conversely, the control environment may undermine the effectiveness of specific controls and is a key factor in our control risk assessments. ➢ Evaluations of the related IT processes that support application and IT dependent manual controls. ➢ Our testing approach over SCOTs and disclosure processes (i.e., controls reliance or substantive only strategy). ➢ The expectation of the operating effectiveness of controls based on the understanding of entity's processes.

QNO 315.05	RMM & Audit Risk - Exclusions	New Course -- (N18M)
	The assessment of risks is a matter of professional judgment. Explain stating clearly what is not included in Audit Risk?	

Answer

➢ **Assessment of Risks - Matter of Professional Judgement**

The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

➢ **Definition of Audit Risk**

The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Audit risk is a function of the risks of material misstatement and detection risk.
From the above, it is clear that –
Audit Risk = Risk of Material Misstatement x Detection Risk------(1)
Further Risk of Material Misstatement= Inherent Risk x Control Risk------(2)
From (1) and (2), we arrive at
Audit Risk = Inherent Risk x Control Risk x Detection Risk

➢ **What is not included in Audit Risk?**

- Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
- Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

QNO 315.05.50	Inquiry for risk assessment	New Course -- (N20R)
	Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority. Explain with the help of examples.	

➢ Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.

- Inquiries directed towards **those charged with governance** may help the auditor understand the environment in which the financial statements are prepared.1
- Inquiries directed toward **internal audit personnel** may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures. 3
- Inquiries directed to the **risk management function** (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting. 2

	- Inquiries directed toward **in-house legal counsel** may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract terms. 4 - Inquiries directed towards **marketing or sales personnel** may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers. 6 - Inquiries directed to **information systems personnel** may provide information about system changes, system or control failures, or other information system related risks. 5 - Inquiries of **employees** involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies. 7

QNO 315.06	**Analytical Procedure as substantive test for Risk Assessment**	**New Course -- (N20R)**
	Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Explain in detail.	
	- **New Information which auditor was unaware** Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. - **Financial as well as non-financial** Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. - **Unusual Items** Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. - **Results of Analytical Procedures & Other Information will be helpful** Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.	

CNO 315.06.50	**Using Observation & Inquiry as Risk Assessment Procedure**	**New Course -- (M21E)**
	CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations.	
Answer	Observation and inspection may support inquiries of management and others and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following: - The entity's premises and plant facilities. - The entity's operations. - Documents (such as business plans and strategies), records, and internal control manuals.	

	➢ Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings).

QNO 315.07	Understanding Entity & its Environment	Old Course -- (P16M/N17R/N19M/N17E /M21R) New Course -- (S17M/ N19M/M21R)
	In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment. **OR** **Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment.** **OR** **'Knowledge of Client business is one of the important principles in developing an overall audit plan. Explain.**	

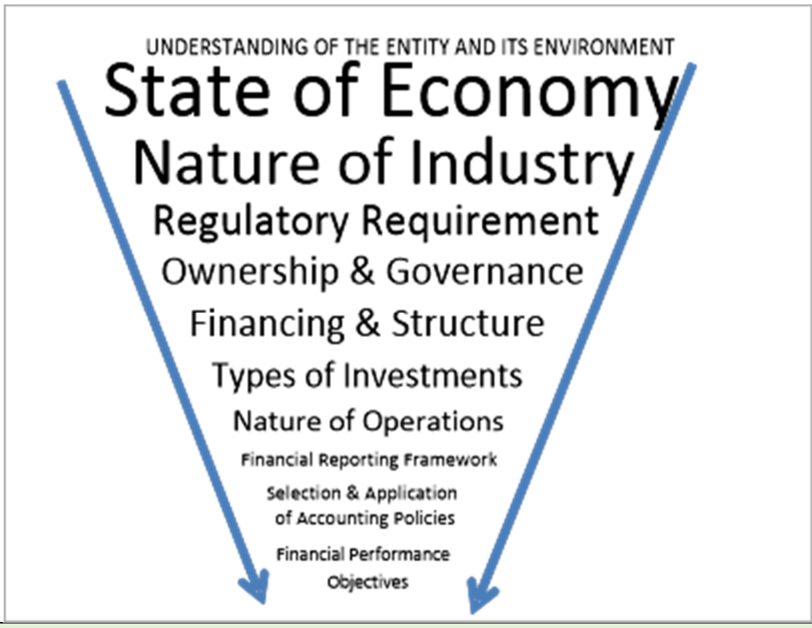
Answer

➢ The auditor shall **obtain an understanding** of the following:

- Relevant **industry, regulatory**, and other **external factors** including the applicable **financial reporting framework.**
- **The nature of the entity**, including:
  - its **operations**;
  - its **ownership and governance** structures;
  - The **types of investments** that the entity is making and plans to make, including investments in special-purpose entities; and
  - The way that the **entity is structured and how it is financed**; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- The entity's **selection and application of accounting policies**, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- The **entity's objectives and strategies**, and those **related business risks that** may result in risks of material misstatement.
- The measurement and review of the **entity's financial performance**.

➢ In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

➢ While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area.



AUTHORS NOTE:

The above points can be arranged from macro to micro for remembrance and convenient:

1. ***State of Economy***
2. ***Nature of Industry***
3. ***Regulatory Requirement***
4. ***Ownership and Governance***
5. ***Financing and Structure***
6. ***Types of Investment***
7. ***Nature of Operations***
8. ***Financial Reporting Framework***
9. ***Selection & Application of Accounting Policies***
10. ***Financial Performance***
11. ***Objectives***

QNO 315.08	Understanding Entity & its Environment – Examples of types of understanding to be obtained #Unique	Old Course -- (M20R) New Course -- (M20R)
	"Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples."	

Answer

- **Examples are:**
  - The competitive environment, including demand, capacity, product and price competition as well as cyclical or seasonal activity.
  - Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those entities.
  - Technological developments, such as those related to the entity's products, energy supply and cost.
  - The effect of regulation on entity operations.

QNO 315.09	Need for Understanding Entity & its Environment	Old Course -- (S17M/M20R/S20M) New Course -- (M20R)
	The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed.	

	OR **"Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples."**
Answer	➢ Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and Analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when: (M-ain AREAS) ∀ M- **Determining materiality** in accordance with SA 320; ∀ A-Considering the **appropriateness of the selection and application of accounting policies;** ∀ **R-Assessing risks** of material misstatement of the financial statements; ∀ E-Evaluating the **sufficiency and appropriateness of audit evidence** obtained, such as the appropriateness of assumptions and of management's oral and written representations. ∀ **A-Developing expectations for use** when performing **analytical procedures**; ∀ S-Identifying areas where **special audit consideration** may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions; ➢ Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The auditor should proceed accordingly.

QNO 315.11	**Risk of Material Misstatement- Definition & Components**	**New Course -- (S17M/ S20M/S21M)**
	Define Risk of material misstatement. Explain its components also. **OR** **Risk of material misstatement consists of two components Explain clearly defining risk of material misstatement**	
Answer	➢ **Risk of Material Misstatement** ∀ ***Definition*** The risk that the financial statements are materially misstated prior to audit. ∀ ***Components*** As per SA 200, the risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. The nature of each of these types of risk and their interrelationship is discussed below ➢ **Inherent Risk** ∀ ***Definition*** The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements before **consideration of any related controls.** *(E.g. Retail, Jewellery, Telecom)* ➢ **Control Risk** ∀ ***Definition*** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, **will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.**	

QNO 315.13	Combined assessment of the "risks of material misstatement	New Course -- (S17M/N19R/ S20M/S21M)
	The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain.	

Answer

- **Combined Vs Separate Assessment**
  - The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.
  - The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms.
  - In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

    (In big assignments go for separate analysis, further if auditor is relying extensively on test of controls then separate analysis id preferred)
  - It can be concluded from the above that-

    Risk of Material Misstatement= Inherent Risk x Control Risk

QNO 315.15	Identify & Assess Risk of Material Misstatement	New Course -- (N18M/N20R)
	The auditor shall identify and assess the risks of material misstatement at both levels to provide a basis for designing and performing further audit procedures. For the purpose of Identifying and assessing the risks of material misstatement the auditor shall Identify risks, assess the identified risks, relate the identified risks and consider the likelihood of misstatement. Explain the above in detail.	

Answer

- **Levels of Risk**

  The auditor shall **identify and assess** the risks of material misstatement at:
  - **The financial statement level**; and
  - The **assertion level** for classes of transactions, account balances, and disclosures; to provide a basis for designing and performing further audit procedures.
- **For this purpose, the auditor shall follow the following steps:**
  - **Identify risks throughout the process** of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements; ***(Har information collect karne ke baad risk ke baarein mein sochtein raho)***
  - Relate the **identified risks to what can go wrong at the assertion level, taking account of relevant controls** that the auditor intends to test; and ***(Kahi assertion level pet oh nahi)***
  - Assess the identified risks, and evaluate whether they relate more **pervasively to the financial statements as a whole and potentially affect many assertions**; ***(Ya financial statement level pet oh nahi)***
  - Consider the **likelihood of misstatement**, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. ***(Badi risk toh nahi hai, with big amount and more probability)***

QNO 315.16	Assertions-Brief	Old Course -- (M20R) New Course -- (M20R)
	"Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit."	

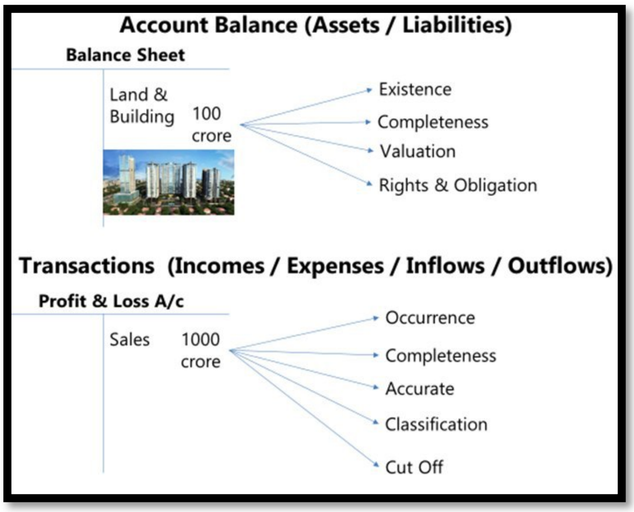
Answer

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

	➢ A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures. ➢ In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding: ∀ completeness. ∀ cut-off. ∀ existence/ occurrence. ∀ valuation/ measurement. ∀ rights and obligations; and ∀ presentation and disclosure of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. ➢ **Example** If Company X's balance sheet shows building with carrying amount of Rs 50 lakh, the auditor shall assume that the management has claimed/ asserted that: ∀ The building recognized in the balance sheet exists as at the period- end (existence assertion); ∀ Company X owns and controls such building (Rights and obligations assertion); ∀ The building has been valued accurately in accordance with the measurement principles (Valuation assertion); ∀ All buildings owned and controlled by Company X are included within the carrying amount of Rs 50 lakh (Completeness assertion).
	Author's Note This is a brief answer for assertions. Use this answer if they talk about all the assertions and the marks allocated are 3-4

QNO 315.17	Assertions-Detailed	Old Course -- (P16M /M16M/N16R/ N17M/N17R /N17E/M18M/N18M/N18R/M19R M20R) New Course – (M20R)
	What are the various assertions an auditor is concerned with while obtaining audit evidence from substantive procedure? **OR** **Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered. Explain stating the different categories of assertions used by the auditor.** **OR** **In the context of SA-3l5, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit.** **OR** **Assertions used by auditor to consider potential misstatements about presentation and disclosure at the period end.** **OR** **Assertions used by auditor to consider potential misstatements about presentation and disclosure at the period end.** **OR** **What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory.**	
Answer	➢ **Risk of Material Misstatement at the Assertion Level:** ∀ According to SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. ∀ In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may	

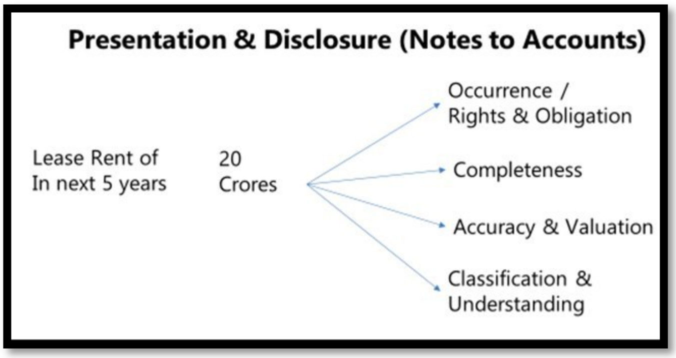
take the following forms –



- **Assertions about classes of transactions and events for the period under audit:**
  - o **Occurrence**—transactions and events that have been recorded have occurred and pertain to the entity.
  - o **Completeness**—all transactions and events that should have been recorded have been recorded.
  - o **Accuracy**—amounts and other data relating to recorded transactions and events have been recorded appropriately.
  - o **Cut-off**—transactions and events have been recorded in the correct accounting period.
  - o **Classification**—transactions and events have been recorded in the proper accounts.

- **Assertions about account balances at the period end:**
  - o **Existence**—assets, liabilities, and equity interests exist.
  - o **Rights and obligations**—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
  - o **Completeness**—all assets, liabilities and equity interests that should have been recorded have been recorded.
  - o **Valuation and allocation**—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
    - **Example of Valuation and allocation**
      - ▪ Inventory has been recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories.
      - ▪ Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory.
      - ▪ An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

- **Assertions about presentation and disclosure:**



  - o **Occurrence and rights and obligations**—disclosed events, transactions, and other matters have occurred and pertain to the entity.
  - o **Completeness**—all disclosures that should have been included in the financial statements have been included.

	o **Classification and understandability**—financial information is appropriately presented and described, and disclosures are clearly expressed. o **Accuracy and valuation**—financial and other information are disclosed fairly and at appropriate amounts.
	Author's Note **This is a master answer for Assertions. Students are required to write the appropriate part as per the requirements of the question. For example student may be asked about one particular assertion, student should write that only in the answer.**

QNO 315.19	Identifying Assertion for Audit Procedure-Cases #Unique	Old Course -- (N20R/M21M) New Course -- (M18E/M21M)
	Name the assertions for the following audit procedures: **1. The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.** **2. Depreciation has been properly charged on all assets.** **3. Year-end inventory verification** **4. All liabilities are properly recorded in the financial statements.** **5. Related party transactions are shown properly.**	
Answer		

1. The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company	**Rights and Obligations Assertions**
2. Depreciation has been properly charged on all assets	**Valuation Assertions**
3. Year-end inventory verification	**Existence Assertions**
4. All liabilities are properly recorded in the **financial** statements	**Completeness**
5. Related party transactions are shown properly	**Presentation and Disclosure**

QNO 315.23	Identifying Assertions of financial item (P&M)	Old Course -- (N18E/M21M) New Course -- (M19M/M21M)

"Assertions in the following case:

Particulars	Amount(Rs.)	Amount(Rs.)
Plant and Machinery (at cost)	2,00,000	
Less: Depreciation till the end of previous year	70,000	
Depreciation for the year	13,000	
	83,000	
	1,17,000"	

OR

State assertions that are implied in the extract of financial statement given below: (Rs.)

Plant & Machinery (at Cost)		400,000
Less: Depreciation: Up to Previous year	1,40,000	
For the year	26,000	1,66,000
		2,34,000

(i) Indicate assertions in respect of transactions and events for the period relating to Fixed Assets.
(ii) State specific assertions relating to the above extract of financial statement.

Answer

➢ **Assertions about classes of transactions and events for the period under audit:**
- **Occurrence**—transactions and events that have been recorded have occurred and pertain to the entity.
- **Completeness**—all transactions and events that should have been recorded have been recorded.
- **Accuracy**—amounts and other data relating to recorded transactions and events have been recorded appropriately.
- **Cut-off**—transactions and events have been recorded in the correct accounting period.

- **Classification**—transactions and events have been recorded in the proper accounts.

➢ **The specific assertions are as follows:**
- the firm owns the plant and machinery;
- the historical cost of plant and machinery is Rs. 4 lacs;
- the plant and machinery physically exists;
- the asset is being utilised in the business of the company productively;
- total charge of depreciation on this asset is Rs. 1,66,000 to date on which Rs. 26,000 relates to the year in respect of which the accounts are drawn up; and
- the amount of depreciation has been calculated on recognised basis and the calculation is correct

QNO 315.25	Significant Risk	Old Course -- (P16M/N17M/M17R/M18R/N18R/N19R/N21R) New Course – (N21R)

The auditor may exercise his judgement to identify which risks are significant risks. Explain the above in context of SA-315.

OR

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor. Explain the above in context of SA-315.

Answer

➢ **Identification of Significant Risks:**
- SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.
- As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, **a significant risk.** In exercising this judgment, **the auditor shall exclude the effects of identified controls related to the risk.**
- In exercising judgment, as to which risks are significant risks, the auditor shall consider at least the following:
  (CFO-CSR)
  - Whether the risk is related to recent significant economic, accounting, or other developments like **Changes** in regulatory environment, etc., and, therefore, requires specific attention
  - Whether the risk is a risk of **Fraud**;
  - Whether the risk involves significant transactions that are **Outside the normal course of business** for the entity, or that otherwise appear to be unusual.
  - The **Complexity** of transactions;
  - The degree of **Subjectivity** in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
  - Whether the risk involves significant transactions with **Related parties**;
  - When the auditor has determined that a **significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.**

Author's Note

Shortcut to remember- (CFO-CSR)

QNO 315.26	Risk of Material Misstatement due to Non Routine Transactions & Significant Judgemental Matters leads to Significant Risk	Old Course -- (N21R) New Course –(N21R)

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental

	matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail.
Answer	**Risks of Material Misstatement– Greater for Significant Non-Routine Transactions** Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following: ➢ Greater management intervention to specify the accounting treatment. ➢ Greater manual intervention for data collection and processing. ➢ Complex calculations or accounting principles. ➢ The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks. **Risks of material misstatement– Greater for Significant Judgmental Matters** Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following: ➢ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation. ➢ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

QNO 315.27	Internal Controls Definition ,Objectives & Purpose	Old Course -- (M16R/M20R) New Course -- (M20R/S20M/S21M)
	Explain the concept of Internal Control. Also state the objectives of Internal Control. **OR** **"Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control."**	
Answer	➢ **Internal Control:** As per SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" the internal control may be defined as "the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control." ➢ **Objectives of Internal Control:** ∇ ***Assets*** • assets are safeguarded from unauthorized access, use or disposition; and • the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences. ∇ ***Operations*** • transactions are executed in accordance with managements general or specific authorization; • Transactions are efficient & effective ∇ ***Law Compliance*** • Rules & Regulations are followed while executing transactions ∇ ***Financial Reporting*** • all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;	

QNO 315.29	Benefits of Understanding of Internal Controls	Old Course -- (M21R) New Course -- (S17M/M21R)
	Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard.	

Answer

- **Understanding Entity's Internal Control**
  The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

- **Benefits of Understanding of Internal Control**
  An understanding of internal control assists the auditor in:
  - identifying types of potential misstatements;
  - identifying factors that affect the risks of material misstatement, and
  - designing the nature, timing, and extent of further audit procedures. The auditor shall obtain an understanding of internal control relevant to the audit.

- **Not all Controls are relevant:**
  Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

TRUE AND FALSE

TNO- SA 315 - 1	
	Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
Answer	**Incorrect**
	Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls

TNO- SA 315 – 2	
	There is no relation between Inherent risk, Control risk and Detection risk.
Answer	**Incorrect**
	There is an inverse relationship between detection risks and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.

TNO- SA 315 - 3	
	The assessment of risks is a matter capable of precise measurement
Answer	**Incorrect**
	The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement

TNO- SA 315- 5	
	The SAs ordinarily refer to inherent risk and control risk separately
Answer	**Incorrect**
	The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made

TNO- SA 315 - 8	
	'Significant Risk' is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.
Answer	**Correct**
	SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

TNO- SA 315 - 9	
	When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk.
Answer	**Incorrect**
	When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

TNO- SA 315 - 10	
	The use of computer facilities by a small enterprise may increase the control risk.
Answer	**Correct**
	Many controls which would be relevant to large entities are not practical in the small business. For example, in case of small business using computer facilities, accounting work may not be segregated and be performed by only a few persons. These persons may have both operating and custodial responsibilities, and segregation of functions may be missing or severely limited thereby increasing the control risk.

TNO- SA 315 - 11	
	Inherent risk is the susceptibility of an account balance or class of transactions to misstatement assuming that there were no related internal controls.
Answer	**Correct**
	Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

TNO- SA 315 - 12	
	If Company X's balance sheet shows building with carrying amount of Rs 100 lakh, the auditor shall assume that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.

Answer	**Incorrect**
	If Company X's balance sheet shows building with carrying amount of Rs. 100 lakhs, the auditor shall assume that the management has claimed/ asserted that: • The building recognized in the balance sheet exists as at the period- end (existence assertion); • Company X owns and controls such building (Rights and obligations assertion); • The building has been valued accurately in accordance with the measurement principles (Valuation assertion); All buildings owned and controlled by Company X are included within the carrying amount of Rs 100 lakh (Completeness assertion).

TNO- SA 315 - 13	
	Risk of material misstatement may be defined as the risk that the financial statements are materially misstated subsequent to audit.
Answer	**Incorrect**
	Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit.

TNO- SA 315 - 14	
	For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion.
Answer	**Incorrect**
	The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion

TNO- SA 315 - 15	
	Risk assessment procedures are not performed to obtain an understanding of the entity and its environment
Answer	**Incorrect:**
	Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

TNO-SA-315-16	
	Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.
Answer	**Incorrect**
	Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

TNO-SA-315-17	
	Information obtained by performing risk assessment procedures shall not be used by the auditor as audit evidence to support assessments of the risks of material misstatement.
Answer	**Incorrect**
	Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement.

TNO-SA-315-18	
	During the assessment of Internal Controls , if the auditor can test Compensating controls , he should obtain evidence of other mitigating factors.
Answer	**Incorrect**
	If the auditor can test Compensating controls, he should obtain additional evidence that may be required. Obtaining evidence of other mitigating factors is required when he can't test compensating controls during his assessment of the Internal Controls.

TNO-SA-315-19	
	Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates.
Answer	**Correct**
	Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Thus, judgmental matters are not always unusual due to their size or nature.

QNO ICS.01	Purpose of Internal Control	Old Course -- (M19R) New Course – Relevant, Concept Covered in New Course SM
	Explain the purpose of Internal Control.	
Answer	➢ **Purpose of Internal Control:** Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern- ∀ Safeguarding of assets. ∀ The effectiveness and efficiency of its operations; ∀ Its compliance with applicable laws and regulations; and ∀ The reliability of the entity's financial reporting;	

QNO ICS.03	Control Environment, Its Elements and Components	Old Course -- (M19E/N19R/M20M/N20M) New Course -- (S17M/M19M/N19R/M20M/N20M/S20M/S21M)
	The auditor of XYZ Ltd, engaged in FMCG (Fast Moving Consumable Goods) obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether: **(i) Management has created and maintained a culture of honesty and ethical behaviour; and** **(ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.** **Advise what is included in control environment. Also explain the elements of control environment.** **OR** **The auditor shall obtain an understanding of the control environment Explain stating what is included in control environment.** **OR** **The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behaviour and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.** **Advise what is included in control environment. Also explain the elements of control environment.** **OR** **"The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control."** **OR** **"The auditor of MARUT Ltd, engaged in manufacturing of Smart Motor Bikes, obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:** **(i) Management has created and maintained a culture of honesty and ethical behaviour; and** **(ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.** **Advise what is included in control environment. Also explain the elements of control environment."**	
Answer	➢ **Control Environment:** ∀ **Component of Internal Control:** The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether: • Management has created and maintained a culture of honesty and ethical behavior; and • The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control. ➢ **What is included in Control Environment?** The control environment includes: ∀ the governance and management functions and ∀ the attitudes, awareness, and actions of those charged with governance and management.	

- The control environment sets the tone of an organization, influencing the control consciousness of its people.

- **Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:**
  - **TCWG Related**
    - Participation by those charged with governance – Attributes of those charged with governance such as:
      - Their **independence** from management.
      - Their **experience** and **stature** *(Reputation)*.
      - The **extent of their involvement** and the information they receive, and the scrutiny of activities.
      - The appropriateness of their actions, including the degree to which **difficult questions** are raised and pursued with management, and their interaction with internal and external auditors.
  - **Management Related**

    Management's philosophy and operating style – Characteristics such as management's:
    - Approach to taking and **managing business risks**.
    - Attitudes toward **information processing and accounting functions** and personnel.
    - Attitudes and actions toward **financial reporting**.
  - **Human Resource**

    Human resource policies and practices – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.
  - **Competence:**

    Commitment to competence – Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
  - **Organisational structure**

    Organisational structure – The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
  - **Authority and Responsibility:**

    Assignment of authority and responsibility - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.
  - **Communication:**

    Communication and enforcement of integrity and ethical values – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.

- **Division of Internal Control into Components:**

  The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit t:
  - The control environment;
  - The entity's risk assessment process;
  - Monitoring of controls.
  - Control activities; and
  - The information system, including the related business processes, relevant to financial reporting, and communication;

- **Satisfactory Control Environment - not an absolute deterrent to fraud:**
  - The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, **a satisfactory control environment is not an absolute deterrent to fraud.**
  - Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud.

	∀ For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures. ∀ **The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.**

QNO ICS.05	**Control Environment (Satisfactory) Positive but not absolute deterrent to fraud.**	**Old Course -- (M16R/M17R/M17E/M18R)** **New Course -- (M19R)**
	The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain.	
Answer	➢ Satisfactory Control Environment - not an absolute deterrent to fraud: ∀ The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a **satisfactory control environment is not an absolute deterrent to fraud.** ∀ Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. ∀ ***For example***, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures. ∀ **The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.**	
	Author's Note **Answer is also covered in ICS.03**	

QNO ICS.06	**Internal Control Component - Control Activities**	**Old Course -- (M21R)** **New Course –(M21R)**
	The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. Explain in detail stating clearly the meaning of control activities and also discuss control activities that are relevant to the audit.	
Answer	The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. An audit requires an understanding of **only those control activities** related to **significant class of transactions, account balance, and disclosure** in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. **Control activities that are relevant to the audit are:** • Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or • Those that are considered to be relevant in the judgment of the auditor;	

	• As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

QNO ICS.07	Monitoring of Internal Control over Financial Reporting	Old Course -- (M18E) New Course -- (S17M/N20E /S20M/S21M)
	The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting Explain	

Answer

- The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.
  - **Monitoring of controls Defined:**
    Monitoring of controls is a process to assess the effectiveness of internal control performance over time.
  - **Helps in assessing the effectiveness of controls on a timely basis:**
    It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
  - **Management accomplishes through ongoing activities, separate evaluations etc.:**
    Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
  - **Management's monitoring activities include:**
    Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
  - **In case of Small Entities:**
    Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

QNO ICS.08	Internal Control Component - Understanding Information System	Old Course -- (M21R) New Course –(M21R)
	The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard.	

Answer

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

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

QNO ICS.11	Maintenance of ICS	Old Course -- (P16M) New Course – Relevant, Concept Covered in New Course SM
	Comment on the following statements: **Maintenance of internal control system is responsibility of Statutory Auditor.**	

Answer	➢ **Maintenance of Internal Control System:** It is the responsibility of the management for the maintenance of internal control system rather than of the Auditor. Because internal control is the process designed, implemented and maintained by those charged with governance, management to provide reasonable assurance about the achievement of entity's objectives.

QNO ICS.13	IT Risks #Unique	Old Course -- (M16E/M19R) New Course -- (M16E)
	What are the specific risks related to internal control in an IT environment? **OR** **Which are specific risks to the company's internal control having IT environment?**	

Answer

Risks because of IT Systems

IT system also poses specific risks to an entity's Internal Control. They are–

(First Comes IT Personnel)

- ➢ **IT Personnel gaining access, Privileges beyond necessary**
  - The possibility of **IT personnel gaining access privileges** beyond those necessary to perform their assigned duties thereby breaking down segregation of duties. *(Approved Purchase & Payment)*

(Then comes Data)

- ➢ **Unauthorised Access to Data leading to destruction, unauthorised transaction, non-existent transaction / Potential loss of Data**
  - Unauthorised **access to data** that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
  - **Potential loss of data or inability to access data** as required. *(Ransomware)*

(Then happened processing)

- ➢ **Manual Intervention / Inaccurate Processing / Processing Inaccurate Data**
  - **Inappropriate manual intervention.**
  - Reliance on systems or programs that are **inaccurately processing data, processing inaccurate data**, or both. *(TDS Calculator / NPA Calculator)*

(If required Changes)

- ➢ **Failure to make Changes / Unauthorised changes to systems / Unauthorised changes to Master Files**
  - **Failure** to make necessary **changes to systems or programs**. *(Boss shifted to Office 365, Rest of the office on Office 2007)*
  - Unauthorised **changes to systems or programs.**
  - Unauthorised **changes to data in master files**.

QNO ICS.14	Relevance of Controls for Audit	Old Course -- (M21R/M21E) New Course -- (M21R)
	Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as materiality, the significance of the related risk etc. Explain in detail.	

Answer

Controls Relevant to the Audit: Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

(i) Materiality.
(ii) The significance of the related risk.
(iii) The size of the entity.
(iv) The nature of the entity's business, including its organisation and ownership characteristics.
(v) The diversity and complexity of the entity's operations.
(vi) Applicable legal and regulatory requirements.
(vii) The circumstances and the applicable component of internal control.

	(viii) The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations. (ix) Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

QNO ICS.15	Tools of Review -- Flow Chart	Old Course -- (P16M/M16E) New Course – Relevant, Concept Covered in New Course SM
	Write short note on the use of flowcharts in evaluation of internal control.	
Answer	➢ **Use of flow chart in evaluation of internal control** ∇ **It is a graphic presentation of each part of the company's system** of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. ∇ It minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form. ∇ It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels of goods and materials as well as cash, both inward and outward; and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him understand and evaluate the internal controls in the correct perspective.	

QNO ICS.17	Tools of Review -- Internal Control Questionnaire	Old Course -- (P16M/M16M) New Course – Relevant, Concept Covered in New Course SM
	Explain briefly the technique of Internal Control Questionnaire to facilitate the accumulation of information necessary for proper evaluation of internal control.	
Answer	➢ **Internal Control Questionnaire:** ∇ Internal control questionnaire is a comprehensive series of questions concerning internal control. It is the most widely used form for collecting information about the existence, operation and efficiency of internal control in the organisation. ∇ **The questionnaire is usually issued to the client and the client** is requested to get it filled by the concerned executives and employees. ∇ In the questionnaire, generally questions are so framed that a **'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness.** Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given. ∇ This is a **comprehensive series of questions** concerning internal control. ∇ This is the **most widely used form for collecting information** about the existence, operation and efficiency of internal control in an organisation. ∇ With a proper questionnaire, all internal control evaluation can be **completed at one time or in sections**. ∇ **It** is the general practice to **review the internal control system annually and record the review in detail.** ∇ If on a perusal of the answers, **inconsistencies or apparent incongruities are noticed, the matter is further discussed** by auditor's staff with the client's employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.	

QNO ICS.21	Check List	Old Course -- (M16R) New Course – Relevant, Concept Covered in New Course SM
	What is check list? Give few examples of check list instruction.	
Answer	➢ **Check List** ∇ This is a series of **instructions and/or questions which a member of the auditing staff must follow and/or answer** ∇ When he completes instruction, he initials the space against the instruction. ∇ Answers to the check list instructions are **usually Yes, No or Not Applicable.** This is again an on-the-job requirement and instructions are framed having regard to the desirable elements	

	of control. ➢ **A few examples of check list instructions are given hereunder:** ∀ Are tenders called before placing orders? ∀ Are the purchases made on the basis of a written order? ∀ Is the purchase order form standardised? ∀ Are purchase order forms pre-numbered? ∀ Are the stock control accounts maintained by persons who have nothing to do with: • custody of work; • receipt of stock; • inspection of stock; and • Purchase of stock? The complete check list is studied by the Principal/Manager/Senior to ascertain existence of internal control and evaluate its implementation and efficiency.

QNO ICS.23	Narrative record	Old Course -- (N17E) New Course – Relevant, Concept Covered in New Course SM
	Narrative record	
Answer	➢ **The Narrative Record:** ∀ This is a **complete and exhaustive description** of the system as found in operation by the auditor. ∀ Actual testing and observation are necessary before such a record can be developed. ∀ It may be **recommended in cases where no formal control system** is in operation and would be more suited to small business. ➢ **The basic disadvantages of narrative records are:** ∀ **To comprehend the system in operation is quite difficult.** ∀ **To identify weaknesses or gaps in the system.** ∀ To incorporate **changes arising on account of reshuffling of manpower, etc**	

QNO ICS.25	Narrative record Vs Check List	Old Course -- (N16E) New Course – Relevant, Concept Covered in New Course SM
	What is the difference between Narrative records and Checklist?	
Answer	➢ **Difference between Narrative records and Checklist:** ∀ The Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor whereas checklist is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instructions are usually Yes, No or Not Applicable ∀ The Narrative Record may be recommended in cases where no formal control system is in operation and would be more suited to small business whereas check list is an on-the-job requirement and instructions are framed having regard to the desirable elements of control.	

QNO ICS.27	ICS in Small Business	Old Course -- (P16M/N20R) New Course – Relevant, Concept Covered in New Course SM
	Write a short note on the internal control in small business.	
Answer	➢ **Internal Control in Small Business:** ∀ The auditor needs to obtain the same degree of assurance in order to give an unqualified opinion on the financial statements of both small and large entities. However, many controls which would be relevant to large entities are not practical in the small business e.g., in small business accounting work may be performed by only a few persons. These persons may have both operating and custodial responsibilities, and segregation of functions may be missing or severally limited. ∀ Inadequate segregation of duties may, in some cases, be offset by owner/manager supervisory controls which may exist because of direct personal knowledge of the business and involvement in the business transactions. In circumstances where segregation of duties	

	is limited or evidence of supervisory controls is lacking, the evidence necessary to support the auditors' opinion on the financial information may have to be obtained largely through the performance of substantive procedure.

QNO ICS.29	Inherent Limitations of ICS	Old Course -- (P16M /M16M/N16M/N17R/M18M/N18M/N18R/M19M/M19R) New Course -- (M18E/M19M)
	Briefly discuss the limitations of Internal Control. **OR** **Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. In view of above, briefly state some of the inherent limitations of Internal Control System.** **OR** **Internal Control System can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. Briefly explain the inherent limitations that the system suffers.**	

Answer

- **Internal control can provide only reasonable assurance:**
  Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.

Top Management

- **Judgements by Management:**
  Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Middle Management

- **Lack of understanding the purpose:**
  Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

- **Collusion among People:**
  Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

Lower Management

- **Human judgment in decision-making:**
  Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.

Limitations in case of Small Entities:

- Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.
- On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

QNO ICS.31	Benefits of Evaluation of Internal Controls	Old Course – (M19E) New Course -- (M19R)
	So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor. **OR** **The examination and evaluation of internal control system is an indispensable part of the overall audit programme. State the areas which the 'Review of Internal controls' will enable the auditor to know.**	

Answer

- **Benefits of Evaluation of Internal Control to the Auditor:** The review of internal controls will enable the auditor to know:

  Remember Shortcut:-$A^4R^2IS^2E^2$ for benefits

  - A- whether an **adequate internal control system** is in use and operating as planned by the management;
  - A- whether any **administrative control** has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
  - A- what would be **appropriate audit technique and the audit procedure** in the given circumstances;
  - A- what are the **areas where control is weak and where it is excessive**; and
  - R- how far and how adequately the management is discharging its function in so far as correct **recording of transactions** is concerned;
  - R- how **reliable the reports, records and the certificates** to the management can be;
  - I- whether an effective **internal auditing department** is operating;
  - S- whether the controls adequately **safeguard the assets;**
  - S- whether some worthwhile **suggestions** can be given to improve the control system
  - E-whether **errors and frauds** are likely to be located in the ordinary course of operations of the business;
  - E- the **extent and the depth of the examination** that he needs to carry out in the different areas of accounting;

QNO ICS.33	Benefits of IT Controls #Unique	Old Course -- (M19R) New Course – Relevant, Concept Covered in New Course SM
	Explain how does IT benefits an entity's internal control.	

Answer -**C^2AATS** is good IT system for companies

Generally, IT benefits an entity's internal control by enabling an entity to:

Reduce **the risk that Controls will be circumvented;**	***(frauds may not be aware about hidden systems , so that they cannot circumvent them)***
Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;	***(E.g. Bonus calculation of 10,000 employees)***
Facilitate the Additional analysis of information;	***(average leaves and overtime analysis)***
Enhance the Ability to monitor the performance of the entity's activities and its policies and procedures;	***(Anytime, anywhere access to server)***
Enhance the Timeliness, availability, and accuracy of information	***(Every day at 12pm automatic backup)***
Enhance the ability to achieve effective Segregation of duties by implementing security controls in applications, databases, and operating systems.	***(Id based data and programme access)***

	Author’s Note C^2**AATS** is good IT system for companies

QNO ICS.33.400	**Meaning of IFC in Detail**	**New Course –(N21M)**
	Explain the meaning of internal financial controls as per the Companies Act, 2013. Also explain its objectives	
Answer	**Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as**, “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.” From the above definition, it is clear that **internal financial controls are** the policies and procedures adopted by the company for: 1. ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, 2. the safeguarding of its assets, 3. the prevention and detection of frauds and errors, 4. the accuracy and completeness of the accounting records, and 5. the timely preparation of reliable financial information.”	

QNO ICS.33.500	**Law Related to IFC**	**Old Course -- (N21R)** **New Course –(N21R)**
	Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Explain in detail quoting specifically the Law in the above context covering each and every aspect.	
Answer	Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half -yearly financial statements, unless such reporting is required under any other law or regulation. **Objectives of an auditor in an audit of internal financial controls over financial reporting**: The auditor’s objective in an audit of internal financial controls over financial reporting is, “ **to express an opinion on the effectiveness of the company’s internal financial controls over financial reporting.” It is carried out along with an audit of the financial statements.** **Reporting under Section 143(3)(i)** is dependent on the underlying criteria for internal financial controls over financial reporting adopted by the management. However, any system of internal controls provides only a reasonable assurance on achievement of the objectives for which it has been established. Also, the auditor shall use the concept of materiality in determining the extent of testing such controls. **Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014** requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements. The inclusion of the matters relating to internal financial controls in the directors responsibility statement is in addition to the requirement of the directors stating that they have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.	

QNO ICS.34	IFC Vs IFCR	Old Course -- (N21R) New Course -- (N21R/N20E)
	Explain clearly the difference between Internal Financial Control and Internal Controls over financial reporting.	
Answer	**Internal Financial Control as per Section 134(5)(e)**, "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information." **On the other hand, Internal controls over financial reporting-is required** where auditors are required to express an opinion on the effectiveness of an entity's **internal controls over financial reporting**, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.	

QNO ICS.39	Weakness in ICS (Case Study) #Unique	Old Course -- (P16M/N18R/M19M) New Course – Relevant, Concept Covered in New Course SM
	In a medium size trading organisation the accountant was given additional responsibility of making recoveries from the trade receivables. On one occasion, when an insurance claim of Rs 45,000 was received, he credited the same to the account of a trade receivable and misappropriated the cash which he had recovered from the said trade receivable. Pinpoint weaknesses in the internal control system which led to this situation. Comment.	
Answer	➢ **Weaknesses in the Internal Control System:** Following two essential features of internal control are relevant here- ∀ Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end, and ∀ Segregation of accounting and custodial functions. ➢ **Weakness in internal control system in the instant case-** ∀ The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries. ∀ It also appears that system for issuing receipts for amount received – whether cash or cheque is also lacking. ∀ In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking. Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.	

QNO ICS.41	Formulation of audit programme after satisfactory understanding of the I.C systems and their actual operation #Unique	Old Course -- (N19R) New Course –(N19R)
	The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. Analyse and explain.	
Answer	➢ **Understanding of the internal control systems makes Audit Programme efficient and Effective -** ∀ **Understanding & testing** The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. ∀ **Installation doesn't means operational** Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only	

	partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion if he does not take care. ➢ **Review & Weaknesses of the system** It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed. ➢ **Nature, Timing & Extent depends on Internal Control System** ∀ From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance. ∀ A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme. In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

QNO ICS.43	**Control risk assessment when control deficiencies are identified #Unique**	**Old Course -- (M20R) New Course -- (M20R/ S20M/S21M)**
	"When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain"	
Answer	➢ **Control risk assessment when control deficiencies are identified:** ∀ When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. ∀ When control deficiencies are identified and auditor identifies and tests more than one control for each relevant assertion, he evaluates control risk considering all of the controls he has tested. If auditor determines that they support a 'rely on controls' risk assessment, or if compensating controls are identified, tested and evaluated to be effective, he may conclude that the 'rely on controls' is still appropriate. Otherwise we change our control risk assessment to 'not rely on controls.' ∀ When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls have been identified that mitigate the risk related to the assertion. If the deficiency relates to one WCGW (what can go wrong) out of several WCGW's, he can 'rely on controls' but performs additional substantive procedures to adequately address the risks related to the deficiency.	

TRUE AND FALSE

TNO- ICS -1	
	Check list is a complete and exhaustive description of the system as found in operation by the auditor.
Answer	**Incorrect**
	Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor. On the other hand, a Check List is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer

TNO- ICS -2	
	The term internal audit is defined as the checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud.
Answer	**Incorrect**
	As defined in scope of Standards on Internal Audit, "Internal Audit means an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system ".

TNO- ICS -3	
	A flow chart is a graphic presentation of each point of the company's system of internal control.
Answer	**Correct**
	Flow chart is a graphic presentation of each part of the entity's system of internal control. It minimizes the amount of narrative explanation and thereby achieves a presentation not possible in any other form. It gives bird's eye view of system for suggestion

TNO- ICS -4	
	Internal control can provide absolute assurance.
Answer	**Incorrect**
	Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations.

TNO- ICS -5	
	Internal control questionnaires are a good source of identifying weakness in internal control system.
Answer	**Correct**
	The questionnaire form provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review in detail. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness

TNO- ICS-T-6	
	Maintenance of Internal Control System is the responsibility of the Statutory Auditor
Answer	**Incorrect**
	The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of business. Maintenance of internal control system is responsibility of management because the internal control is process designed, implemented and maintained by those charged with governance/ management to provide reasonable assurance about the achievement of entity's objective.

TNO- ICS-T-7	
	Reliability of manual elements in internal control may be less reliable than automated elements.
Answer	**Correct**
	Hint answer for Nov 20 Exam : Automated controls are computer based hence consistent in application to each and every transaction over the period of time, on the over hand manual controls are based on human beings which may change.