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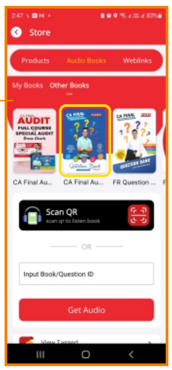

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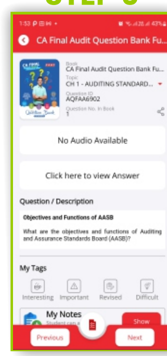

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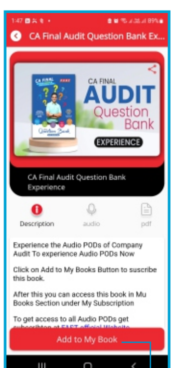

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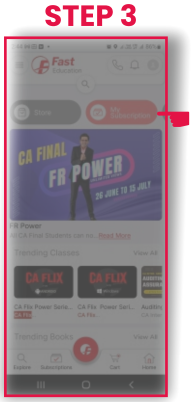

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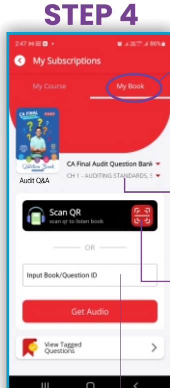

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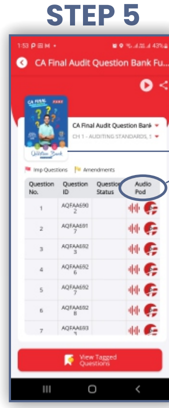

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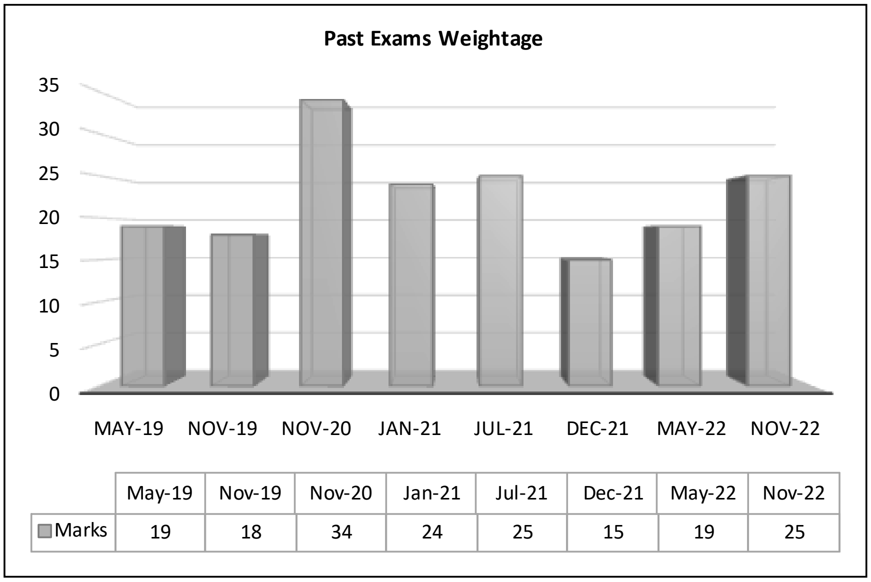
Chapter 1
AUDITING STANDARDS, STATEMENTS AND GUIDANCE NOTES



Topics	Unique Qs	Total Qs
Basics - Engagement & Quality Control Standards : Introduction	5	5
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SA-210 - Agreeing the Terms of Audit Engagements	7	10
SA-220 & SQC 1 - Quality Control for an Audit of Financial Statements & Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements	11	13
SA-230 - Audit Documentation	7	7
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Topics	Unique Qs	Total Qs
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Engagement & Quality Control Standards : Introduction

1. Objectives and Functions of AASB

What are the objectives and functions of Auditing and Assurance Standards Board (AASB)?

Ans. **The following are the objectives and functions of the Auditing and Assurance Standards Board-**

(i) **Review & Development: -** To review the **existing and emerging auditing practices** worldwide and **identify areas** in which Standards on Quality Control, Engagement Standards and Statements on Auditing **need to be developed.**

(ii) **Formulate Engagement Standards: -** Formulate **Standards on Quality Control** and **Statements on Auditing** so that these may be issued under the **authority of the Council** of the Institute.

(iii) **Review & Assessment: -To review the existing Standards** and Statements on Auditing **to assess their relevance in the changed conditions** and to undertake their revision, if necessary.

(iv) **To develop Guidance Notes: -**On issues arising out of **any Standard, auditing issues pertaining to any specific industry** or on generic issues, so that those may be issued under the authority of the Council of the Institute.

(v) **To review the existing Guidance Notes to assess**: -Their relevance in the **changed circumstances** and to undertake their revision, if necessary.

(vi) **To formulate General Clarifications: -** Where necessary, on **issues arising from Standards.**

(vii) **To formulate and issue**: **- Technical Guides, Practice Manuals, Studies** and other papers under its own authority for **guidance of professional accountants** in the cases felt appropriate by the Board.

2. Engagement Standards

Discuss "Standards collectively known as the Engagements Standards issued by AASB under the authority of the council of ICAI".

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Ans.

The following standards issued by the **Auditing and Assurance Standards Board** under the authority of the Council are **collectively known as the Engagement Standards-**

(i) **Standards on Auditing** (SAs), to be applied in the audit of historical financial information.

(ii) **Standards on Review Engagements** (SREs), to be applied in the review of historical financial information.

(iii) **Standards on Assurance Engagements** (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.

(iv) **Standards on Related Services** (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.

3. Compliance with Standards on Auditing by a Non-Profit Organisation

Comment on M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.

Ans.

(i) Preface to Standards on Auditing

- **As per the Preface:-** The **SAs will apply whenever an independent audit is carried out**; that is, in the **independent examination** of financial statements/information of any entity;
- **Whether profit oriented or not** and irrespective of **its size, or legal form** (unless specified otherwise) when such an examination is conducted **with a view to expressing an opinion** thereon.

(ii) Section 143 of the Companies Act, 2013

- **As per section 143(9): -** Every auditor shall **comply with the auditing standards.**
- **As per section 143(10)**: - The **Central Government** may prescribe the **standards of auditing** or **any addendum** thereto, as recommended by the ICAI, constituted under **section 3 of the CA Act, 1949**, in consultation with and after examination of the recommendations made by the NFRA.
- **It is provided** that until **any auditing standards are notified**, any standard, or **standards of auditing specified by the ICAI** shall be deemed to be the auditing standards.

(iii) ICAI / Code of Ethics requirements

- **It is the duty of the Chartered Accountant** to ensure that **SAs are followed in the audit of financial information** covered by their audit reports.

(iv) Conclusion: - In the given case, even though the **client is a non-profit oriented entity** the **SAs shall apply** and the **auditor shall be guilty of professional misconduct** for failing to discharge his duty in case of non-compliance with SAs.

4. Standard on Auditing

In terms of the Preface, name the Standard on Auditing based on the type of assurance, provide also list of Standards with their numerical series.

Ans.

In terms of the Revised Preface, the Auditing and Assurance Standards are now renamed based on the type of assurance provided by the engagement undertaken by a member, viz.,

- **Standards on Auditing (SAs)-** These applies in the audit of historical financial information.
- **Standards on Review Engagements (SREs)-** These applies in the review of historical financial information.
- **Standards on Assurance Engagements (SAEs)-** These applies in assurance engagements, dealing with subject matters other than historical financial information.
- **Standards on Related Services (SRSs)-** These applies to engagements to apply agreed upon procedures to information and other related services engagements such as compilation engagements.

The type of standards and the numerical series are as follows:

Type of Standard	Numerical Series
Standards on Quality Control (SQCs)	01-99
Standards on Auditing (SAs)	100-999
Standards on Review Engagements (SREs)	2000-2699
Standards on Assurance Engagements (SAEs)	3000-3699
Standards on Related Services (SRSs)	4000-4699

5. **"Statements" and "Guidance Notes"** of ICAI- whether mandatory or recommendatory?

Ans. **Statements and Guidance Notes of ICAI –whether Mandatory or Recommendatory:**

(i) **Statements:** The 'Statements' have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. 'Statements' therefore are **mandatory**.

Accordingly, while discharging their attest function, it will be the duty of the members of the Institute to ensure that statements are followed and complied with.

(ii) **Guidance Notes:** 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are **recommendatory** in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

There are, however a **few guidance notes** in case of which the Council has specifically stated that they should be **considered as mandatory on members** while discharging their attest function.

SA – 200
Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

6. **Inherent Limitation of Audit**

Yupee (P) Ltd. got incorporated on 15th May 2021 and Mr. Harsh, the director of Yupee (P) Ltd. proposed to Kamal & Co. on 24th May 2021, for being appointed as its statutory auditor. Mr. Kamal, the sole proprietor of Kamal & Co., after checking the compliance with all the statutory requirements, accepted the said offer and issued an audit engagement letter vide email to Yupee (P) Ltd.

Mr. Harsh found all terms of audit engagement to be proper but in the paragraph relating to auditor's responsibly in the engagement letter, as produced below:-

"We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement."

Certain queries raised in his mind that what does reasonable assurance meant? Which Standard on Auditing requires the auditor to obtain such reasonable assurance? Is it possible to give absolute assurance on such financial statements?

Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above. **(MTP-May-2022)**

Ans.

(i) As per SA 200: - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is required:-

- To obtain **reasonable assurance** about whether the financial statements as a **whole are free from material misstatement**, whether due to fraud or error, thereby enabling the auditor **to express an opinion** on whether the financial statements are prepared, in **all material respects**, in accordance with an applicable financial reporting framework.
- Reasonable assurance is a **high level of assurance** and is **less than absolute assurance**. It is obtained when the auditor has obtained **sufficient appropriate audit evidence to reduce audit risk** (i.e., the risk that the auditor expresses **an inappropriate opinion** when the financial statements are materially misstated) to an acceptably low level.

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

(iii) **The inherent limitations of an audit arise from:**

- The nature of **financial reporting**;
- The nature of **audit procedures;** and
- The need for the audit to be conducted within a **reasonable period of time** and at a **reasonable cost.**

7. **Certain Assertions or Subject Matters where it is Difficult to detect MM due to Potential Effects of Inherent Limitations**

M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2021-2022. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations. **(July-2021-New)**

Ans.

(i) **As per SA 200- "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"** and **as per SQC 1** because of 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 SAs.

Accordingly, the **subsequent discovery of a material misstatement** of the financial statements resulting from **fraud or error** does not by itself indicate a **failure to conduct an audit** in accordance with SAs.

However, the **inherent limitations of an audit are not a justification** for the auditor to be satisfied with **less-than-persuasive audit evidence.**

Whether the **auditor has performed an audit in accordance with SAs** is determined by the audit procedures performed in the circumstances, the **sufficiency and appropriateness** of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

(ii) **Conclusion:- In view of above, it can be concluded** that auditors **did not give correct statement**. In the case of **certain assertions or subject matters**, the potential effects of the **inherent limitations** on the auditor's ability to **detect material misstatements** are particularly significant. **Such assertions or subject matters include:**

(i) **Fraud**, particularly fraud involving senior management or collusion.
(ii) The **existence and completeness** of related party relationships and transactions.
(iii) The **occurrence of non-compliance** with laws and regulations.
(iv) **Future events or conditions** that may cause an entity to cease to continue as a going concern.

8. Auditor's Responsibility to Express an Opinion

"An opinion expressed by the auditor is neither an assurance as to the future viability of the enterprise nor the efficiency or effectiveness with which management has conducted the affairs of the enterprise." Elucidate in light of SA 200.

Ans.

As per SA 200 –"Overall Objectives of the Independent Auditor and Conduct of Audit in accordance with SA", states that in conducting an **audit of financial statements**, the auditor is required to **express an opinion** that whether the **F.S. are prepared, in all material respects**, in accordance with an **applicable FRF**.

- The **opinion expressed** by the auditor is **common to all audits** of financial statements.
- For this **purpose of expressing opinion** he is required to **obtain reasonable assurance** about whether the F.S. as **a whole are free from material misstatement**, whether due to **fraud or error**.
- The term **reasonable assurance** has been defined as **higher level** of assurance but not absolute.
- The **auditor's opinion,** therefore, does not assure, the **future viability of the entity nor the efficiency** or **effectiveness** with which management has conducted the affairs of the entity.

9. Independence of Auditor

Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants. Comment in light of SA 200 whether this would affect auditors independence.

Ans.

(i) Provision: -As per SA 200, **"Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing"**

- In the case of an audit engagement **it is in the public interest** and, therefore, required by the **Code of Ethics**, that the **auditor be independent** of the entity subject to the audit.
- **The Code describes independence** as comprising both **independence of mind** and **independence in appearance**.
- The auditor's independence from the entity **safeguards the auditor's ability** to form an audit opinion **without being affected by influences** that might compromise that opinion.
- **Independence enhances** the auditor's ability to **act with integrity**, to be objective and to maintain an attitude of **professional skepticism.**

(ii) In the instant case: - Mr. Fat has his **office and residence** in the building owned by **Thin Ltd.** who are subject to **audit by Mr. Fat**. Giving **10% concession** in rent may be due to some other reasons other than holding auditorship of Thin Ltd. It may be **due to being very old tenant** or due to office and residence in the same building or Mr. Fat might have carried out major renovation and so on.

(iii) Conclusion: -Thus in the instant case **unless and until there is direct proof**, giving 10% concession in rent **does not affect independence** of the auditor in expressing his opinion on the audit of Thin Ltd.

SJ's Note: *Answer is subjective and alternate view may be taken*

10. Reasonable Assurance & Limited Assurance

List out the key differences between "Reasonable Assurance" and "Limited Assurance" engagements.

(Nov-2018-Old)

OR

Difference of Reasonable assurance engagement from limited assurance engagement. **(May-2018-New)**

Ans. **Key Difference between Reasonable Assurance Engagement and Limited Assurance Engagements :**

Type of Engagement	Objective	Evidence-gathering procedures	The Assurance Report
Reasonable Assurance Engagement	A **reduction in assurance engagement risk** to an **acceptably low level** in the circumstances of the engagement as the basis for a **positive form of expression** of the practitioner's conclusion	• **Sufficient appropriate evidence** is obtained as part of a **systematic engagement process** that includes: • Obtaining an **understanding of the engagement** circumstances; • **Assessing risks;** • **Responding** to assessed risks; • **Performing further procedures using a combination of** inspection, observation, confirmation, recalculation, re-performance, analytical procedures and inquiry. Such further procedures involve substantive procedures, including, where applicable, obtaining corroborating information, and depending on the nature of the subject matter, tests of the operating effectiveness of controls; and • **Evaluating the evidence obtained**	**Description of the engagement circumstances** and a **positive form of expression** of the conclusion
Limited Assurance Engagement	A **reduction in assurance engagement risk** to a level that is **acceptable in the circumstances** of the engagement but where that **risk is greater than for a reasonable assurance engagement**, as the basis for a negative form of expression of the practitioner's conclusion	**Sufficient appropriate evidence** is obtained as part of a **systematic engagement process** that includes **obtaining an understanding of the subject matter** and other **engagement circumstances**, but in which procedures are **deliberately limited** relative to reasonable assurance engagement	Description of the **engagement circumstances**, and a **negative form** of expression of the conclusion

SJ's Note: *Limited assurance related standards and topics are not in course. This question is added for knowledge purpose.*

SA-210
Agreeing the Terms of Audit Engagements

11. **Preconditions for an Audit Engagement**

Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement?**(I**

Ans. **(i)** **Provision: -SA 210 "Agreeing the Terms of Engagement"** deals with the **auditor's responsibilities** in agreeing the **terms of the audit engagement** with management. Before **accepting/ refusing** an audit engagement, to establish whether the **preconditions for an audit are present**, the auditor shall:

(a) Determine whether the **financial reporting framework** to be applied in the preparation of the financial statements is **acceptable**; and

(b) **Obtain the agreement** of management that it **acknowledges and understands** its **responsibilities for followings:**

(1) the **preparation of the F.S.** in accordance with the **applicable FRF.**

(2) **exercising necessary internal control** to enable the preparation of **F.S.** that are **free from material misstatement**, whether due to fraud or error.

(3) **to provide the auditor with:**

- **Access to all relevant information** such as records, documentation and other matters;
- **Additional information** that the auditor may request from management for the purpose of the audit; and
- **Unrestricted access to persons** within the entity from whom the auditor determines it necessary to obtain audit evidence.

(ii) Acceptance of limitation:

- if management or those charged with governance **impose a limitation on the scope** of the auditor's work in the terms of a **proposed audit engagement** such that the auditor believes the limitation will result in the **auditor disclaiming an opinion** on the financial statements, the auditor **shall not accept such a limited engagement** as an audit engagement, **unless required by law or regulation** to do so.
- In addition **if the preconditions for an audit are not present**, the auditor shall discuss the matter with management. **Unless required by law or regulation** to do so, the auditor **shall not accept** the proposed audit engagement.

(iii) Conclusion: -In the instant case, **Mr. Ram should not accept the appointment** as statutory auditor of XYZ Private Limited due to limitation imposed on his scope of work.

12. Limitations Imposed by Management

Director (Finance) of KK Ltd. informed their newly appointed statutory auditor that they have sound Internal control system implemented by a renowned professional firm and he is satisfied with its effectiveness and functioning and therefore, the statutory auditor should concentrate on verifying only the routine books and financial statements. What further action should auditor take?

Ans.

(i) As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing",

- The purpose of an audit is to **enhance the degree of confidence** of intended users in the financial statements. This is achieved by the **expression of an opinion** by the auditor on whether the financial statements are prepared, in **all material respects**, in accordance with an **applicable financial reporting framework**.
- **In the case of most general purpose frameworks**: **-** That opinion is on **whether the financial statements** are presented **fairly, in all material respects**, or **give a true and fair view** in accordance with the framework.

(ii) Terms of Engagement & Limitation on Terms

- The **scope of an audit of financial statements** will be determined by the auditor for having regard to the **terms of the engagement**, the requirement of relevant legislation and the pronouncements of the Institute.
- The **terms** of engagement **cannot, however, restrict the scope** of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.

(iii) Limitation imposed by Management

- **In the instant case -**management has **no right to guide and place any restriction** on the work of the **auditor** as it would amount to **restriction on the scope of the audit.**
- **The auditor should ask the management - Not to impose such restriction** on his scope of the audit that **impairs his ability to examine** and **express an opinion** and
- If the management **does not agrees**, he should issue a **qualified opinion** or **disclaimer, as appropriate.**

13. **Agreement on Audit Engagement Terms: Content**

AKJ Ltd. is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors.

The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter? **(Study Material)(MTP-May-2019)**

Ans.

- **As per SA 210 Agreeing the Terms of Audit Engagements**: **-** The auditor shall agree the terms of the audit engagement with **management** or **TCWG**.
- The agreed terms of the audit engagement **shall be recorded in an audit engagement letter** or **other suitable form** of written agreement and shall include:
  - (i) The **objective and scope** of the audit of the financial statements;
  - (ii) The **responsibilities of the auditor;**
  - (iii) The **responsibilities of management;**
  - (iv) Identification of the **applicable financial reporting framework** for the preparation of the financial statements; and
  - (v) **Reference to the expected form and content** of any reports to be issued by the auditor and a statement that there may be circumstances **in which a report may differ** from its expected form and content.

14. **Audit Engagement Terms : Missing Content**

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2021-22. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited? **(RTP-Nov-2020)(MTP-Dec-2021)**

Ans.

(i) **As per SA 210, "Agreeing the Terms of Audit Engagements"**:

- The auditor shall agree the **terms of the audit engagement** with management or those charged with governance, as appropriate.
- Subject **to prescribed details under Law or Regulations**, the agreed terms of the audit engagement shall be recorded in an **audit engagement letter** or **other suitable form of written agreement** and **shall include:**
  - (a) The **objective and scope** of the audit of the financial statements;
  - (b) The **responsibilities of the auditor;**
  - (c) The **responsibilities of management;**
  - (d) Identification of the **applicable financial reporting framework** for the preparation of the financial statements; and
  - (e) **Reference to the expected form and content** of any reports to be issued by the auditor and a statement that there may be circumstances **in which a report may differ** from its expected form and content..

(ii) In the given scenario: - MEA Limited appointed **Mr. X, Mr. Y and Mr. Z**, as its **joint auditors** for the year 2019-20 and issued engagement letter to all of them. **The engagement letter contains** the details on **objective and scope of audit**, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors.

(iii) Conclusion: -In the given case engagement letter issued by MEA Ltd. **does not specify the responsibilities of management**, whereas as per **SA 210,** it should also specify **responsibilities of management.**

15. New Audit Engagement Letter

'P' an auditor decides not to send a new audit engagement letter to G Ltd. every year. Whether he is right in his approach? State the circumstances where sending new engagement letter, would be appropriate. **(Nov-2015)**

Ans.

(i) As per SA 210, "Agreeing the Terms of Audit Engagements"

- **On recurring audits**: - The auditor shall assess **whether circumstances require the terms of the audit engagement to be revised** and
- Whether there is a **need to remind the entity** of the existing terms of the audit engagement.
- **It is not necessary to issue audit engagement letter each year** for repetitive audit. It is enough if the same had been issued **at the time of taking initial engagement**.
- **Therefore**, **Mr. P is right in his approach.**

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

(i) Any indication that the entity **misunderstands the objective and scope** of the audit.
(ii) **Any revised or special terms** of the audit engagement.
(iii) A recent change of **senior management**.
(iv) A significant change in **ownership.**
(v) A significant change in **nature or size of the entity's business.**
(vi) A change in **legal or regulatory requirements**.
(vii) A change in the **financial reporting framework** adopted in the preparation of the financial statements.
(viii) A change in **other reporting requirements.**

16. Circumstances that may Warrant the Revision in Terms of Engagement

T & Co, firm of Chartered Accountants has not revised the terms of engagements & obtained confirmation from clients for last 5 years despite changes in business & professional environment. Please elucidate circumstances that may warrant the revision in terms of engagement. **(Nov-2020-Old)**

OR

Comment on the following: "It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter." Explain those situations where new engagement letter is to be sent.

Ans.

As per SA 210 on **"Agreeing the Terms of Audit Engagements"**

- The auditor may decide **not to send a new audit engagement letter** or **other written agreement** each period.
- **However, the following factors** may make it **appropriate to revise** the **terms of the audit engagement or to remind the entity of existing terms:**
  (i) Any indication that the entity **misunderstands the objective and scope** of the audit.
  (ii) **Any revised or special terms** of the audit engagement.
  (iii) A recent change of **senior management.**
  (iv) A significant change in **ownership.**
  (v) A significant change in **nature or size of the entity's business.**
  (vi) A change in **legal or regulatory requirements**.

(vii) A change in the **financial reporting framework** adopted in the preparation of the financial statements.

(viii) A change in **other reporting requirements.**

17. **Acceptance of a Change in Engagement**

As an auditor, how would you consider the acceptance of a change in audit engagement? **(May-2018-Old)**

OR

X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.

OR

"An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss.

Ans. **As per SA 210 "Agreeing the Terms of Engagement"**

- If prior to **completing the audit engagement**, the auditor is **requested to change the audit engagement** to an engagement that conveys a **lower level of assurance**, The auditor shall determine **whether there is reasonable justification for doing so.**
- The auditor shall **not agree to a change** in the terms of the **audit engagement** where there is **no reasonable justification** for doing so.
- **If the terms of the audit engagement are changed**, the auditor and management shall **agree on and record the new terms** of the engagement in an engagement letter or other suitable form of written agreement.
- If the auditor is **unable to agree to a change of the terms** of the audit engagement and is **not permitted by management to continue** the original audit engagement, the auditor shall:
  - ➢ **Withdraw** from the audit engagement where **possible under applicable law** or **regulation**; and
  - ➢ **Determine** whether there is **any obligation, either contractual or otherwise**, to report the circumstances to other parties, such as TCWG, owners or regulators.

SA -220 Quality Control for an Audit of Financial Statements & SQC-1 Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

18. **Information assist in Accepting and Continuing of relationship with Client**

Ace Limited (manufacturer of textile goods) got an order of manufacturing of PPE kits in December 2020. But there was shortage of machinery and manpower to accomplish the ordered requirement of PPE kits. Ace Ltd. approached another manufacturing unit Jack Limited for purchase of the unit. Jack Limited was interested in the sale of unit, so the deal went through and Ace Limited acquired ninety five percent shares of Jack Limited. The new management of Jack Limited proposed and appointed NKB Associates, Chartered Accountants, (already auditors of Ace Limited) as new auditors of Jack Limited. NKB Associates accepted the assignment without considering information whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. Comment with respect to appropriate Standard on Auditing what type of information assists the engagements partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate or not? **(Dec-2021-Old)**

OR

Mention any four information which assists the auditor in accepting and continuing of relationship with the client as per SA 220 **(May-2015)**

Ans. **Acceptance and Continuance of Client Relationships and Audit Engagements :**

As per SA 220 - "Quality Control for an Audit of Financial Statements" & SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and

Related Services Engagements"

- The auditor should obtain **information considered necessary** in the circumstances **before accepting an engagement** with a **new client**, when deciding whether to **continue an existing engagement** and When **considering acceptance of a new engagement** with an existing client.
- **Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate::**
  - (i) The **integrity of the principal owners**, key management and those charged with governance of the entity;
  - (ii) Whether the **engagement team is competent to perform** the audit engagement and has the necessary **capabilities**, including **time and resources;**
  - (iii) Whether the firm and the engagement team can **comply with relevant ethical requirements**; and
  - (iv) **Significant matters that have arisen** during the current or previous audit engagement, and their implications for continuing the relationship.

19. **Considerations as to Integrity of Clients**

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

OR

BSS & Associates is a partnership firm of Chartered Accountants which was established five years back. The firm was offering only advisory services at the beginning, however, after audit rotation and advent of GST, firm sees lot of potential in these areas also and started looking for opportunities in these areas also. These services being assurance in nature, the firm required some internal restructuring and set up some policies and procedures for compliance year on year.

The firm started getting new clients for these new services and is now looking to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, it has been setting up a process to document how the issues were resolved.

The firm is now looking to work with only select clients which are in line with the policies of the firm. The firm understands that the extent of knowledge it will have regarding the integrity of a client will grow within the context of an ongoing relationship with that client. With regard to the integrity of a client, you are required to give some examples of the matters to be considered by the firm as per the requirements of SQC1.

(RTP-May-2019)

Ans. **As per SQC 1**, the firm should obtain **such information as it considers necessary** in the circumstances before **accepting an engagement** with a new client, when deciding whether to **continue an existing engagement**, and when considering **acceptance of a new engagement** with an existing client.

Where **issues have been identified**, and the firm decides to **accept or continue** the client relationship or a **specific engagement**, it should document how the issues were resolved.

With regard to the integrity of a client, matters that the firm considers include, for example:

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

b) The **nature of the client's operations**, including its business practices.

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

d) Whether the client is aggressively concerned with maintaining the **firm's fees as low as possible**.

e) Indications of **an inappropriate limitation** in the scope of work.

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

g) The **reasons for the proposed appointment** of the firm and **non-reappointment of the previous firm.**

The extent of knowledge a firm will have **regarding the integrity of a client** will generally grow within the context of an **ongoing relationship** with that client.

20. **Relying on Work Performed by Another Partner**

M/s Suresh Chandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2021-22. CA. Suresh, one of the partners of M/s Suresh Chandra & Co., completed entire routine audit work by 29 th May, 2022. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA. Chandra, another partner of M/s Suresh Chandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA. Suresh. State with reasons whether CA. Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor. **(MTP-May-2018)**

Ans.

(i) As per SA 220, "Quality Control for an Audit of Financial Statements":

The engagement partner shall take **responsibility for reviews** being performed in accordance with the **firm's review policies and procedures**. Review procedures **consists of the considerations, whether,**

1. The work has been performed in accordance with **professional standards and regulatory and legal requirements;**
2. **Significant matters** have been raised for further consideration;
3. **Appropriate consultations** have taken place and the resulting conclusions have been documented and implemented;
4. The work **performed supports the conclusions reached** and is appropriately documented;
5. The **evidence obtained is sufficient and appropriate** to support the auditor's report; and
6. The **objectives of the engagement procedures** have been achieved.

(ii) Using work performed by other

- When the auditor **delegates work to assistants** or **uses work performed by other auditors/experts** he will continue to be **responsible for forming and expressing** his opinion on the financial statements.
- However, **he will be entitled to rely on the work performed by others**, provided he exercises **adequate skill** and **care** and is not aware of any reason to believe that he should not have so relied.
- The auditor should carefully **direct, supervise** and **review work delegated** to assistants.
- He **should obtain reasonable assurance** that work performed by other auditors/experts and assistants is adequate for his purpose.

(iii) In the instant case: - Mr. Suresh, a partner of the **firm had completed routine audit work** and **died before signing** audit report. Mr. Chandra another **partner of the firm has signed the accounts** of SC Ltd, relying on the work performed by Mr. Suresh.

(iv) Conclusion:- CA. Chandra is **allowed to sign the audit report**, though, will be **responsible for expressing the opinion.** He may rely on the work performed by **CA. Suresh** provided **he further exercises adequate skill and due care** and **review** the work performed by him.

21. Determination of Review Responsibility of EP

J.A.C.K. & Co., a Chartered Accountant firm was appointed as the statutory auditor of Falcon Ltd. after ensuring the compliance with relevant provisions of the Companies Act, 2013. Mr. Jay was the engagement partner for the aforesaid audit and prior to commencement of the audit, Mr. Jay had called for a meeting of the engagement team in order to direct them and assign them their responsibilities. At the end of meeting, Mr. Jay assigned review responsibilities to two of the engagement team members who were the most experienced amongst all, for reviewing the work performed by the less experienced team members. While reviewing the work performed by the less experienced members of the engagement team, what shall be the considerations of the reviewers? **(MTP-May-2021)**

Ans.

(i) As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements":

- **Review responsibilities** are determined on the basis that **more experienced team members**, including the **engagement partner**, review work performed by **less experienced team members.**

(ii) In the given situation: - Mr. Jay, engagement partner **assigned review responsibilities** to two of the **engagement team members** who were the most experienced team members.

(iii) While **reviewing the work performed** by **less experienced members** of the engagement team, **both the more experienced Reviewers** should consider whether:

1. The work has been performed in accordance with **professional standards and regulatory** and **legal requirements**.
2. Significant **matters** have been raised for further consideration.
3. Appropriate **consultations** have taken place and the resulting conclusions have been documented and implemented.
4. There is a need to revise the **nature, timing and extent** of work performed.
5. The work performed **supports the conclusions reached** and is appropriately documented.
6. The evidence obtained is **sufficient and appropriate to support the report**; and
7. The **objectives of the engagement procedures** have been achieved.

22. Reviewing the Work Performed by Assistant

"The work performed by each assistant needs to be reviewed by personnel of at least equal competence."

Ans.

(i) Responsibility of EP under SQC-1:

- Under SQC 1, the **firm's review responsibility** policies and procedures are determined on the basis that **work of less experienced team members is reviewed by more experienced team members.**
- However, it has placed the **final responsibility** of review of audit engagement on **engagement partner.**

(ii) EP Definition and Responsibility to Review:

- **As** per **SA 220** "Quality Control for an Audit of Financial Statements", "**Engagement partner**" is :
  - ➢ the **partner or other person in the firm** who is a **member of the ICAI** and
  - ➢ is in **full time practice** and
  - ➢ is responsible for the **engagement and its performance**, and
  - ➢ for the report that is **issued on behalf of the firm**, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
- **Reviews at appropriate stages**: **-** During the audit engagement **allow significant matters to be** resolved **on a timely basis**, to the engagement partner's satisfaction **on or before** the date of the auditor's report.

(iii) Review Objectives: -The **engagement partner** shall ensure that **reviews being performed** are in accordance with the **firm's review policies and procedures**. A review consists of consideration whether, **for example:**

1. The work has been performed in accordance with **professional standards and regulatory and legal** requirements;
2. **Significant matters** have been raised for further consideration;
3. **Appropriate consultations** have taken place and the resulting conclusions have been documented and implemented;
4. There is a need to **revise the nature, timing and extent** of work performed;
5. The work performed **supports the conclusions reached** and is appropriately **documented**;
6. The evidence obtained is **sufficient and appropriate** to support the **auditor's report;** and
7. The **objectives of the engagement procedures** have been achieved.

23. Difference of Opinion/Limitation on Auditor:

You are an audit senior working for the firm Bohra & Company. You are currently carrying out the audit of Wisdom Ltd., a manufacturer of waste paper bins. You are unhappy with Wisdom Ltd.'s inventory valuation policy and have raised the issue several times with the audit manager. He has dealt with the client for a number of years and does not see what you are making an objection about. He has refused to meet you on site to discuss those issues. As the audit manager had dealt with Wisdom Ltd. for so many years, the other partners have decided to leave the audit of Wisdom Ltd. in his capable hands. Comment on the situation outlines above.

Ans.

(i) Provision: - SQC – 1 "Quality Control for Firms that perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" requires:

- A firm to establish the **policies & procedures** for **dealing/resolving differences of opinion** with in engagement team.
- An **engagement partner** is usually **appointed to each audit engagement** undertaken by the firm, to **take responsibility for the engagement** on behalf of the firm. Assigning the audit to an **experienced audit manager** is **not sufficient.**

(ii) SA 220 "Quality Control for an Audit of Financial Statement": **-** Requires that the **audit engagement partner** takes responsibility for **settling disputes** in accordance with the **firm's policy** in respect of **resolution of difference of opinion** required by SQC 1.

(iii) In the present case:

- Partners of the firm have decided to **leave the audit in the hands of Audit manager** and **no engagement partner has been assigned**.
- The lack of an audit engagement partner also means that **several of the requirements of SA 220**, about ensuring that engagements in relation to **independence** and **directing, supervising** and **reviewing** the audit are not in place.
- Further, the **audit manager and senior have conflicting views** about the valuation of inventory. This does not appear to have been handled well, with the manager refusing to discuss the issue with the senior.

(iv) Conclusion: Failure to resolve the **difference of opinion is a breach of the firm's policy under SQC 1**. It indicates that the firm **does not have a suitable policy** concerning such disputes required by SQC1.

24. Date of Signing of Audit Report

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2022 got completed on May 1, 2022. The auditor's report was dated May 12, 2022. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2022. Engagement partner had completed his reviews in entirety by May 10, 2022 and signed the report on May 12, 2022. Comment. **(MTP-Nov-2018)**

Ans.

(i) As per SA 220, "Quality Control for an Audit of Financial Statements"

- The engagement partner shall take **responsibility for reviews being performed** in accordance with the **firm's review policies and procedures**.
- **For audits of financial statements of listed entities, the engagement partner shall:**
  - (a) Determine that an **engagement quality control reviewer** has been appointed;
  - (b) **Discuss significant matters arising** during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
  - (c) **Not date the auditor's report** until the completion of the engagement quality control review.

(ii) SA 700, "Forming an Opinion and Reporting on Financial Statements", requires:

- The auditor's report to be **dated no earlier than** the date on which the auditor has **obtained sufficient appropriate evidence** on which to base the auditor's opinion on the financial statements

(iii) In the present case: - OP & Associates are the **statutory auditors of a listed company** which started its operations **5 years back**. The field work during the audit of the financial statements of the company for the year ended **March 31, 2022** got completed on **May 1, 2022.** The auditor's report was **dated May 12, 2022.** During the documentation review of the engagement, it was observed that the engagement quality control review was **completed on May 15, 2022.**

(iv) Conclusion: - Signing of auditor's report i.e. on **May 12, 2022 which is before the completion of review** engagement quality control review i.e. **May 15, 2022, is not in order**.

25. Engagement Quality Control Review

HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not? **(July-2021-New, MTP-Nov-2022)**

Ans.

(a) As per SQC 1, an engagement quality control review for audits of financial statements of **listed entities** includes **considering the following:**

- (i) The work has been performed in accordance with **professional standards and regulatory and legal requirements;**
- (ii) **Significant matters** have been raised for further consideration;
- (iii) **Appropriate consultations** have taken place and the resulting conclusions have been documented and implemented;
- (iv) There is a need to revise the **nature, timing and extent** of work performed;
- (v) The work performed supports the **conclusions reached** and is appropriately documented;
- (vi) The evidence obtained is **sufficient and appropriate** to support the report; and
- (vii) The objectives of the **engagement procedures** have been achieved.

(b) The firm should establish policies and procedures:

- (i) **Setting out criteria** for determining the need for safeguards to **reduce the familiarity threat to an acceptable level** when using the same senior personnel on an assurance engagement over a long period of time; and
- (ii) **For all audits of financial statements of listed entities**
  - Requiring the rotation of the engagement partner **after a specified period** in compliance with the Code.
  - The **familiarity threat is particularly relevant** in the context of financial statement audits of listed entities.

- **For these audits**, the engagement partner should be **rotated after a predefined period**, normally **not more than seven years**.

(c) Conclusion:- From the **facts given in the question** and from the **above stated paras of SQC 1**, it can be concluded that **firm is not complying with SQC 1** as Engagement Partner H is continuing for more than 7 years.

26. Responsibilities of EP and EQCR in relation to Assessment of Independence

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220. **(RTP-May-2022)(Study Material)(MTP-Nov-2019)(RTP-May-2019)**

Ans.

(i) As per SA 220 - Quality control for an Audit of Financial Statements

The engagement partner shall form a **conclusion on compliance with independence requirements** that apply to the audit engagement. In doing so, **the engagement partner shall:**

(a) **Obtain relevant information from the firm** and, where applicable, network firms, to **identify and evaluate circumstances** and relationships that create threats to independence;

(b) **Evaluate information on identified breaches**, if any, of the **firm's independence policies and procedures** to determine whether they create a **threat to independence** for the audit engagement; and

(c) **Take appropriate action to eliminate such threats** or reduce them to an **acceptable level** by applying safeguards, or, if considered appropriate, **to withdraw** from the audit engagement, where withdrawal is **permitted by law or regulation.** The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

(ii) For audits of financial statements of listed entities: - The **engagement quality control reviewer**, on performing an engagement quality control review, shall also consider among other things, **the engagement team's evaluation** of the firm's independence in relation to the audit engagement.

(iii) Conclusion: - In the given case, the **Engagement Partner is not right**. The **independence assessment documentation** should also be given to Engagement Quality Control Reviewer for his review.

27. SQC-1 : Complaints & Allegations

M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2021-2022. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2020-21 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period. Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC).

(MTP-May-2022)(Jan-2021-New)

Ans.

(i) In the given question: - NK & Co. **did not apply audit procedures** to ensure that **opening balances had been correctly brought forward**. A complaint was **filed against the auditors** in this context.

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

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

- **Complaints and allegations** (which do not include those that are clearly frivolous) may originate from **within or outside** the firm.
- They may be made by **firm personnel, clients or other third parties**. They may be received by engagement **team members** or other firm personnel.
- As part of this process, **the firm establishes clearly defined channels** for firm personnel to **raise any concerns** in a manner that enables them to come forward without fear of reprisals.
- **The** firm **investigates such complaints** and **allegations** in accordance with established **policies and procedures**. The investigation is **supervised by a partner** with sufficient and appropriate **experience and authority** within the firm but who is not otherwise involved in the engagement, and includes **involving legal counsel** as necessary.
- **Small firms and sole practitioners** may use the services of a **suitably qualified external person** or another **firm** to carry out the investigation. Complaints, allegations and the responses to them are documented.
- Where the **results of the investigations indicate deficiencies** in the design or operation of the firm's quality **control policies and procedures**, or **non-compliance** with the firm's system of quality control by an individual or individuals, the **firm takes appropriate action**

28. **Quality Control for Audit Work at Firm Level**

Write short notes on Quality control for audit work at firm level.

Ans.

- **Quality control systems, policies and procedures** are the responsibility of the **audit firm.**
- Within the context of the **firm's system of quality control**, engagement teams have a responsibility to **implement quality control procedures** that are applicable to the audit engagement; and
- provide the **firm with relevant information** to enable the functioning of that part of the **firm's system of quality control** relating to independence as envisaged in ***SQC 1 - Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements***.
- **The brief requirements are as follows-**

(i) **Leadership Responsibilities for Quality on Audits:** The engagement partner shall take **responsibility for the overall quality** on each audit engagement to which that partner is assigned.

(ii) **Relevant Ethical Requirements:** Throughout the audit engagement, the engagement partner shall **remain alert, through observation** and making **inquiries as necessary**, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

(iii) **Acceptance and Continuance of Client Relationships and Audit Engagements:** The engagement partner shall be satisfied that **appropriate procedures** regarding the **acceptance and continuance of client relationships** and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate.

(iv) **Assignment of Engagement Teams:** The engagement partner shall be satisfied that the **engagement team**, and any **auditor's experts** who are **not part of the engagement team**, collectively have the appropriate competence and capabilities to perform the audit engagement in accordance with **professional standards and regulatory and legal requirements** and enable an auditor's report that is appropriate in the circumstances to be issued.

(v) **Engagement Performance:** The engagement partner shall take **responsibility for the direction, supervision and performance** of the audit engagement. He shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures and shall take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters.

(vi) **Monitoring:** The engagement partner shall **consider the results of the firm's monitoring process** as evidenced in the **latest information circulated** by the firm and, if applicable, other network firms and whether **deficiencies noted** in that information may affect the audit engagement.

SA-230
Audit Documentation

29. Audit Working Papers (WPs)

What are audit working papers and why should they be carefully preserved by the Auditor?

Ans.

(i) Definition: -As per SA 230(Revised) "Audit Documentation"

Audit Working Papers are the **record of audit procedures performed**, relevant **audit evidence obtained**, and **conclusions the auditor reached.** Working papers are the:

(a) evidence of the **auditor's basis for a conclusion** about the achievement of the overall objective of the auditor; and

(b) evidence that the **audit was planned and performed** in accordance with SAs and applicable legal and regulatory requirements.

(ii) Benefits: - Besides they serve a number of additional purposes, **including the following:**

1. Assisting the engagement team to **plan and perform the audit.**
2. Assisting members of the engagement team **responsible for supervision** to direct and **supervise the audit work**, and to **discharge their review responsibilities** in accordance with SA 220.
3. Enabling the engagement team **to be accountable for its work.**
4. Retaining a record of matters of **continuing significance** to future audits.
5. Enabling the **conduct of quality control reviews** and inspections in accordance with SQC 1.
6. Enabling the **conduct of external inspections** in accordance with applicable legal, regulatory or other requirements.

(iii) SQC 1 – Property of Auditor

- **Standard on Quality Control (SQC) 1**, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that,
  - ➢ Unless otherwise specified by law or regulation, working papers are the **property of the auditor.**
  - ➢ **He may at his discretion**, make portions of, or **extracts from, working papers** available to clients, provided such disclosure **does not undermine the validity of the work performed**, or, in the case of assurance engagements, the **independence of the auditor** or of his personnel

(iv) Retention of Working Papers

- Working papers should be **retained, long enough**, for a period of time sufficient to **meet the needs of his practice** and satisfy any **legal or professional requirement** of record retention.
- SQC 1 requires firms to **establish policies and procedures** for the retention of engagement documentation.
- The retention period for audit engagements **ordinarily is no shorter than seven years** from the date of the auditor's report, or, if later, the date of the group auditor's report.

30. Utility, Ownership, Custody and Retention of WP

What does SA 230 says about utility, ownership, custody and retention of working papers?

Ans.

(i) Utility of working papers: According to **SA 230 on 'Audit Documentation'** working papers help in **planning and performance** of the audit, **supervision and review** of the audit work and provide **evidence of the audit work performed** to support the auditor's opinion.

(ii) **Ownership of working papers**: Working papers are the **property of the auditor** and he may, at his discretion, **make portions of or extracts** from his working papers to his client.

(iii) **Custody of working papers:** The auditor should adopt **reasonable procedures** for **safe custody** and **confidentiality** of his working papers.

(iv) **Retention of working papers:**

- Working papers should be **retained, long enough**, for a period of time sufficient to **meet the needs of his practice** and satisfy any **legal or professional requirement** of record retention.
- SQC 1 requires firms to **establish policies and procedures** for the retention of engagement documentation.
- The retention period for audit engagements **ordinarily is no shorter than seven years** from the date of the auditor's report, or, if later, the date of the group auditor's report.

31. **Factors Influencing the Amount of WPs**

Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit?

(RTP-May-2020), (Nov- 2015)

Ans.

(i) **As per SA 230 "Audit Documentation"**:- Which refers to the record of **audit procedures performed**, relevant **audit evidence obtained** and **conclusions** the auditor reached,

(ii) **The amount of audit working papers depend on factors such as-**

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

32. **Access to WPs of Subsidiary Company**

As an auditor, how would you deal with the following: The statutory auditor of the holding company demands for the working papers of the auditors of the subsidiary company, of which you are the auditor?

Ans.

(i) **As per SA 230-"Audit Documentation": -** Working papers are the **property of the auditor.** The auditor may, **at his discretion**, make portion of or extracts of his working papers available to his client.

(ii) **SA 600 -Using the Work of Another Auditors**

- Also states that an auditor should **respect the confidentiality of information** acquired during the course of his audit work and
- Should **not disclose** such information unless there is a **legal or professional duty** to disclose.

(iii) **As per ICAI Guidelines**:

- Statutory auditor of an enterprise **does not have right of access** to the audit working papers of the branch auditor.
- An auditor **can rely on the work of another auditor**, without having any right of access to the audit working papers of other auditor.

(iv) **Conclusion: -** Statutory auditor of **Holding company cannot have access to audit working papers of the subsidiary company's auditor**. He can however, **ask the auditor to answer certain questions** about the manner in which the **audit is conducted** and certain **other clarifications** regarding audit. (Refer answer to Q.34)

33. Access to WPs to Regulators & Third Parties

Discuss the Auditor's responsibility to provide access to his audit working papers to Regulators and third parties.

Ans.

(i) Code Of Ethics: Clause (1) of Part I of Second Schedule to the CAs Act, 1949 states that:

- A CA in practice shall be **deemed to be guilty of professional misconduct** if he **discloses information acquired** in the course of his **professional engagement** to any person other than **his client**, without the **consent** of his client or otherwise than as **required by law** for the time being in force.

(ii) SA 200 on "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing" also reiterates that,

- The auditor should respect the **confidentiality of the information** obtained and should **not disclose any such information** to any third party without specific authority or unless there is a **legal or professional** duty to disclose".
- If there is a **request to provide access** by the **regulator** based on the legal requirement, the same has to be **complied with after informing the client** about the same.

(iii) SQC–1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", provides that,

- Unless otherwise specified by **law or regulation**, audit documentation is the **property of the auditor**.
- **He may at his discretion, make portions of, or extracts from**, audit documentation available to clients, provided such disclosure **does not undermine the validity** of the work performed, or, in the case of **assurance engagements**, the independence of the auditor or of his personnel.

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

(v) Conclusion: - It is auditor's responsibility to provide access to his audit working papers **to Regulators when required by law** whereas auditor is under **no obligation to provide** access to working papers **to third parties.**

34. Access to WP of Branch Auditor

Mr. A is a statutory auditor of ABC Ltd.. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit. **(May-2018-New)**

Ans.

(i) As per SA 230 "Audit Documentation":

- Working papers are the **property of the auditor**. He may at his discretion, **make available portions or extracts** from his working paper to his client.
- The auditor should **adopt reasonable procedures** for **custody** and **confidentiality** of his working papers.
- An auditor is **not required to provide the clients** or **other auditors'** access to his working papers.
- **Main auditor** of the company **does not have right of access** to the working papers of the branch auditor.

(ii) In the case of a company: - The main auditor has to consider the **report of the branch auditor** and has a right to **seek clarification** and to **visit the branch but cannot ask for the copy** of working paper.

(iii) Conclusion: Therefore, the branch auditor is under **no compulsion to give photocopies** of his working paper to the principal auditor.

35. Access to WPs of Retiring Auditor

M/s Health Zone, a partnership firm, running a nursing home have decided to discontinue you as an auditor for next year and requests you to handover all the relevant working papers of the previous year.

Ans. **(i) As per SA 230** on **"Audit Documentations"**

- The working papers are the **property of the auditor** and the auditor has **right to retain them**. He **may at his discretion** can make available working papers to his client.
- The auditor should retain them **long enough to meet the needs of his practice** and legal or **professional requirement**.
- Working papers are the **important records of the auditor**.
- They **serve as evidence of the auditor's exercise of due care** and **conclusion reached** regarding significant matters.
- The **client does not have a right to access the working papers** and it is up to the discretion of the auditor to make them available or not to others including the client.

(ii) Conclusion: -Hence in the instant case, management of **M/s Health Zone can't insist upon the auditor** to handover the working papers of the previous year.

SA-240
The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements

36. Detection of Fraud & Error

Discuss, is detection of fraud and error duty of an auditor? **(May-2015)**

Ans. **Duty of an Auditor:**

- **As per SA-240- The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements: -** Primary responsibility for the **prevention and detection of fraud** rests with both **TCWG** of the entity and **management**.
- It is important that **management, with the oversight of TCWG**, place a strong emphasis on **fraud prevention,** which may reduce opportunities for fraud to take place.
- **Broadly, the general principles laid down in this regard are:**
  (i) An auditor conducting an audit in accordance with SAs is responsible for **obtaining reasonable assurance** that the financial statements taken as a **whole are free from material misstatement**, whether caused by **fraud or error**. Owing to the **inherent limitations of an audit**, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
  (ii) The risk of not detecting a **material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.** This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.
  (iii) Furthermore, the risk of the auditor not detecting a **material misstatement resulting from management fraud** is greater than for employee fraud, because **management is frequently in a position to directly or indirectly manipulate** accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.
  (iv) When obtaining reasonable assurance, the auditor is responsible for maintaining an **attitude of professional skepticism** throughout the audit, considering the **potential for management override of controls** and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.
- **Conclusion: -**It may be concluded from the above that **detection of fraud and error is not the duty of the auditor** provided that he complies with the requirements given in **Standards on Auditing,** maintains professional skepticism throughout the audit and is **not grossly negligent in the performance** of his duties as an auditor.

37. Fraud Detected after Audit

'After the statutory audit has been completed a fraud has been detected at the office of the audited.' What is your defense as an auditor?

Ans.

(i) Responsibility of Management and Auditor towards Frauds

- As per SA 240, the **primary responsibility for the prevention and detection of fraud rests with both TCWG of the entity and management**.
- An auditor conducting an audit in accordance with SAs is **responsible for obtaining reasonable** assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

(ii) Inherent Limitations of Auditor

- Owing to the **inherent limitations** of an audit, there is an **unavoidable risk that some material misstatements** of the financial statements will not be detected, even though the **audit is properly planned and performed** in accordance with the SAs.
- **The risk of not detecting a material misstatement** resulting from fraud is **higher than the risk of not detecting one resulting from error**. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as **forgery, deliberate failure to record transactions**, or intentional misrepresentations being made to the auditor.

(iii) Auditor's Responsibility for Frauds detected subsequently

- The subsequent discovery of **material misstatement of the financial information** resulting from **fraud or error** existing during the period covered by the **auditor's report** does not, in itself, indicate that whether the auditor has adhered to the basic principles governing an audit.
- The question of **whether the auditor has adhered** to the **basic principles governing an audit** is determined by the **adequacy of the procedures** undertaken in the circumstances and the suitability of the **auditor's report** based on the results of these procedures.
- The liability of the auditor for **failure to detect fraud exists** only when such failure is **clearly due to not exercising reasonable care and skill**.
- Thus, **in the instant case** after the completion of the statutory audit, **if a fraud has been detected**, the same by itself **cannot mean that the auditor did not perform his duty properly**.
- **If auditor can prove with help of his papers** (documentation) that he followed **adequate procedures** necessary for proper conduct of an audit, **he cannot be held responsible for the same**.
- If however, the same **cannot be proved**, **he would be held responsible.**

38. Possible Sources of Fraudulent Financial Reporting

In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls. **(Nov-2020-New) (MTP-Dec-2021)**

Ans.

(i) **As per SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements"** fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. **It may be accomplished by,**

- **(a)** **Manipulation, falsification, or alteration of accounting records** or supporting documents from which the financial statements are prepared or
- **(b)** **Misrepresentation in, or intentional omission** from, the financial statements of **events, transactions or other significant information** or
- **(c)** **Intentional misstatements involve intentional misapplication of accounting principles** relating to measurement, recognition, classification, presentation, or disclosure etc.

(ii) Fraud can be committed by management overriding controls using such techniques as:

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

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

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

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

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

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

(vii) **Embezzling receipts** (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).

(viii) **Stealing physical assets or intellectual property** (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

(ix) Causing an entity to **pay for goods and services not received** (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).

(x) **Using an entity's assets for personal use** (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

(iii) As per Section 143(12) of the Companies Act, 2013:

- If an auditor of a company, **in the course of the performance of his duties** as auditor, has reason to believe that an offence **involving fraud is being** or **has been committed against the company** by **officers or employees** of the company, he shall immediately report the matter to the **Central Government within 60 days** of his knowledge and after following the prescribed procedure.

39. Possibility of Fraud due to Problematic or Unusual Relationships

Write the circumstances that indicate the possibility of fraud due to problematic or unusual relationships between the auditor and management. **(May-2018-Old)**

Ans. **Problematic or unusual relationships between the auditor and management, including:**

1. **Denial of access to records**, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
2. **Undue time pressures** imposed by management to resolve **complex or contentious issues.**
3. **Complaints by management** about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
4. **Unusual delays by the entity** in providing requested information.
5. **Unwillingness to facilitate auditor access** to **key electronic files** for testing through the use of computer-assisted audit techniques.
6. **Denial of access to key IT operations staff and facilities**, including security, operations, and systems development personnel.
7. **An unwillingness to add or revise disclosures** in the financial statements to make them **more complete and understandable.**
8. An unwillingness to address **identified deficiencies in internal control** on a timely basis.
9. Unwillingness by management to **permit the auditor to meet privately** with **TCWG**

10. **Accounting Policy** that appears to be variance with industry norms
11. **Frequent changes in accounting estimates** that do not appear to result from changed circumstances
12. **Tolerance of variations** in the entity's code of conduct

40. **Auditor's Duties in case of MM resulting from Management Fraud**

Cloud Ltd. appointed an auditor for the financial year 2021-22. While going through the audit procedure, the auditor observed that the management has entered into certain transactions which are irregular in nature and the management is personally benefited from such transactions. Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.

OR

Fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity. In view of the above-mentioned circumstances of management fraud, explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from such Management Fraud.

OR

Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.

Ans.

(i) Management & Auditor's Responsibility

- As per SA 240 **"The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, the primary responsibility for the **prevention and detection of fraud** rests with both **TCWG** of the entity and **management.**
- The auditor, conducting an audit, is **responsible for obtaining reasonable assurance** that the financial statements taken as a **whole are free from material misstatement**, whether caused by **fraud or error.**

(ii) Inherent Limitation of Auditor

- 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.
- As described in SA 200, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud.

(iii) Detection Risk Higher in Frauds than Errors

- The risk of not detecting a **material misstatement** resulting from fraud is **higher than the risk of not detecting one resulting from error**.
- This **is because fraud may involve** sophisticated and carefully organized schemes designed to conceal it, such as **forgery, deliberate failure to record transactions**, or **intentional misrepresentations** being made to the auditor.
- Such attempts at concealment may be even **more difficult to detect** when accompanied by collusion. Conclusion may cause the auditor to believe that **audit evidence is persuasive** when it is, **in fact, false.**
- While the auditor may be able to **identify potential opportunities for fraud** to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

(iv) Detection Risk even Higher for Management Frauds

- Furthermore**, the risk of the auditor** not detecting a material misstatement resulting from management fraud is greater than for employee fraud, **because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.**

(v) Professional Skepticism

- When obtaining **reasonable assurance**, the auditor is responsible for **maintaining professional skepticism throughout the audit**, considering the potential for **management override of controls** and recognizing the fact that audit procedures that are **effective for detecting error** may not be **effective in detecting fraud**.

(vi) Companies Act – Reporting of Frauds

- **As per section 143(12) of the Companies Act, 2013**: **-** if an auditor of a company, in the course of the performance of **his duties as auditor**, has reason to believe that an **offence involving fraud is being or has been committed against the company** by officers or employees of the company, he shall immediately report the matter to the **Central Government within 60 days** of his knowledge and after following the prescribed procedure.

41. Auditor's Duties in case of Suspected Fraud

M/s Honest Limited has entered into a transaction on 5th March, 2022, near year-end, whereby it has agreed to pay ₹ 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but ₹ 60 lakhs are provided in books of account as on March 31, 2022. Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach and reporting responsibilities? **(RTP-Nov-2018)**

Ans.

(i) As per SA 240 on **"The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"** fraud can be **committed by management** by various means including therein **recording of fictitious journal entries**, particularly **close to the end of an accounting period**, to manipulate operating results or achieve other objectives.

(ii) In the given case: - Honest Ltd. has entered into an agreement with **Mr. Y, at year-end**, for engineering consultation. It also provides **₹ 60 lakhs in the books of accounts**, however, **no documentary or other evidence** of receipt of such service is available. It appears that company has passed **fictitious journal entries**, near year-end, to manipulate the operating results.

(iii) SA 240 further provides that If, as a result of a **misstatement resulting from fraud** or suspected fraud, the auditor encounters exceptional circumstances that bring into question **the auditor's ability to continue performing the audit, the auditor shall:**

(1) Determine the **professional and legal responsibilities** applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(2) Consider whether **it is appropriate to withdraw from the engagement**, where withdrawal from the engagement is legally permitted.

(iv) Sec. 143(12) of the Companies Act, 2013 read with Rule 13 of Companies (Audit & Auditor's) Rules, 2016 requires that if an auditor of a company, **in the course of the performance of his duties** as auditor, has **reason to believe** that an offence **involving fraud** is being or has been committed against the **company** by **officers or employees** of the company, he shall immediately report the matter to the audit committee within 2 days of his knowledge (as amount involved is less than ₹ 1 Cr.) mentioning the following:

(a) **Nature of Fraud** with description;

(b) **Approximate amount** involved; and

(c) **Parties involved** etc.

(v) Para 3(xi) of CARO, 2020 also requires the company auditor to report:

- Whether **any fraud by the company** or **any fraud on the company** has been **noticed or reported during the year**;
- If yes, the **nature and the amount** involved is to be indicated.

42. Reporting of Fraud committed by Management/Directors of the Company

On 15th March, 2022, the directors of Phony Ltd. instructed their accountant to enter purchases amounting ₹ 1.02 crores from a company incorporated dated 11th March, 2022. However, no amount was actually paid and ₹ 1.02 crore was provided in the books of account as purchases for the year ending on 31st March, 2022. On inspection, no documentary or other evidence of such purchases was found. As the auditor of Phony Ltd., what would be your approach regarding reporting of such bogus purchases? **(MTP-May-2020)**

Ans.

(i) **As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, fraud can be committed by **management overriding controls** using such techniques as recording **fictitious journal entries**, particularly **close to the end of an accounting period**, to manipulate operating results or achieve other objectives.

(ii) **In the given case: -** Phony Ltd. has made **purchases amounting ₹ 1.02 crores**, at year-end. It also debited the sum in the books of account, however, **no documentary or other evidence of such purchases was found**, on investigation. It is clear that company has passed **fictitious journal entries**, near year-end, to manipulate the operating results.

(iii) **Auditor's Approach in the above case:**

- The auditor would **adopt the approach** which will be based on the **result of misstatement** on the basis of **such fictitious journal entry**, i.e. if, as a **result of a misstatement resulting from fraud** or suspected fraud,
- The auditor encounters **exceptional circumstances** that bring into question the **auditor's ability to continue performing the audit**, the auditor shall determine the **professional and legal responsibilities** applicable in the circumstances, including
- Whether there is a **requirement for the auditor to report to the person or persons** who made the audit appointment or, in **some cases, to regulatory authorities**; or
- The auditor may **consider for appropriateness of withdrawal** from such engagement, where withdrawal from the engagement is **legally permitted.**

(iv) **Reporting requirement: -**

- **As per section 143(12)**, if an auditor of a company in the **course of the performance of his duties** as auditor, has **reason to believe** that an offence of fraud, which **involves or is expected to involve** individually an amount of **₹ 1 crore or above** is being or has been committed in the company by its **officers or employees**, he shall report the matter to the **Central Government** in prescribed manner.
- The auditor is also required to report under **clause (xi) of paragraph 3 of Companies (Auditor's** Report**) Order, 2020**, whether **any fraud by the company or any fraud on the Company has been noticed or reported** during the year. If yes, the **nature and the amount** involved is to be indicated.

43. Impossibility to Continue the Performance of Audit

You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit. As a Statutory Auditor, how would you deal?

Ans.

(i) **Report and Withdraw, unless Legally Prohibited – SA 240**

According to SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", if, as a result of a **misstatement resulting from fraud** or suspected fraud, the auditor encounters exceptional circumstances that bring into question **the auditor's ability to continue performing the audit, the auditor shall:**

(1) Determine the **professional and legal responsibilities** applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(2) Consider whether **it is appropriate to withdraw from the engagement**, where withdrawal from the engagement is legally permitted and

(3) **If the auditor withdraws:**

(a) **Discuss with the appropriate level of management** and those charged with governance, the auditor's withdrawal from the engagement and **the reasons for the withdrawal**; and

(b) Determine whether **there is a professional or legal requirement to report** to the person or persons who **made the audit appointment** or, in some cases, **to regulatory authorities**, the auditor's withdrawal from the engagement and the **reasons for the withdrawal.**

(ii) Companies Act – Reporting of Frauds

As per section 143(12) of the Companies Act, 2013: - if an auditor of a company, in the course of the performance of **his duties as auditor**, has reason to believe that an **offence involving fraud is being or has been committed against the company** by officers or employees of the company, he shall immediately report the matter to the **Central Government within 60 days** of his knowledge and after following the prescribed procedure.

44. Risk Factotrs - Misappropriation of Assets

M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA Kumar observed that there is misappropriation of assets in the form of theft of en tity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation. Guide CA Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. **(Dec-2021-New)**

Ans. **Guidance to CA Kumar with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:**

- As per SA 240, **"The Auditor's Responsibilities Relating to Fraud in an auditof Financial Statements"**, misappropriation of assets **involves the theft of entity's assets** and is often **perpetrated by employees** in relatively small and immaterial amounts. However, it can **also involve management** who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.
- **Misappropriation of assets** can be accomplished in a variety of ways including **stealing physical assets or intellectual property** (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Risk factors that relate to **misstatements arising from misappropriation of assets** are also classified according to the **three conditions** generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization.

(A) Incentives/Pressures

Personal financial obligations may create pressure on **management or employees** with access to cash or other assets **susceptible to theft to misappropriate those assets.** Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. **For example, adverse relationships may be created by the following:**

(i) Known or anticipated **future employee layoffs.**

(ii) Recent or anticipated **changes to employee compensation** or benefit plans.

(iii) **Promotions, compensation**, or other rewards inconsistent with expectations.

(B) Opportunities

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

(i) **Large amounts of cash** on hand or processed.

(ii) **Inventory items** that are small in size, of high value, or in high demand.

(iii) **Easily convertible assets**, such as bearer bonds, diamonds, or computer chips.

(iv) **Fixed assets which are small in size**, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

(i) Inadequate **segregation of duties** or independent checks.

(ii) Inadequate **oversight of senior management expenditures**, such as travel and other reimbursements.

(iii) Inadequate **management oversight of employees** responsible for assets, for example, inadequate supervision or monitoring of remote locations.

(iv) Inadequate **job applicant screening** of employees with access to assets.

(v) Inadequate **record keeping** with respect to assets.

(vi) Inadequate **system of authorization** and approval of transactions (for example, in purchasing).

(vii) Inadequate **physical safeguards over cash**, investments, inventory, or fixed assets.

(viii) Lack of complete and timely reconciliations of assets.

(ix) Lack of **timely and appropriate documentation** of transactions, for example, credits for merchandise returns.

(x) Lack of **mandatory vacations for employees** performing key control functions.

(xi) **Inadequate management understanding** of information technology, which enables information technology employees to perpetrate a misappropriation.

(xii) **Inadequate access controls** over automated records, including controls over and review of computer systems event logs.

(C) Attitudes/Rationalizations

(i) Disregard for the **need for monitoring or reducing risks** related to misappropriations of assets.

(ii) Disregard for **internal control over misappropriation of assets** by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.

(iii) Behaviour indicating **displeasure or dissatisfaction** with the entity or its treatment of the employee.

(iv) **Changes in behaviour** or lifestyle that may indicate assets have been misappropriated.

(v) Tolerance of **petty theft**.

44A. **Responsibility of Auditor relating to fraud**

Arihant Limited was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ₹ 35 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings. In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

(RTP-Nov-2022)

Ans. **(i)** **As per SA 240-** "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" **and SA 315**, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the

Entity and Its Environment",

- The auditor shall **identify and assess the risks of material misstatement due to fraud** at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.
- When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, **based on a presumption** that there are **risks of fraud** in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

(ii) **In accordance with SA 240**, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" **and 330**," The Auditor's Responses to Assessed Risks"

- The auditor shall determine **overall responses to address the assessed risks of material misstatement** due to fraud at the financial statement level and assertion level.
- The **presumption that there are risks of fraud** in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simpl e revenue transaction, for example, leasehold revenue from a single unit rental property.
- However, **when there is a complex revenue structure** or when there is lack of controls on revenue recognition, then there is a **high probability of fraud risk** in revenue recognition.
- **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.

(iii) **In the current scenario:**

- The company was **earning revenue from multiple streams.** Also, it was identified that the controls are **not properly designed** to mitigate the risk of fraud and risk of improper revenue recognition.
- During the year it was **identified that the management did not account for revenue** from corporate hotel bookings **amounting to ₹ 35 crore.** These amounts were partially received **in the company's bank accounts** and partially received **in the CFO's personal account**. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

(iv) **Conclusion:**

- Therefore, the auditor while performing the **risk assessment procedures** should consider the **complexity and nature of the revenue** for determining the fraud risks in revenue recognition.
- Also, **there were no adequate controls** addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk.
- Moreover, the **audit team should have recognised fraud risk** by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is **required to report all the frauds identified** during the course of the audit **involving amounts above ₹ 1 crore** within the prescribed time frame to the Central Government

SA-250
Consideration of Laws and Regulations in an Audit of Financial Statements

45. **Management's Responsibility for Compliance with Laws and Regulations**

PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, CA Jazz wants to implement such policies and procedures that can assist him in the prevention and detection of non-compliance with laws and regulations. Help CA Jazz by citing examples of such policies and procedures. **(Nov-2020-New)**

OR

"Management is responsible for compliance with laws and regulations."

Ans.

(i) According to **SA 250** on **"Consideration of Laws and Regulations in an Audit of Financial Statements"**

- It is **management's responsibility**, to ensure that the entity's operations are conducted in accordance with the **provisions of laws and regulations**.

- Laws and regulations **may affect an entity's financial statements** in different ways for example, **most directly**; they may affect **specific disclosures required** of the entity in the financial statements.

(ii) The following are the procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations-

a) Monitoring **legal requirements** and ensuring that **operating procedures** are designed to meet these requirements.

b) Instituting **and operating** appropriate systems of **internal control**.

c) Developing**, publicizing** and following a **code of conduct**.

d) Monitoring **compliance** with the code of conduct and **acting appropriately** to discipline employees **who fail to comply** with it.

e) Engaging **legal advisors** to assist in monitoring legal requirements.

f) Maintaining **a register of significant laws and regulations** with which the entity has to comply within its particular industry and a record of complaints.

g) Ensuring employees are **properly trained and understand** the code of conduct.

46. **Roles & Responsibilities of the Auditor**

What are the roles and responsibilities of the statutory auditors in relation to compliance with the laws and regulations by the entity?

Ans.

(i) **Obtaining understanding of L&R F/W: -** As per **SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements"**, as part of obtaining an understanding of the **entity and its environment** the auditor **shall obtain a general understanding of:**

(a) The **legal and regulatory framework** applicable to the **entity and the industry or sector** in which the entity operates; and

(b) **How the entity is complying** with that framework.

(ii) Audit Procedures - Directly Affecting and Others Laws and Regulations

- The auditor shall obtain **sufficient appropriate audit evidence** regarding compliance with the provisions of **those laws and regulations** generally recognised to have **a direct effect on the determination of material amounts** and **disclosures** in the financial statements.

- The auditor shall **perform the following audit procedures** to help identify instances of **non-compliance with other laws and regulations** that may have a material effect on the financial statements:
  - ➢ **Inquiring of management** and, where appropriate, **TCWG**, as to whether the entity is in **compliance with such laws and regulations**; and
  - ➢ **Inspecting correspondence,** if any, with the relevant **licensing** or **regulatory authorities.**

(iii) Other Audit Procedures & WR

- During the audit, the auditor **shall remain alert to the possibility** that other audit procedures applied may bring **instances of non -compliance** or **suspected non- compliance** with laws and regulations to the auditor's attention.

- **The auditor shall request management** and, where appropriate, TCWG to provide **written representations** that all known **instances of non -compliance** or **suspected non-compliance** with laws and regulations **whose effects should be considered** when preparing financial statements have been **disclosed to the auditor**.

(iv) Conclusion

- Thus, the **auditor is responsible for obtaining reasonable assurance** that the financial statements, taken as **a whole, are free from material misstatement**, whether caused by **fraud or error.**
- In conducting an audit of financial statements, the auditor takes into account **the applicable legal and regulatory framework.**

47. Verifying Compliance with Laws and Regulations

You are appointed as an auditor of BHK Ltd., a company engaged in export of agricultural equipment. During the course of audit, your audit team informed you regarding non - deduction of TDS on huge payments made to legal counsel of BHK Ltd. You want to alert your team on the possibility of non-compliance with Laws and Regulations by BHK Ltd. Help your audit team in identifying any other indications of non-compliance with Laws and Regulations particularly related to payments made by the company **(Dec-2021-Old)**

OR

R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non-compliance with Laws and Regulations **(Study Material)**

OR

As an Auditor of TRP Ltd., you are suspicious that there might be noncompliance with laws and regulations to which the company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some based to further inquire.

(May-2018-New) (MTP-Dec-2021)

OR

During the course of Audit of POP Ltd., you as an auditor while performing the audit procedures become aware of the existence of certain instances which seem to be an indication of non-compliance with Laws and regulations. List out any five such instances identified by you as an auditor, suggestive of non-compliance with Laws and regulations. **(Jan-2021-Old)**

Ans.

(i) As per SA 250, "Consideration of Laws and Regulations in an audit of Financial Statements

- The auditor shall perform the audit procedures to **help identify instances of non-compliance** with **other laws and regulations** that may have a **material effect on the financial statements** by inquiring of **management and, where appropriate, TCWG**, as to whether the entity is in compliance with such laws and regulations; and
- Inspecting **correspondence**, if any, with the relevant licensing or regulatory authorities.

(ii) However**,** when the **auditor becomes aware of the existence** of, or information about**,** the following matters, **it may also be an indication of non-compliance with laws and regulations:**

a) **Investigations by regulatory organisations** and government departments or payment of **fines or penalties**.

b) **Payments** for **unspecified services** or loans to consultants, related parties, employees or government employees.

c) **Sales** commissions **or agent's fees** that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.

d) Purchasing at **prices significantly above** or **below market price**.

e) **Unusual payments in cash**, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.

f) Unusual payments towards **legal and retainership fees**.

g) Unusual transactions with **companies registered in tax havens**.

h) Payments **for goods or services** made other than to the country from which **the goods or services originated**.

i) Payments without **proper exchange control** documentation.

j) **Existence of an information system** which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.

k) Unauthorised **transactions** or improperly recorded transactions.

l) Adverse media comment.

48. Reporting Requirements in case of Non-Compliance with L & R

State the reporting responsibility of an auditor in the context of non-compliance of Law and Regulation in an audit of Financial Statement.

Ans.

(a) Reporting to Management & TCWG:

- The auditor shall **communicate with TCWG** matters involving **non-compliance with laws and regulations** that come to the auditor's attention.
- If, in the **auditor's judgment**, the non-compliance is **believed to be intentional and material**, the auditor shall **communicate the matter to TCWG** as soon as practicable.
- **If the** auditor **suspects that management or TCWG** are involved in noncompliance, the auditor shall communicate **the matter to the next higher level of authority** at the entity, if it exists, such as an **audit committee** or **supervisory board**.
- **Where no higher authority exists**, the auditor shall consider the need to **obtain legal advice.**

(b) Reporting in Auditor's Report:

- If the auditor concludes that the **non-compliance has a material effect** on the financial statements and has **not been adequately reflected** in the financial statements, the auditor shall, express **a qualified or adverse opinion** on the financial statements.
- **If the** auditor **is precluded by management or TCWG** from obtaining sufficient appropriate audit evidence, the auditor shall express **a qualified opinion or disclaim an opinion**.
- **If the auditor is unable to determine** whether noncompliance has occurred because of **limitations imposed by the circumstances** rather than by management or TCWG, the **auditor shall evaluate the effect on the auditor's opinion.**

(c) Reporting to Regulatory and Enforcement Authorities:

- If the auditor has **identified or suspects non-compliance** with laws and regulations, the auditor shall determine **whether the auditor has a responsibility to report** the identified or suspected non-compliance **to parties outside the entity**.

49. Compliance with other Laws & Regulations

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws. **(MTP-May-2021)(RTP-May-2018)**

OR

CA. Young has been appointed as an auditor of Rama Ltd., a textile entity. While going through the employee records of the company, CA. Young identified that most of the labourers employed are of the age between 11-12 years. On enquiring the same, the management argues that there is no such boundation with regard to employment of such lower age children and contends that it is out of the scope of audit as well to check such compliance. Comment in the context of relevant standard on auditing whether the contention of management is tenable. **(MTP-May-2020)**

Ans. **(i)** As per **SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"**

- The auditor shall **obtain sufficient appropriate audit evidence** regarding compliance with the provisions of those laws and regulations generally recognised to have a **direct effect** on the determination of **material amounts and disclosures** in the financial statements **including tax and labour laws.**

(ii) In case of other laws:

- On-compliance with **other laws and regulations** may result in found that a major portion for the entity, the **costs of which may need to be provided for in the financial statements,** but are not considered to have a direct effect on the financial statements.

(iii) In the instant case: - Major portion of the **labour employed** in the company was **child labour**. While questioning by auditor, reply of the management that **it was outside his scope of financial audit** to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

(iv) Conclusion: -Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that **non-compliance has a material effect on the financial statements** and has **not been adequately reflected in the financial statements**, the auditor shall **express a qualified or adverse opinion** on the financial statement.

50. Non-Compliance of Laws and Regulations

XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-22 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:

- Income Tax relating to Assessment Year 2018-19 rupees 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-20.
- Customs duty rupees 85 lakhs - Demand notice received on 15-9-21 but no action has been taken to pay or appeal.

As an auditor, how would you bring this fact to the members? **(Involve Refrence of CARO) (MTP-May-2019)**

Ans.

(i) As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement"

- It is the **responsibility of management**, with the oversight of TCWG, to ensure that the **entity's operations are conducted** in accordance with the **provisions of laws and regulations**, **including compliance** with the provisions of laws and regulations that determine the **reported amounts and disclosures** in an entity's financial statements.

(ii) Auditor's Responsibility:

- The auditor is **responsible for obtaining reasonable assurance** that the financial statements, taken as a **whole, are free from material misstatement**, whether caused by fraud or error.
- In **conducting an audit of financial statements**, the auditor takes into account the **applicable legal and regulatory framework.**
- **Owing to the inherent limitations** of an audit, there is an **unavoidable risk** that some material misstatements in the financial statements may not be detected, even though the audit is **properly planned and performed** in accordance with the SAs.

(iii) Reporting:

- If the auditor concludes that the **non-compliance has a material effect on the financial statements**, and has **not been adequately reflected** in the financial statements,
- The auditor shall express **a qualified or adverse opinion** on the financial statements. Further, the auditor is required to **report on certain matters specified in Para 3 of CARO, 2020** under **section 143 of the Companies Act, 2013.**
- **One of such matter is non-payment of dues to Government**, on account of any dispute. **As per** clause **(vii) of Para 3 of CARO, 2020**, in case dues of income tax or GST or duty of customs or duty of

excise have **not been deposited** on account of any dispute, then the **amounts involved and the forum where dispute is pending** shall be mentioned. {A mere representation to the concerned Department shall not be treated as a dispute.}

(iv) **In the present case: -** There is **Income Tax demand of ₹ 125 Lacs** and the company has gone for an appeal, it needs considerations as to **whether the entire demand is disputed**, because it is difficult to presume that the demand by **Income Tax authority is without any basis**.

(v) **Conclusion:**

- Therefore, as per **AS 29/Ind AS-37 "Provisions, Contingent Liabilities and Contingent Assets"**, partly to the extent the **company considers that the demand** is based on some logical basis, that **amount may be provided** for and the remaining may be **disclosed as the contingent liability**.
- Further, **it should be brought to notice of the members by reporting**. Additionally, the demand notice has been received for **Customs duty of ₹ 85 lakhs** and is outstanding on the closure of financial year, **for which no action has been taken by the management**. Therefore, it should also be brought to **notice of the members by reporting.**

51. **Non-compliance is Identified or Suspected – Audit Procedure**

CA Abhinanadan is an auditor of KM Private Limited. During the course of audit, CA Abhinanadan becomes aware of information concerning an instance of noncompliance or suspected non-compliance with laws and regulations. Being a senior partner of CA. Abhinanadan, guide him regarding audit procedures to be followed when non-compliance is identified or suspected. **(RTP-May-2022)**

Ans.

- As per **SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"**, if the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:
  - (i) An understanding of the **nature of the act and the circumstances** in which it has occurred; and
  - (ii) Further information to **evaluate the possible effect on the financial statements**.
- **If the auditor suspects there may be non-compliance,** the auditor shall discuss the matter with **management** and, **where appropriate, those charged with governance**.
- **If management or, as appropriate, those charged with governance do not provide sufficient information** that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the **suspected non-compliance may be material** to the financial statements, the auditor shall consider the **need to obtain legal advice**.
- **If sufficient information about suspected non-compliance cannot be obtained**, the auditor shall evaluate the **effect of the lack of sufficient appropriate audit evidence** on the auditor's opinion.
- The auditor shall **evaluate the implications of non-compliance** in relation to other aspects of the audit, including the **auditor's risk assessment** and the **reliability of written representations**, and take appropriate action.

51A. **Violation of environmental laws – Reporting**

Abhinandan Limited a chemical manufacturing company, having its factory located at Nanded Village, for the year 2021-22 appointed Subahu & Co. as their statutory auditors. During the course of the audit, Subahu & Co. identified that Abhinandan Limited received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Abhinandan Limited was dumping toxic solid waste, without treating it, on the nearby grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Abhinandan Limited. A show cause notice was already issued to Abhinandan Limited by the National Green Tribunal for levying the penalty of an amount of ₹ 500 crore. The unaudited profit for the financial year 2021-22 of Abhinandan Limited was ₹ 35 crore and the unaudited turnover was ₹ 100 crore. Upon inquiry it was identified that Abhinandan Limited has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company's legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter. **(RTP-Nov-2022)**

Ans.

(a) As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"

- The auditor is required to **obtain an understanding** and **need to evaluate the impact of other laws and regulations** that do not have a **direct effect** on the determination of the **amounts and disclosures** in the financial statements, but compliance with which may be **fundamental to the operating aspects** of the business, to an entity's ability to continue its business, or to **avoid material penalties** (for example, compliance with the terms of an operating license, **compliance with regulatory solvency requirements**, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.
- The auditor shall perform the **following audit procedures** to help identify **instances of non - compliance with other laws and regulations** that may have a material effect on the financial statements:
  (a) **Inquiring of management and, where appropriate, TCWG**, as to whether the entity is in compliance with such laws and regulations; and
  (b) **Inspecting correspondence**, if any, with the relevant licensing or regulatory authorities As per Section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

(b) As per SA 570, "Going Concern"

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

(i) **Adequately disclose the principal events or conditions** that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(ii) **Disclose clearly that there is material uncertainty** related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

(c) If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall

(a) **Express a qualified opinion or adverse opinion**, as appropriate, in accordance with SA 705; and

(b) **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.

(d) In the current scenario:- Abhinandan Limited has received a show cause notice from the **National Green Tribunal** of an amount which is **more than the net profit and the turnover** of the company for the year. In the event of an **unfavourable order** for Abhinandan Limited, there will be an **impact on Abhinandan Limited's ability to continue as a going concern.** As a result, appropriate disclosure should be provided by management for such events which cast significant doubt on the entity's ability to continue as a going concern.

(e) Conclusion:- As **no appropriate disclosure** has been provided by Abhinandan Limited for such show cause notice, **Subahu & Co. should report this matter** in their audit report under **"Going Concern Para"**

as per SA 570 and under **clause (j) of Section 143(3) of the Companies Act, 2013**. Also, the auditor is required to issue an adverse opinion as per **SA 705, "Modifications to the Opinion in the Independent Auditor's Report"**

SA-260
Communication with Those Charged with Governance

52. **Communication of Findings with TCWG**

"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such communication.

OR

The auditor shall communicate all significant findings with those charged with governance.

Ans. **As per SA-260 "Communication with Those Charged with Governance",** the auditor shall **communicate the following significant findings** from the audit, with those charged with governance-

(a) The auditor's views about **significant qualitative aspects** of the entity's **accounting practices, including** accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor **shall explain to TCWG why the auditor considers a significant accounting practice**, that is acceptable under the **applicable financial reporting framework**, not to be most appropriate to the particular circumstances of the entity;

(b) **Significant difficulties**, if any, encountered during the audit;

(c) **Unless all of TCWG are involved in managing the entity:**

  (i) **Significant matters**, if any, arising from the audit that were discussed, or subject to correspondence with management; and

  (ii) **Written representations** the auditor is requesting; and

(d) **Other matters,** if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

53. **Significant Difficulties in the Audit**

M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260. **(RTP-May-2022)**

OR

State the significant difficulties encountered during audit with reference to SA-260. **(May-2015)**

Ans. **As per SA 260 "Communication with Those Charged with Governance"**, significant difficulties encountered during the audit may **include such matters as:**

- **Significant delays by management**, the unavailability of **entity personnel**, or an unwillingness by management to provide **information necessary for the auditor** to perform the auditor's procedures.
- **An unnecessarily brief time** within which to complete the audit.
- **Extensive unexpected effort** required to obtain sufficient appropriate audit evidence.
- The **unavailability of expected information**.
- **Restrictions imposed on the auditor** by management.
- **Management's unwillingness to make** or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a **scope limitation** that leads to a **modification of the auditor's opinion.as per SA 705 (Revised)**, Modifications to the Opinion in the Independent Auditor's Report.

54. Communication to TCWG & Mandatory Review Areas

Mr. BK, Partner in M/s. BK and Associates, as part of their audit presentation to the Audit Committee of M/s. XYZ Limited, a listed company, highlighted the following:

- Difficulties faced during the audit
- Disagreements with the management
- Management Letter Points
- Draft Management Representation letter to be provided by the Company in connection with the audit.

Some of the Audit Committee members were not happy with the above presentation and asked Mr. BK to take it back and submit directly to the Board. They believe that Audit Committee is not the forum for discussing such problems and this has to be sorted out between auditors and the management. Please comment on the above.

(Nov-2020-New)

Ans.

(i) As per SA 260 – "Communication with Those Charged with Governance":

The **statutory auditor** of the Company is having an obligation to bring certain matters to the **attention of those in charge of governance**, which inter alia **includes aspects such as –**

- **Difficulties faced** by them during the audit
- **Disagreements** with the management
- **Management Letter** points
- Draft **Management Representation letter** to be provided by the Company in connection with the audit.

(ii) AS per LODR Regulations:

- The Audit Committee is also having an **obligation to mandatorily review certain areas** before providing their **recommendations/inputs** to the board. Given below are the areas required to be **mandatorily reviewed by the ACM** in the case of **listed companies**

- **The Audit Committee shall mandatorily review among other points the following information as per LODR Regulations:**
  - ➢ **Management discussion and analysis** of financial condition and results of operations;
  - ➢ **Statement of deviation of funds raised**;
  - ➢ **Management letters** / letters of internal control weaknesses issued by the statutory auditors;
  - ➢ **Internal audit reports** relating to internal control weaknesses;
- The auditor should further ascertain whether the **Management Discussion and Analysis report** includes **discussion on the matters stipulated**. Where certain **deficiencies** or **adverse findings** are noted by the Audit Committee, the auditor will be required to see that these have been **suitably dealt with by the management** in the report on corporate governance.

(iii) In the instant case: - Mr. BK, Partner in M/s BK and Associates **highlighted the facts such as:**

- **difficulties faced** during the audit,
- **disagreements with the management**,
- **managements letters points** and
- **draft management letters** to be provided by the Company in connection with the audit.

However, **some of the audit committee members were not happy** and as according to them audit committee is **not the forum for discussing such problems.**

(iv) Conclusion: -Contention of those audit committee members regarding **problems to be sorted out between auditors and the management is not in order** as Audit Committee is required to **mandatorily review** the same in accordance with **Schedule II of SEBI (LODR) Regulations, 2015**

55. **Modes of Communication – Factors**

Factors governing modes of communication of auditor with those charged with governance.

Ans. **Factors governing modes of communication of auditor with those charges with governance**

As per SA 260, "Communication with Those Charge with Governance" the auditor may decide **whether to communicate orally** or **in writing**, the extent of detail or **summarisation in the communication**, and whether to communicate in a **structured or unstructured manner**) may be affected by **such factors as:**

(i) The **size, operating structure, control environment**, and legal structure of the entity.

(ii) In the case of an audit of **special purpose financial statements**, whether the auditor also audits the **entity's general purpose financial statements**.

(iii) **Legal requirements**. In some jurisdictions, a written communication with TCWG is required in a prescribed form by local law.

(iv) **The expectations of TCWG**, including arrangements made for periodic meetings or **communications with the auditor.**

(v) The **amount of ongoing contact** and dialogue the auditor has with those charged with governance.

(vi) Whether there have been **significant changes in the membership** of a **governing body** .

SA-265
Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

56. **Significant Deficiencies in Internal Control**

CA. N has been appointed as an auditor of TRP Ltd. While conducting the audit he has identified some deficiencies in the Internal control. He needs to determine whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency" and has to communicate them in writing to those charged with Governance and management on a timely basis. Guide CA. N with some examples of matters to be considered while determining 'significant deficiency' in internal control with reference to relevant SA

(Nov-2020-New)

Ans. **(i)** **Significant deficiencies: -** As per SA 265 **"Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**, significant deficiency in internal control means:

- A **deficiency or combination of deficiencies** in internal control that, in the **auditor's professional judgement**, is of **sufficient importance** to merit the **attention of those charged with governance.**

(ii) **Examples of matters** that **CA N, auditor of TRP Ltd may consider** in determining whether a **deficiency or combination** of deficiencies in internal control **constitutes a significant deficiency include:**

- The **likelihood of the deficiencies** leading to material misstatements in the financial statements in the future.
- The **susceptibility to loss or fraud** of the related asset or liability.
- The **subjectivity and complexity of determining estimated amounts**, such as fair value accounting estimates.
- The financial statement **amounts exposed to the deficiencies**.
- The **volume of activity** that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The **importance of the controls** to the financial reporting process; for example:
  - ➢ **General monitoring controls** (such as oversight of management).
  - ➢ Controls over the **prevention and detection of fraud.**
  - ➢ Controls over the selection and application of **significant accounting policies.**
  - ➢ Controls over **significant transactions** with related parties.

- Controls over significant transactions **outside the entity's normal course of business.**
- Controls over the **period-end financial reporting process** (such as controls over non-recurring journal entries).

- The cause and **frequency of the exceptions detected** as a result of the deficiencies in the controls.
- The interaction **of the deficiency** with other deficiencies in internal control.

57. **Indicators of Significant Deficiencies in Internal Control**

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization. **(Jan-2021-New)**

Ans.

(i) **In the given case of ABC Ltd: -** Auditors, while conducting audit has come across **significant deficiency** existing in the **internal control system** and also auditors wanted to **ascertain that deficiency.**

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

a) **Evidence of ineffective aspects** of the control environment, such as:

1. Indications that **significant transactions** in which management is **financially interested** are not being **appropriately scrutinised** by those charged with governance.
2. **Identification of management fraud**, whether or not material, that was **not prevented** by the entity's internal control.
3. **Management's failure** to implement appropriate **remedial action** on significant deficiencies previously communicated.

b) **Absence of a risk assessment process** within the entity where such a process would **ordinarily be expected** to have been **established.**

c) Evidence **of an ineffective entity risk assessment process**, such as management's failure to identify a **risk of material misstatement** that the auditor would expect the entity's risk assessment process to have identified.

d) Evidence **of an ineffective response** to identified significant risks (e.g., absence of controls over such a risk).

e) Misstatements **detected by the auditor's procedures** that were not prevented, or detected and corrected, by the **entity's internal control.**

f) **Disclosure of a material misstatement** due to error or fraud as prior period items in the current year's Statement of Profit and Loss.

g) **Evidence of management's inability** to oversee the preparation of the **financial statements.**

57A. **Significant Deficiency in Internal Control**

During the course of the audit of Tirthankara Limited, CA. Shreyansh Manager in the audit team identified that there is significant risk in lease transactions due to complex cross -border sale and lease back arrangements. This significant risk or risk of material misstatement was not identified in management's risk assessment process. Upon various inquiries with Management regarding their risk assessment process, it was identified and concluded by the audit team that the management's risk assessment process is not effective to identify all the significant risks. CA. Shreyansh decided that this in combination with other potential deficiencies in internal control constitutes significant deficiencies in internal control and hence, is required to be communicated to those charged with governance. However, the engagement partner had a different view regarding the audit of Tirthankara Limited. According to him, the only matter that is identified and poses significant deficiencies due to their magnitude is only required to be communicated. Matters of potential misstatements that are not actual misstatements cannot be termed as significant deficiencies. You are required to guide CA. Shreyansh with respect to examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency. **(MTP-Nov-2022)**

Ans.

(i) Significant deficiencies: - As per SA 265 **"Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**, significant deficiency in internal control means:

- A **deficiency or combination of deficiencies** in internal control that, in the **auditor's professional judgement**, is of **sufficient importance** to merit the **attention of those charged with governance.**
- Also, the **significance of a deficiency or a combination of deficiencies** in internal control depends not only on **whether a misstatement has actually occurred** but also on the **likelihood that a misstatement could occur** and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.

(ii) Examples of matters that **auditor may consider** in determining whether a **deficiency or combination** of deficiencies in internal control **constitutes a significant deficiency include:**

- The **likelihood of the deficiencies** leading to material misstatements in the financial statements in the future.
- The **susceptibility to loss or fraud** of the related asset or liability.
- The **subjectivity and complexity of determining estimated amounts**, such as fair value accounting estimates.
- The financial statement **amounts exposed to the deficiencies.**
- The **volume of activity** that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.

SA-299
Joint Audit of Financial Statements

58. Joint Auditors Responsibilities

P Limited is a listed company and its business activities are divided into three regions. The company appointed PY & Co., KL & Co. and MK & Co., Chartered Accountants to conduct a Joint Audit and report on the financial statements for the Financial Year 2021-22. Explain the relationship among the joint auditors for the audit of the financial statements for the year 2021-22. **(Nov-2015)**

Ans.

- **SA 299 on, "Joint Audit of Financial Statements"** deals with the **professional responsibilities**, which the auditors undertake in accepting **such appointments as joint auditors.**
- **In respect of the work divided amongst the joint auditors**, each joint auditor is responsible **only for the work allocated to him**, whether or not he has made a separate report on the work performed by him.
- **On the other hand** the joint auditors are **jointly and severally responsible** in respect of the audit conducted by them as under:
  i. in respect of the audit work which is **not divided among the joint auditors** and is carried out by all of them;
  ii. in respect of **decisions taken by all the joint auditors** under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;
  iii. in respect of matters which are **brought to the notice of the joint auditors** by any one of them and on which there is an agreement among the joint auditors;
  iv. **for examining that the financial statements** of the entity comply with the requirements of the relevant statute;
  v. **for ensuring presentation and disclosure of the financial statements** as required by the applicable financial reporting framework;
  vi. **for ensuring that the audit report complies with the requirements of the relevant statutes**, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

- It is the separate and specific responsibility of each joint auditor to **study and evaluate the prevailing system of internal control** relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
- The responsibility of **obtaining and evaluating information** and explanation from management is generally a joint responsibility of all the auditors;
- **Each joint auditor is entitled to assure** that the other joint auditors have carried out **their part of work in accordance with the generally accepted audit procedures** and therefore it would not be necessary for joint auditor to **review the work performed by other joint auditors.**

SJ Note: *Questions involving explanation of relationship between joint auditor should be answered with reference to responsibilities of joint auditor*

59. Circumstances in which Joint Auditors are Jointly Liable

Your firm is one of the Joint Auditors of FMP Ltd. Under what circumstances joint auditors are jointly liable for the work in relation to audit of financial statements? Is there any restriction on a joint auditor to communicate a dissenting note differing from the majority opinion of the other joint auditors in the audit report issued under Section 143 of the Companies Act 2013? **(Nov-2018-Old)**

Ans.

- **SA 299 on, "Joint Audit of Financial Statements"** deals with the **professional responsibilities**, which the auditors undertake in accepting **such appointments as joint auditors.**
- **In respect of the work divided amongst the joint auditors**, each joint auditor is responsible **only for the work allocated to him**, whether or not he has made a separate report on the work performed by him.
- **On the other hand** the joint auditors are **jointly and severally responsible** in respect of the audit conducted by them as under:
  i. in respect of the audit work which is **not divided among the joint auditors** and is carried out by all of them;
  ii. in respect of **decisions taken by all the joint auditors** under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;
  iii. in respect of matters which are **brought to the notice of the joint auditors** by any one of them and on which there is an agreement among the joint auditors;
  iv. **for examining that the financial statements** of the entity comply with the requirements of the **relevant statute**;
  v. **for ensuring presentation and disclosure of the financial statements** as required by the applicable financial reporting framework;
  vi. **for ensuring that the audit report complies with the requirements of the relevant statutes**, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

Restrictions as to communication of dissenting note:

- **SA 299 requires** the Joint auditors to **issue common audit report**. However, **in case of any disagreement** among joint auditors with regard to the opinion or **any matters to be covered by the audit report**, they shall express their opinion in **a separate audit report.**
- **A joint auditor is not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and **shall express opinion formed** by the said joint auditor in **separate audit report** in case of disagreement. In such cases, an Other Matter paragraph to be given in the auditor's report as per SA 706.

60. Responsibility and Co-ordination among Joint Auditors

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2022. In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors. Comment on the above situation with regard to responsibilities among joint auditors. **(May-2019-New)**

OR

ABC & Co. and DEF & Co. Chartered Accountant firms were appointed as joint auditors of Good Health Care Ltd. for 2020-21. An investigation was conducted under Companies Act 2013 during March 2022 and observed gross understatement of Revenue. The revenue aspects were looked after by DEF & Co, but there was no documentation for the division of work between the joint auditors. Comment.

Ans.

(i) **As per SA 299, "Joint Audit of Financial Statements"**, where joint auditors are appointed, they should, **by mutual discussion**, **divide the audit work among themselves**.

- The division of the work would **usually be in terms of audit identifiable units** or **specified area**.
- In some cases **due to the nature of the business** entity under audit, such a division of the work **may not be possible**.
- **In such situations: -** The division of the work may be with **reference to items of assets or liabilities** or **income or expenditure** or with reference to period of time.
- The division of the work among **joint auditors as well as the areas of work** to be covered by all of them should be **adequately documented** and **preferably communicated** to the entity.

(ii) **In respect of the work divided amongst the joint auditors**, each joint auditor is responsible **only for the work allocated to him**, whether or not he has made a separate report on the work performed by him. **On the other hand** the joint auditors are **jointly and severally responsible** in respect of the audit conducted by them as under:

i. in respect of the audit work which is **not divided among the joint auditors** and is carried out by all of them;
ii. in respect of **decisions taken by all the joint auditors** under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors;
iii. in respect of matters which are **brought to the notice of the joint auditors** by any one of them and on which there is an agreement among the joint auditors;
iv. **for** examining **that the financial statements** of the entity comply with the requirements of the **relevant statute**;
v. **for ensuring presentation and disclosure of the financial statements** as required by the applicable financial reporting framework;
vi. **for** ensuring **that the audit report complies with the requirements of the relevant statutes**, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

The joint auditors shall **also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas** of audit to be performed by **each of the joint auditors** and the same shall be **communicated to those charged with governance.**

After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, in respect of **audit work divided among the joint auditors**, each joint auditor shall be responsible **only for the work allocated to such joint auditor** including proper execution of the audit procedures.

In the instant case. Dice Ltd. appointed two MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates.

(iii) **Conclusion: -**In view of SA 299 **MN & Associate will be held responsible** for the same as **inventory**

valuation work was looked after by MN & Associates only. Further, there is **violation of SA 299** as the division of work **has not been documented**.

61. **Reporting Responsibility**

Excellent Bank Ltd. is a Public Limited Company. The said Bank has various branches all over India. The Bank appoints 3 Joint Auditors for the financial year ending 31/03/2022. All the 3 Joint Auditors divide the work with mutual consent. Verification of Consolidation, however, remained undivided. All branches and zones were divided amongst the 3 Joint Auditors. During audit of zones, CA. Z, one of the Joint auditors expressed a concern about internal control in one of the large corporate branches situated. in his zone. The irregularity was not reported in the final accounts as the other 2 Joint Auditors were not in favour of reporting and decision of not reporting the same was taken on the basis of majority. Subsequently, fraud was detected in the said branch which was audited by CA. Z. The Bank seeks your advice about the responsibility of the 3 Joint Auditors in the above situation. **(Nov-2019-Old)**

Ans.

(i) As per SA 299, "**Joint Audit of Financial Statements**" where joint auditors are appointed, they should, **by mutual discussion**, divide the audit work among themselves

- The division of the work would usually be **in terms of audit identifiable units** or **specified area**. In respect of the audit work divided among the joint auditors, **each joint auditor is responsible only for the work allocated to him**, whether or not he has prepared a separate audit of the work performed by him.
- **On the other hand all the joint auditors** are **jointly and severally responsible** for the audit work which is not divided among the joint auditors and. is carried out jointly and matters which are brought to the **notice of the joint auditors** by any one of them and on which there is an agreement among the joint auditors.

(ii) **In the instant case: -** Excellent Bank Ltd. **Appoints 3 joint auditor** for the financial year ending 31.03.2019. All the joint auditors **divided the work with mutual consent**. The only work which remained undivided was **verification of Consolidation**. In accordance with SA 299, **all the joint auditors are responsible** for the same.

(iii) **Analysis of the case**

- Further, during audit of zone, **CA Z, one of the joint auditors** expressed a concern about **internal control in one of the large corporate branches** situated in his zone, however, this **irregularity was not reported** as 2 of the joint auditors (i.e. majority of the joint auditors) were not in favour of the same.
- Later on, **fraud has been detected in the same branch** which was audited by CA. Z. As per SA 299, Before finalizing their audit report, **the joint auditors shall discuss** and **communicate** with each other their respective conclusions that would form the content of the audit report.
- Further, **a joint auditor is not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and **shall express opinion formed** by the said joint auditor **in separate audit report** in case of disagreement.

(iv) **Conclusion: -** in the present scenario, **CA. Z brought this matter in the notice of the other 2 joint auditors** and the **decision for not reporting was taken on majority basis** and no separate opinion was expressed through **separate audit report** pointing out irregularity. Thus, **all the 3 joint auditors will be held responsible** for the fraud detected in the branch audited by CA. Z as per SA 299.

SA-300
Planning an Audit of Financial Statements

62. **Establishment of Overall Strategy**

Comment on the following: -"Auditor shall establish an overall strategy that sets the scope, timing and directions of the audit, and that guides the development of the audit plan" **(May-2018)**

Ans.

(i) According to **SA 300, "Planning an Audit of Financial Statements"** the auditor shall **establish an overall audit strategy** that sets the **scope, timing and directions** of the audit, and that guides the development of the audit plan.

(ii) In establishing the overall audit strategy, the auditor shall:

- Identify the **characteristics of the engagement** that define its scope;
- Ascertain the **reporting objectives of the engagement** to plan the timing of the audit and the nature of the communications required;
- Consider the factors that, in **the auditor's professional judgment**, are significant in **directing the engagement team's** efforts;
- Consider the **results of preliminary engagement activities** and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- Ascertain the **nature, timing and extent of resources** necessary to perform the engagement.

63. Audit Strategy & Audit Plan – Relationship

Discuss the relationship between overall audit strategy and audit plan. **(RTP-May-2022)(Nov-2016)**

Ans.

Relationship between the Overall Audit Strategy and the Audit Plan:

- The audit strategy provides the **guidelines for developing the audit plan**. It establishes the **scope and conduct of the audit procedures** and thereby works as basis for **developing a detailed audit plan.**
- Detailed audit plan would include **the nature, timing and extent of the audit procedures** to obtain sufficient appropriate audit evidence.
- The audit strategy is prepared **before the audit plan.**
- The audit plan **contains more details** than the overall audit strategy.
- **Audit strategy and audit plan are inter-related** because change in one would result into change in other.

64. Changes in Audit Plan

Mr. S & Mr. J are a senior and junior articled assistant respectively, in a renowned audit firm. Both were assigned statutory audit of a manufacturing company. Mr. S instructed his junior to draft an audit plan by taking reference from a similar client (a partnership firm) who was engaged in the same business. Mr. J was confused as to how that reference could suit in this case, since the nature and extent of planning would vary for both clients. After few days, the audit work commenced. During the course of the audit, certain events took place, which made Mr. J to rethink about the audit plan initially designed. He approached Mr. S and enquired about when would an audit plan require a change. Comment about both the situations face by Mr. J in the above situation. **(MTP-Dec-2021)**

Ans.

SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" states that in order to achieve the **overall objectives** of the audit, the auditor shall use the objectives stated in relevant SAs in **planning and performing the audit**. Without a careful plan, the overall objective of an audit **may not be achieved**. The audit **planning is necessary** to conduct an effective audit, in an efficient and timely manner. So far as the nature of planning is concerned, it would vary according to-

(i) Size and Complexity of the Auditee - If the **size and complexity of organization** of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.

(ii) Past Experience & Expertise - The key engagement team members' **previous experience & expertise** also contributes towards variation in planning activities.

(iii) Change in Circumstances - Another factor contributing towards **variation in planning** activities is change in circumstances.

Changes to Audit Planning: The auditor should update and change the overall audit strategy and audit plan as necessary during the course of the audit. The auditor may need to modify the overall audit strategy and audit