

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

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

149.

### Specific Inquiries to Evaluate Subsequent Events

M/s LMP Associates, Chartered Accountants while conducting the audit of PQR Ltd want to conduct an inquiry of management and those charged with governance as to whether any subsequent event have occurred which might affect the financial statements. Guide M/s LMP Associates with the matters where specific enquiry may be conducted to evaluate subsequent events. **(MTP-May-2022)(May-2019-Old)**

OR

Inquiry from Management is helpful for Auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements.

Ans.



- **As per SA 560, "Subsequent Events"**, in inquiring of **management** and, where appropriate, **those charged with governance**, as to whether **any subsequent events** have occurred that might affect the **financial statements**,
- The auditor may inquire as to the **current status of items** that were accounted for on the basis of **preliminary or inconclusive data** and may make **specific inquiries about the following matters**:
  - Whether **new commitments, borrowings or guarantees** have been entered into.
  - Whether **sales or acquisitions of assets** have occurred or are planned.
  - Whether there have been **increases in capital or issuance of debt instruments**, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
  - Whether **any assets have been appropriated by government or destroyed**, for example, by **fire or flood**.
  - Whether there have been any developments regarding **contingencies**.
  - Whether any **unusual accounting adjustments** have been made or are contemplated.
  - Whether **any events have occurred** or are **likely to occur** that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
  - Whether **any events have occurred** that are **relevant to the measurement of estimates or provisions made** in the financial statements.
  - Whether any events have occurred that are **relevant to the recoverability of assets**.

150.

### Treatment of Subsequent Events

A Co. Ltd. has not included in the Balance Sheet as on 31-03-2022 a sum of ₹ 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2022. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2022. The auditor came to know the result of the negotiations on 15-05-2022. Comment.

Ans.



#### (i) As per SA 560 "Subsequent Events"

- In respect of **events occurring between the date of F.S. and date of the Audit Report**, the auditor shall perform **audit procedures** to obtain sufficient & appropriate audit evidence to ensure that events which require **adjustments or disclosure** in the F.S. have been **identified**.

#### (ii) AS-4 & AS-29

- This case requires attention to **AS 4 "Contingencies and Events occurring after the Balance Sheet Date"** and **AS 29 "Provisions, Contingent liabilities and Contingent Assets"**.

- As per AS 4 “Contingencies and Events occurring after the Balance Sheet Date”, adjustments to **assets and liabilities are required for events** occurring after the balance sheet date that provide **additional information materially affecting** the determination of the **amounts relating to conditions existing** at the balance sheet date.
  - **Similarly as per AS 29 “Provisions, Contingent liabilities and Contingent Assets”**, future events that may affect the **amount required to settle an obligation** should be reflected in the **amount of a provision** where there is sufficient objective evidence that the will occur.
- (iii) **In the instant case:** - The amount of ₹ 1.50 crores is a **material amount** and it is the result of an event, which has occurred **after the Balance Sheet date**. The facts have become known to the auditor **before the date of issue of the Audit Report** and Financial Statements.
- (iv) **Audit Procedure:**
- The auditor has to **perform the procedure** to obtain **sufficient, appropriate evidence** covering the period from the date of the financial statements **i.e. 31-3-2022** to the date of Auditors Report **ie.31-05-2022**.
  - It will be observed that **as a result of long pending negotiations** a sum of ₹ 1.50 cores representing **arrears of salaries** of the year **2020-21 and 2021-22** have not been included in the financial statements. **It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.**
- (v) **Conclusion:** -So the auditor should request **the management to adjust the sum of ₹ 1.50 crores by making provision for expenses**. If the management **does not accept** the request **the auditor should qualify the audit report**.

151.

**Facts Which Become Known to the Auditor After the Date of the Auditor’s Report but Before the Date the Financial Statements are Issued**

Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2022. The Audit Report for that year was signed by the Auditors on 04/05/2022. The Annual General Meeting was decided to be held during the month of August 2022. On 06/05/2022, the Company had received a communication from the Central Government that an amount of ₹ 5800 crore kept pending on account of incentives pertaining to Financial Year 2021-22 had been approved and the amount would be paid to the Company before the end of May 2022. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released' before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2022. On 08/05/2022, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2022. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

(Nov-2018- New)

Ans.

(i) **Provision:**

- As per SA 560, “Subsequent Events”, the auditor has **no obligation to perform any audit procedures** regarding the financial statements **after the date of the auditor’s report**.
- However, **when, after the date of the auditor’s report** but before the **date the financial statements are issued**, a fact becomes **known** to the auditor that, had it been known to the auditor at the date of the **auditor’s report**, may have caused the auditor to **amend the auditor’s report**,
- The auditor shall
  - **Discuss the matter** with **management** and, where appropriate, **TCWG**.
  - Determine whether the **financial statements need amendment** and, if so,
  - Inquire how management **intends to address the matter** in the financial statements.

**(ii) Audit Procedure & New Audit Report:**

- If management amends the financial statements, the **auditor shall carry out the audit procedures necessary in the circumstances** on the amendment.
- Further, the **auditor shall extend the audit procedures** and provide a **new auditor's report** on the amended financial statements.
- However, the **new auditor's report shall not be dated** earlier than the **date of approval** of the amended financial statements.

**(iii) In the instant case:**

- **XYZ Company Ltd.** received an amount of **rupees 5800 crore** on account of incentives pertaining to **year 2021-22** in the month of **May 2022** i.e. after finalisation of financial statements and signing of audit report.
- **Board of Directors of XYZ Ltd. amended the accounts**, approved the same and **requested the Amudhan & Co. (auditor) to consider this event** and issue a **fresh audit report** on the financial statements for the year ended on 31.03.2022.

**(iv) Conclusion:** -After applying the conditions given in SA 560, **Amudhan & Co. can issue new audit report subject to date of audit report** which should not be **earlier than** the date of approval of the amended financial statements.

152.

**Subsequent Events & Emphasis of Matter Paragraph**

The audit report of Kolsi (P) Ltd. for F.Y. 2021-22 was issued by Bishnoi & Co. on 25<sup>th</sup> July, 2022. However, a case was filed against Kolsi (P) Ltd. on 4<sup>th</sup> August, 2022, with the Civil Court, with respect to an incident caused in its factory on 17<sup>th</sup> January, 2022, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.

Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management and it was determined to amend the financial statements for F.Y. 2021-22. Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case and its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case scenario, please answer the following questions:-

- Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?
- Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements?

**(RTP-Dec-2021)**
**Ans.**

**(a) Auditor's responsibility in case of Subsequent Event**

- Provision:** -As per SA 560, 'Subsequent Events', the auditor has **no obligation to perform any audit procedures** regarding the financial statements after the **date of the auditor's report**. However, when, after the date of the auditor's report **but before the date the financial statements** are issued, a fact becomes **known to the auditor** that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to **amend the auditor's report**, the auditor shall:
  - (1) **Discuss the matter with management** and, where appropriate, those charged with governance.
  - (2) Determine whether the **financial statements need amendment** and, if so,
  - (3) Inquire how management **intends to address the matter** in the financial statements.

(ii) **In the given case:** - On becoming aware of the **court case filed against Kolsi (P) Ltd.**, Mr. Raj discussed the said matter **with the management** and it was determined to amend the financial statements. Also, he inquired **how the management intended** to address the said matter in the financial statements.

(iii) **Conclusion/Comment**

- However, If management **does not take the necessary steps** to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and **does not amend the financial statements** in circumstances where Mr. Raj (hereinafter referred as 'the auditor') believes they need to be amended,
- The auditor shall **notify management and, those charged with governance** (unless all of those charged with governance are involved in managing the entity), that the auditor **will seek to prevent future reliance on the auditor's report**.
- If despite such notification the management or those charged with governance **do not take these necessary steps**, the auditor shall take **appropriate action** to seek to prevent reliance on the auditor's report in accordance with SA 560.

(b) **Disclosure of the court case in the financial statements**

(i) **Provision:** -As per SA 706, 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report', an Emphasis of Matter paragraph is not a substitute for:

- (a) **A modified opinion** in accordance with SA 705 (Revised) when required by the circumstances of a specific audit engagement;
- (b) **Disclosures in the financial statements** that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or
- (c) **Reporting in accordance with SA 570** (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

(ii) **In the given case:** - The management of Kolsi (P) Ltd. has presumed that as the **auditor was going to provide a description of the said court case** and its outcome in the '**Emphasis of Matter**' paragraph in his amended audit report, there was no further need for it to provide additional disclosures about the court case in the financial statements.

(iii) **Conclusion:** -The **said contention of management of Kolsi (P) Ltd. is not valid** as 'Emphasis of Matter' paragraph **cannot be used as a substitute** for disclosures required to be made in the financial statements as per the applicable financial reporting framework or that is otherwise necessary to achieve fair presentation, which is the responsibility of the management.

## SA-570

### Going Concern

153.

#### Evaluating Going Concern Assumption

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

OR

While examining the going concern assumption of an entity, what important indications should be evaluated and examined?

OR

What are the Financial indications to be considered by an auditor for evolution of the going Concern assumption?

Ans.



- (i) **Provision:** -SA 570 “Going Concern”, requires that **while planning a performing audit procedure** and in **evaluating the results** thereof, the auditor should consider the **appropriateness of the going concern assumption** underlying the preparation of the financial statements.
- (ii) **In assessing such a risk, the auditor should examine the following indications-**
- (a) **Financial Indications**
- **Net liability or net current liability position.**
  - **Fixed-term borrowings** approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
  - Indications of **withdrawal of financial support** by trade payables.
  - **Negative operating cash flows** indicated by historical or prospective financial statements.
  - **Adverse** key financial ratios.
  - **Substantial operating losses** or significant deterioration in the value of assets used to generate cash flows.
  - **Arrears or discontinuance of dividends.**
  - **Inability to pay trade payables** on due dates.
  - **Inability to comply with the terms of loan** agreements.
  - Change from **credit to cash-on-delivery** transactions with suppliers.
  - Inability to obtain **financing for essential new product** development or other essential investments.
- (b) **Operating Indications**
- **Management intentions** to liquidate the entity or to cease operations.
  - **Loss of key management** without replacement.
  - **Loss of a major market**, key customer(s), franchise, license, or principal supplier(s).
  - **Labour difficulties.**
  - **Shortages** of important supplies.
  - Emergence of a **highly successful competitor.**
- (c) **Other Indications**
- **Non-compliance** with capital or other statutory requirements.
  - **Pending legal or regulatory proceedings** against the entity that may, if successful, result in claims that the entity is **unlikely to be able to satisfy.**
  - **Changes in law or regulation** or government policy expected to **adversely affect** the entity.
  - **Uninsured or underinsured** catastrophes when they occur.
  - **The significance of such events or conditions** often can be mitigated by other factors.
- For example,** the effect of an entity being unable to make its **normal debt repayments may be counter-balanced by management’s plans** to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. **Similarly, the loss of a principal supplier** may be mitigated by the availability of a suitable **alternative source of supply.**

154.

**Additional Audit Procedures when Events or Conditions are Identified:**

Mr. Ram, an auditor, identified some events that cast significant doubt on the entity’s ability to continue as a going concern. What are the additional procedures he should perform as per the related Standard on Auditing?

(Nov-2016)

Ans.

- (i) **As per SA 570 “Going Concern”,** when events or conditions have been identified that **may cast significant doubt** on the **entity’s ability to continue** as a going concern, the auditor shall obtain **sufficient appropriate audit evidence** to determine whether or not **a material uncertainty exists** through **performing additional audit procedures**, including consideration of mitigating factors.



(ii) **These procedures shall include:**

- When management has **not yet performed an assessment** of the entity's ability to **continue as a going concern**, requesting management to **make its assessment**.
- **Evaluating management's plans for future actions** in relation to its going concern assessment, whether the **outcome of these plans** is likely to **improve the situation** and whether management's plans are **feasible in the circumstances**.
- When the entity has prepared a **cash flow forecast**, and **analysis of the forecast** is a significant factor in considering the **future outcome of events** or **conditions** in the evaluation of management's plans **for future action**:
  - (a) Evaluating the **reliability of the underlying data** generated to prepare the forecast; and
  - (b) Determining whether there is **adequate support for the assumptions** underlying the forecast.
- Considering whether **any additional facts or information** have become available since the date on which management **made its assessment**.
- **Requesting written representations** from management and, where appropriate, TCWG, regarding their **plans for future action** and the **feasibility of these plans**.

**155. Evaluation of Appropriateness of Going Concern Basis**

MNO Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company's ability to continue as a going concern.

The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2021. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2022. The RP reviewed the resolution plans and ensured conformity with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (CoC) on 2 February 2022 and the resolution plan submitted by PQR Ltd. was evaluated as highest evaluated Compliant Resolution Plan. CoC of MNO Ltd. approved the Resolution Plan submitted by PQR Ltd. on 2 March 2022. The approval of NCLT was finally obtained on 4 May 2022.

PQR Ltd. submitted detailed plans and commitments as part of the resolution plan including clearance of all outstanding debts which were leading to negative cash flows. Please suggest how would you deal with this situation as the auditors of MNO Ltd.

**(RTP-Nov-2019)(MTP-May-2019)**

**Ans.**



(i) **As per SA 570 "Going Concern"**, when events or conditions have been identified that **may cast significant doubt** on the **entity's ability to continue** as a going concern, the auditor shall obtain **sufficient appropriate audit evidence** to determine whether or not **a material uncertainty exists** through **performing additional audit procedures**, including consideration of mitigating factors.

(ii) **These procedures shall include:**

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

- Considering whether **any additional facts or information** have become available since the date on which management **made its assessment**.
- **Requesting written representations** from management and, where appropriate, TCWG, regarding their **plans for future action** and the **feasibility of these plans**.

**(iii) Further Audit Procedure**

- The auditor shall evaluate **whether sufficient appropriate audit evidence** has been obtained regarding, and shall conclude on, the **appropriateness of management's use of the going concern** basis of accounting in the preparation of the financial statements.
- **If events or conditions have been identified** that may cast significant doubt on the **entity's ability to continue as a going concern** but, based on the audit evidence obtained the **auditor concludes that no material uncertainty exists**,
- The auditor shall evaluate whether, **in view of the requirements** of the **applicable financial reporting framework**, the financial statements provide **adequate disclosures** about these events or conditions.

**(iv) In the instant case:**

- The **approval of the resolution plan** is a **significant mitigating factor** to counter the going concern issues of **MNO Ltd. PQR Ltd.** has submitted a **detailed plan and commitments** that has been given as part of the **resolution plan** which includes clearance of **all outstanding debts** which were leading to negative cash flows.

**(v) Conclusion:**

- Therefore, it can be said that the **events and conditions are mitigated effectively** and there is **no material uncertainty** in relation to the ability of the **company to continue as a going concern**.
- Company should **disclose events or conditions & mitigating factors** and auditor to **give EOM**.

156.

**Circumstances affects Going Concern**

Star Ltd. is a power generating company which uses coal as raw material for its power generating plant. The Company has been allotted coal blocks in the state of Jharkhand and Odisha. During the FY 2021-22, a scam regarding allotment of coal blocks was unveiled leading to a ban on the allotment of coal blocks to various companies including Star Ltd. This happened in the month of December 2021 and as such entire power generation process of Star Ltd, came to a halt in that month. As a result of such ban, and the resultant stoppage of the production process, many key managerial personnel of the company left the Company. There were delays in the of payment of wages and salaries and the banks from whom the Company had taken funds for project financing also decided not to extend further finance or to fund further working capital requirements of the Company. Further, when discussed with the management, the statutory auditor understood that the Company had no action plan to mitigate such circumstances. Further, all such circumstances were not reflected the financial statements of Star Ltd. What course of action should the statutory auditor of the Company consider in such situation?  
**(RTP-May-2021)(Study Material)**

Ans.



**(i) SA 570- "Going Concern":** - Deals with the **auditor's responsibilities** in the audit of financial statements relating to **going concern** and the **implications for the auditor's report**.

- The **auditor's responsibilities** are to obtain **SAAE** regarding, and
- Conclude on, the **appropriateness of management's use of the going concern** basis of accounting in the preparation of the FSs, and
- To conclude, **based on the audit evidence** obtained, whether a **material uncertainty exists** about the entity's ability to **continue as a going concern**.

**(ii) When the use of going concern basis of accounting is inappropriate:**

- If the financial statements have been **prepared using the going concern basis** of accounting but, in the **auditor's judgment**, management's use of the **going concern** basis of accounting in the preparation of the financial statements is **inappropriate**,
- The auditor shall express an **adverse opinion**.

**(iii) When adequate disclosure of a material uncertainty is not made in the FSs**

- The auditor shall express a **qualified opinion** or **adverse opinion**, as appropriate, in accordance with **SA 705 (Revised)**; and
- **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**.

**(iv) In the present case: -** The following **circumstances indicate the inability of Star Ltd.** to continue as a going concern:

- Ban on the **allotment of coal blocks**
- **Halt in power generation**
- Key Managerial Personnel **leaving the Company**.
- Banks decided **not to extend further finance** and not to fund the working capital requirements of the Company.
- Non availability of **sound action plan** to mitigate such circumstances.

**(v) Conclusion: -**Therefore, **considering the above factors** it is clear that the going concern basis is **inappropriate** for the Company. Further, such circumstances are **not reflected in the FSs** of the Company. **As such, the statutory auditor of Star Ltd. should:**

- **Express an adverse opinion** in accordance with SA 705 (Revised) and
- In the **Basis of Opinion paragraph** of the auditor's report, The statutory auditor **should 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**.

157.

**Appropriateness of using Going Concern Assumption in case of Material Uncertainty Exists**

OM Ltd. is a company engaged in the business of manufacture of spare parts. Shanti & Associates are the statutory auditors of the company for the FY 2021-22. During the course of audit, CA Shanti noticed that the company had a major customer, namely, Korean Mart from South Korea. Owing to an outbreak of war and subsequent destruction leading to government ban on import and export in South Korea, the demand from Korean Mart for the products of OM Ltd. ended for an unforeseeable time period. When discussed with the management, CA Shanti was told that the company is in the process of identifying new customers for their products. CA Shanti understands that though the use of going concern assumption is appropriate but a material uncertainty exists with respect to the identification of new customers. This fact is duly reflected in the financial statements of OM Ltd. for the FY 2021-22. How should CA Shanti deal with this matter in the auditor's report for the FY 2021-22 in accordance with relevant Standard on Auditing? **(MTP-Dec-2021)(Study Material)**

Ans.

**(i) As per SA 570, "Going Concern" -** loss of a major market or a key customer is **one of the operating indicators** that may cast significant doubt on the **company's ability to continue as a going concern**.**(ii) In the present case:**

- OM Ltd. has a **key customer in South Korea** from which the demand for its products has ended on account of outbreak of war, subsequent destruction and government ban on import and export in South Korea.
- Further, the company has **not yet identified new customers** and is in the process of doing the same.
- As such, the identification of **new customer is a material uncertainty** that cast a significant doubt on the company's ability to continue as a going concern.
- However, **this matter is duly disclosed by the management of OM Ltd.** in the financial statements for the year ended 31.03.2021.
- **As such, considering that the going concern assumption is appropriate but a material uncertainty exists with respect to identification of new customer, CA Shanti should:**
  - (1) Express an **unmodified opinion** and
  - (2) Include in his audit report, a **separate section** under the heading **"Material Uncertainty Related to Going Concern"** to:

- (i) **Draw attention to the note in the financial statements** that discloses the matters and
- (ii) **State that these events or conditions** indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

**(iii) Conclusion:** -Thus, CA Shanti should deal with this matter in his auditor's report in the above mentioned manner.

158.

#### Uncertainty Clamping on the Going Concern - Reporting

M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2022 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the, 'Going Concern' would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter. **(Nov-2018-New)**

Ans.



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

#### (ii) If adequate disclosure about the material uncertainty is made in the FS

- The auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
  - **Draw attention to the note** in the financial statements that **discloses the matters** set out above; and
  - **State that these events or conditions** indicate that a **material uncertainty exists** that may cast significant doubt on the **entity's ability to continue** as a going concern and that the **auditor's opinion is not modified** in respect of the matter.

#### (iii) In the instant case:

- **M/s Aircraft Ltd.** is running into **continuous financial losses** as well as reduction in **sales due to stiff competition** and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of **its ability to continue** in near future.
- **Therefore, a committee has been constituted** to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts.

#### (v) Conclusion: -

- Therefore, the **auditor should disclose** about the **material uncertainty** and express an **unmodified opinion** and
- In his audit report shall **include a separate section** under the heading "**Material Uncertainty Related to Going Concern**" to draw attention to the note in the **financial statements** that discloses the matters set out above; and
- State that **these events or conditions indicate** that a **material uncertainty exists** that may cast significant doubt on the **entity's ability to continue** as a going concern and that the **auditor's opinion is not modified** in respect of the matter.

159.

**Contingent Liability & Impact on Going Concern**

ABC Company files a law suit against Unlucky Company for ₹ 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation? (Study Material)

Ans.

**(i) As per AS 29 "Provisions, Contingent liabilities and Contingent Assets"**

- A contingent liability is a **possible obligation** that arises from **past events** and the **existence of which will be confirmed** only by the **occurrence or non-occurrence** of one or more **uncertain future events** not wholly within the control of the enterprise.
- Further, **future events that may affect** the amount required to **settle an obligation should be reflected** in the **amount of a provision** where there is sufficient objective evidence that the event will occur.

**(ii) As per SA 570 "Going Concern"**

- There are **certain examples of events or conditions** that, **individually or collectively**, may cast **significant doubt** about the going concern assumption.
- **Pending legal or regulatory proceedings** against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event.

**(iii) Auditor's procedure:** -When the auditor concludes that the **use of the going concern assumption is appropriate in the circumstances** but a **material uncertainty exists**, the auditor shall determine

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

**(iv) In the instant case:** - ABC Company has **filed a law suit against Unlucky Company for ₹ 5 crores**. Though, the attorney of Unlucky Company feels that the **suit is without merit** so the company merely discloses the **existence of law suit** in the notes accompanying its financial statements.**(v) Conclusion:**

- Auditor should **evaluate the source data** on which **basis the opinion is formed** and **evaluate the appropriateness of use** of going concern assumption.
- If the auditor **finds the uncertainty**, he may request the management to **adjust the sum of ₹ 5 crore** by making provision for expenses **as per AS 29**.
- If the management **does not accept the request** the auditor should **qualify the audit report**.

160.

**Reporting Responsibilities of Statutory Auditor**

Yummy Ltd., dealing in manufacturing and trading of milk butter, has a benchmark in its product for so many years. Tasty Ltd., a rival company to Yummy Ltd., has introduced its new product, peanut butter. Due to being health conscious, the consumers have shifted from milk butter to peanut butter within few months. This has result into massive loss during the year to Yummy Ltd. due to non-selling of perishable milk products. The company has also started having negative net worth. It's production head, finance head and marketing head have also left the company. The company has no sound action plan to mitigate these situations. Kindly guide the auditor of Yummy Ltd., how he should deal with the situation.

**OR**

R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31st March 2022, S Ltd had disclosed in the notes (Note No. X) "The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit. Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd include financial statements of certain branches which are audited by other auditors. What are the reporting responsibilities of R & Co.?

Ans.



This question involves two broad aspect with respect to reporting requirements i.e.

- one which deals with **Going Concern** aspect where the company has gone for legal suit and
- other is **work done by other auditors**.

(i) As per facts of the case:

- The **State Pollution Control Board** has issued the **closure order for S Ltd.**, on account of **environmental damaging** by its only manufacturing plant.
- However, **S Ltd had challenged the same** by way of a law suit. Due to **pendency of the outcome** of the legal suit, the company has prepared its financial statements on **going concern basis**.

(ii) As per SA 570 "Going Concern"

- Under the **going concern assumption**, an entity is viewed as **continuing in business** for the foreseeable future.
- **General purpose financial statements** are prepared on a **going concern basis**, unless management either **intends to liquidate** the entity or to cease operations, or has **no realistic alternative** but to do so.
- **Management's assessment of the entity's ability** to continue as a **going concern** involves making a judgment, at a **particular point in time**, about inherently **uncertain future outcomes** of events or conditions.

(iii) Auditor's Responsibility:

- The auditor's responsibility is to **obtain sufficient appropriate audit evidence** about the appropriateness of **management's use of the going concern** assumption in the **preparation and presentation** of the financial statements and
- To conclude **whether there is a material uncertainty** about the entity's ability to continue as a going concern. For this the auditor **may take the help of expert**.

(iv) As per SA 620, "Using the Work of an Auditor's Expert"

- **If expertise in a field is necessary** to obtain sufficient appropriate **audit evidence**, he may determine to **use the work of an auditor's expert**. On the basis of **expert's opinion** he may decide to **rely or not** on assessment of management.

(v) As per SA 570 "Going Concern"

- Pending legal proceedings is a condition that, individually, may cast significant doubt about the going concern assumption. **Existence of above condition signifies that a material uncertainty exists.**
- Further, when the auditor concludes that the **use of the going concern assumption is appropriate in the circumstances** but a **material uncertainty exists**, the auditor shall determine whether the **financial statements**:
  - **Adequately describe the principal events or conditions** that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
  - **Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern** and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

(vi) Reporting in Audit Report

- **If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph** as per SA 706 "Emphasis of matter paragraphs and other matter paragraphs in the Independent Auditor's Report", in the auditor's report to:
  - **Highlight the existence of a material uncertainty** relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and
  - **Draw attention to the note in the financial statements** that discloses the matters

(vii) **Conclusion:** -In the present situation, **management of S Ltd. had disclosed the above fact in the financial statement.** Further, use of the going concern assumption is **appropriate but a material uncertainty exists** so assuming the assessment and disclosure of S Ltd. in order, **R & Co. should include an Emphasis of Matter paragraph** in the auditor's report.

(viii) **Further, as per SA 600 "Using the work of Another Auditor"**

- When the principal auditor has to **base his opinion on the financial information** of the entity as a whole relying upon the **statements and reports** of the other auditors,
- **His report should state clearly the division of responsibility** for the financial information of the entity by indicating the extent to which the financial information of **components audited by the other auditors** have been included in the financial information of the entity, **e.g., the number of divisions/ branches/ subsidiaries** or other components audited by other auditors.

*SJ Note: Alternative answer is possible assuming that company is not going concern, hence auditor should issue adverse report.*

161.

### Covid-19 Impact

William & Sons Limited is well-known in the hospitality and the entertainment industry with their chain of hotels, travel agencies etc. They arrange packaged tours for customers both in India and abroad.

**A snapshot of their financials for the previous year ended 31st March, 2020 is given below:**

Particulars	Amount in INR Mns	Remarks
Share Capital	5000	Includes fully convertible preference share capital (before 2021) of INR 2000 Mn
Reserves & surplus	200	Includes revaluation reserve of INR 100 Mn
External commercial borrowing	8800	No cover through hedging
Current Assets	2200	Primarily receivables from travel companies who were enjoying credit terms from the company
Current Liabilities	6550	Represents payments to creditors and banks
Property Plant Equipment (incl Goodwill of INR 2200 Mn)	11750	Goodwill has arisen based on the acquisition of hotels

Their business has been severely impacted by COVID-19 pandemic during the period April to June 2020 and the Company has to submit its audited financial statements for the quarter ended 30 June 2020 to its investors. What are the key considerations to be taken into account whilst auditing the financial statements of the Company?

(Nov-2020-Old)

Ans.

### Key Audit Considerations to be taken into account whilst auditing the financial statements

(i) The financial statements have **various items** which would have been **affected by the outbreak of COVID-19**. In addition to the **detailed list of items of financial statements** mentioned in the situation, specific accounting issues could arise in the **following areas:**

- Share Capital:**
  - **Status of conversion** of Preference Share Capital and implication;
- Reserve and Surplus:**
  - 50% of the reserve is **revaluation reserve** which is **not free reserve**.
- External Commercial borrowing :**
  - **Repayment** capacity.
  - **Forex** impact.
  - **Any restructuring / change** in the terms of repayments to be checked.



**4. Current Assets:**

- **Expected credit losses** on the receivables considering the industry in which the company operates. **In the instant case** current assets are **primarily receivable from travel companies** who were enjoying **credit terms** from the company and impact of Covid-19 on travel agency needs assessment.
- **Inventory valuation**, if any inventory is lying with the company.
- **Current ratio** assessment.

**5. Current liabilities**

- Repayment capacity.
- Liquidity position to be analysed.

**6. Goodwill**

- **Impairment** assessment.

**7. Property, Plant and Equipment:**

- **Impairment** assessment.
- **Change in useful lives/** residual values.

(ii) **In the given situation:** - On account of **COVID-19** which has been prevailing, the **liquidity position** of the Company is under distress. The auditor is required **to discuss with the management** as to how they are **perceiving current** and the **near future position** and thereafter assess the **effect of estimation uncertainty** or the **risk assessment** and audit evidence supporting these accounting estimates and related disclosures that may be **affected by the impact of COVID-19** on the business of the entity and the economic environment

(iii) **Conclusion:** -After assessment of the **entire condition**, the auditor may **discuss about the going concern** position of the company. The auditor is also required to **ensure disclosures to be given** in the financial statements are as per ICAI advisory.

*SJ Note: SA 570 is just a part of the whole answer*

**161A.**
**Reporting - Material uncertainty exist with respect to going concern**

CA.K is appointed statutory auditor of SEEK INDIA LTD under Companies Act, 2013 for the first time. The company is preparing its accounts keeping in view applicable requirements of Division II of Schedule III of Companies Act, 2013. On scrutiny of financial statements of company put up for audit, it was noticed that notes to accounts show ageing of trade payables as per amended requirements of Schedule III of the Companies Act, 2013.

The ageing schedule forming part of notes is as under: -

Outstanding for following periods from due date of payment (₹ In crore)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	NIL	NIL	NIL	NIL	NIL
Others	2	4	3	1	10
Disputed dues-MSME	NIL	NIL	NIL	NIL	NIL
Disputed dues-others	NIL	NIL	NIL	NIL	NIL

Besides above, current ratio, debt-equity ratio, trade payables turnover ratio and net profit ratio disclosed in notes to accounts have slipped drastically as compared to last year and from standard norms. Most of the key financial ratios are in red. There is no other relevant information concerning above in notes to accounts.

Further, on reviewing bank statement of cash credit limit (against hypothecation of paid stocks), it was noticed that there is no debit transaction in the month of March,2022. On inquiry, he came to know that stock audit of company was conducted in the month of January,2022 and stock auditors have commented vide their report dated 25.2.2022 that company had negative drawing power due to high creditors. Accordingly, the bankers have refused further debits in cash credit account from start of March,2022. There is no information in this respect in financial statements and notes to accounts. Discuss how CA K should deal with above for reporting in his audit report under the Companies Act, 2013.

**(MTP-Nov-2022)**

**Ans.**
**(i) In the given situation:**

- **it is clear from the ageing schedule** that company is **not able to pay its creditors** on time.



Outstanding to creditors for a **period of 1 year or more** account for 80% of total dues to the creditors of the company from due date of payment.

- **Most of key financial ratios are adverse.**
- **Further, bankers have refused further debits** in cash credit account due to negative drawing power from March 2022. Cash credit loans are repayable on demand. **There is no other information or disclosure available** how the company plans to run its business without bank finance.
- **All the above factors are indicators** that a material uncertainty exists that may cast a significant doubt on the company's ability to continue as going concern.
- **There is no express disclosure** of this fact in financial statements.

**(ii) Conclusion:**

- Therefore, **it is a situation where material uncertainty exists** which has cast a significant doubt on company's ability to **continue as going concern** in accordance with **SA 570, "Going Concern"**.
- **Keeping in view above the fact** that although a material uncertainty exists casting a **significant doubt on the ability of company** to continue as going concern, adequate disclosure of material uncertainty is not made in financial statements, **CA K shall give qualified or adverse opinion** in accordance with SA-705, "Modifications to the Opinion in the Independent Auditor's Report".

## SA-580

### Written Representations

162.

#### Written Representation

Explain what is meant by "Written Representations" and indicate to what extent an auditor can place reliance on such representations.

Ans.



**(i) Meaning of Written Representation**

- **A written statement by management** provided to the auditor to **confirm certain matters** or to **support other audit evidence**.
- Written representations in this context **do not include financial statements**, the **assertions** therein, or **supporting books** and records.
- Similar to **responses to inquiries**, **written representations** are audit evidence.
- Although written representations **provide necessary audit evidence**, they **do not provide sufficient appropriate audit evidence** on their own about any of the matters with which they deal.

**(ii) Extent of Reliance:**

- SA 580, "Written Representations", states that **if the auditor has concerns about the competence, integrity, ethical values or diligence of management**, or about its commitment to or enforcement of these,
- The auditor shall determine the effect that such concerns **may have on the reliability of representations** (oral or written) and audit evidence in general.
- In particular, if **written representations are inconsistent with other audit evidence**, the auditor shall perform audit procedures to:
  - (a) **Attempt to resolve** the matter
  - (b) **If the matter remains unresolved**, the auditor shall reconsider the assessment of the **competence, integrity, ethical values or diligence of management**, or of **its commitment to or enforcement of these**, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general.
  - (c) **If the auditor concludes that the written representations are not reliable**, the auditor shall **take appropriate actions**, including determining the possible effect on the opinion in the auditor's report.

163.

**Date of and Period covered by Written Representation**

Mokshda & Co is the statutory auditor of Get My Trip Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2765 crore and profits are INR 285 crore. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580. **(MTP-May-2021)**

**OR**

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000 crores and profits are INR 190 crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580. **(RTP-May-2019)**

**Ans.**

**(i) As per SA 580, "Written Representations - Date of WR**

- As written representations are **necessary audit evidence**, the auditor's opinion **cannot be expressed**, and the auditor's report **cannot be dated**, before the **date of the written representations**.
- Furthermore, because the **auditor is concerned with events occurring up to the date of the auditor's report** that may require **adjustment to or disclosure** in the financial statements,
- The written representations are **dated as near as practicable to, but not after, the date of the auditor's report** on the financial statements.

**(ii) WR for specific assertions**

- In some circumstances it may be appropriate for the auditor to **obtain a WR about a specific assertion** in the financial statements during the course of the audit. Where this is the case, it may be **necessary to request an updated WR**.

**(iii) Period covered in WR**

- The written representations are for **all periods referred to in the auditor's report** because management **needs to reaffirm** that the written representations it previously made with respect to the **prior periods remain appropriate**.
- The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

**(iv) Management's Responsibility:**

- Situations may arise **where current management were not present during all periods referred to in the auditor's report.**
- Such persons **may assert that they are not in a position to provide some or all of the written representations** because they were not in place during the period.
- **This fact, however, does not diminish such persons' responsibilities** for the financial statements as a whole.
- Accordingly, **the requirement for the auditor to request** from them written representations that cover the **whole of the relevant period(s) still applies.**

164.

**Validity of Written Representation**

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

**OR**

An auditor of Mohan Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?

**OR**

While auditing a lawyer company, Mr. X, the statutory auditor of the company, was unable to get the confirmation about the existence and value of certain books existed in the library worth ₹ 35 lakhs. However, the management gave him a certificate to prove the existence and value of the books as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?

**Ans.****(i) Responsibility of Management & Auditor**

- The **physical verification of stock** is the **primary responsibility** of the management.
- The auditor, however, is required to **examine the verification programme adopted by the management.** He must satisfy himself about the **existence and valuation of stock.**

**(ii) In the case of PQR Pvt. Ltd.:**

- The auditor has not been able to **verify the existence and value of certain stock** despite the verification procedure followed in routine audit.
- **He accepted the certificate given** to him by the management without making any **further enquiry.**

**(iii) As per SA 580 "Written Representations"**

- When representation relate to **matters which are material** to the financial information, then the auditor should seek **corroborative audit evidence** for other sources inside or outside the entity.
- He should evaluate whether **such representations are reasonable** and **consistent** with other evidences and should consider whether **individuals making such representations** can be expected to be **well informed** on the matter.
- **"Written Representations" cannot be a substitute for other audit evidence** that the auditor could reasonably expect to be available.

**(iv) Conclusion:**

- **If the auditor is unable to obtain sufficient appropriate audit evidence** that he believes would

be available regarding a matter, which has or may have a material effect on the financial information, this will **constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter.**

- Therefore, **the approach adopted by the auditor is not tenable.**

165.

**Refusal to provide WR**

In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.

**(Study Material)(MTP-Nov-2018)(RTP-May-2018)**

**Ans.**

**(i) Responsibility of Management & Auditor**

- 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.**
- In addition **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) Fraud Detection Risk**

- 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) As per SA 580, "Written Representations"**

If management **modifies or does not provide the requested written representations**, it may alert the auditor to the **possibility** that one or more significant issues may exist. Further, **If the management does not provide one or more of the requested written representations, the auditor shall:**

- **Discuss the matter with management,**
- **Re-evaluate the Integrity of the management** and **evaluate the effect** that this may have on the **reliability of representations** (oral or written) and audit evidence in general, and
- **Take appropriate actions**, including determining the possible effect on the opinion in the auditor's report.


The auditor shall **disclaim an opinion** on the financial statements if the auditor concludes that there is **sufficient doubt about the integrity of management** such that the written representations are **not reliable; or management does not provide** the written representations.

**(iv) Facts of the case:**

- In the instant case, **in the course of audit of K Ltd.,** its auditor **Mr. N observed that there was a special audit** conducted at the instance of the management on a **possible suspicion of fraud.**
- Therefore, the **auditor requested for special audit report**, which was **not provided** by the management despite of many reminders.
- **Mr. N also insisted for written representation** in respect of fraud on/by the company. For this request also management **remained silent.**



**(v) Conclusion:**

- Hence, the **fact is required to be reported** and the auditor **should also disclaim an opinion** on the financial statements.

166.	<b>Duty of an Auditor if Management Refuses to provide WRs</b> In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty?
Ans. 	<p>(i) <b>As per SA 580 "Written Representations"</b></p> <p>If the management <b>does not provide one or more of the requested written representations</b>, the auditor shall:</p> <ul style="list-style-type: none"> <li>• <b>Discuss the matter with management,</b></li> <li>• <b>Re-evaluate the Integrity of the management and evaluate the effect</b> that this may have on the <b>reliability of representations</b> (oral or written) and audit evidence in general, and</li> <li>• <b>Take appropriate actions</b>, including determining the possible effect on the opinion in the auditor's report.</li> </ul> <p>(ii) <b>Effect on Opinion</b></p> <ul style="list-style-type: none"> <li>• The auditor should <b>disclaim an opinion</b> on the financial statements <b>if management does not provide written representations</b> in accordance with <b>SA 705</b> "Modifications to the Opinion in the Independent Auditor's Report".</li> </ul>

### SA-600

#### Using the Work of Another Auditor

167.	<b>Principal Auditor - Factors to be considered while accepting the position</b> PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head offices and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. What factors will be considered by you while accepting the position of Principal auditor? <div style="text-align: right;">(July-2021-New)</div>
Ans. 	<p><b>SA 600 – Using the work of Another Auditor –</b></p> <p>While accepting the position of Principal Auditor, the <b>auditor should consider</b> whether the auditor's own participation is <b>sufficient to be able to act as the principal auditor</b>.</p> <p><b>For this purpose, the auditor would consider:</b></p> <ol style="list-style-type: none"> <li>the <b>materiality of the portion of the financial information</b> which the principal auditor audits;</li> <li>the principal auditor's <b>degree of knowledge</b> regarding the business of the components;</li> <li>the <b>risk of material misstatements</b> in the financial information of the components audited by the other auditor; and</li> <li>the <b>performance of additional procedures</b> as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.</li> </ol>
168.	<b>Coordination between Principal Auditor and Other Auditor</b> "There should be sufficient liaison between a principal auditor and other auditors". Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by other auditor.
Ans. 	<p>(i) <b>SA 600 on "Using the Work of Another Auditor"</b></p> <ul style="list-style-type: none"> <li>• Lays down the <b>procedure to be applied</b> in situations where a <b>principal auditor reporting</b> on the financial statement of the entity uses the work of <b>another independent auditor</b>.</li> <li>• <b>SA 600 contemplates coordination between auditors and requires that there should be sufficient liaison</b> between the principal auditor and the other auditor. For this purpose, the <b>principal auditor</b> may find it necessary to <b>issue written communication(s)</b> to the <b>other auditor</b>.</li> </ul> <p>(ii) <b>Other Auditor Procedures:</b></p>

- The other auditor, knowing the context in which his work is to be used by the principal auditor, **should co-ordinate with the principal auditor.**
- **For example**, by bringing to the **principal auditor's immediate attention** any **significant findings** requiring to be dealt with **at entity level**, adhering to the time-table for **audit of the component**, etc.
- He should **ensure compliance with the relevant statutory** requirements.

**(iii) Principal Auditor Procedures**

- Similarly, the **principal auditor should advise** the other auditor of **any matters that come to his attention** that he thinks may **have an important bearing** on the other auditor's work.
- **When considered necessary by him**, the principal auditor may require the other auditor to **answer a detailed questionnaire regarding matters** on which the principal auditor requires information for **discharging his duties**. The other auditor should respond to such questionnaire **on a timely basis**.

**(iv) Conclusion**

- When the principal auditor concludes, based on his procedures, that **the work of the other auditor cannot be used** and the **principal auditor has not been able to perform** sufficient additional procedures regarding the **financial information of the component** audited by the other auditor, the principal auditor should express a **qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit**.
- **In all circumstances**, if the other auditor **issues, or intends to issue, a modified auditor's report**, the principal auditor should **consider whether the subject of the modification** is of such **nature and significance**, in relation to the financial information of the entity on which the principal auditor is reporting that it **requires a modification of the principal auditor's report**.

169.

**Principal Auditor's Right to Review the WPs of Branch Auditors**

B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers?

**(May-2018-New)**

**Ans.**



**(i) Using the Work of Another Auditor-Principals**

- **SA 600 "Using the Work of Another Auditor"** guides **principal auditor** regarding the **procedures to be performed** when he is using the work of **another auditor**.
- **As per SA 600**, when principal auditor **plans to use the work of branch auditor**, he should consider the **professional competence of the other auditor** in the context of specific assignment if the other auditor is **not a member of the ICAI**.
- He should perform procedures to obtain **sufficient appropriate audit evidence**, that the **work of the other auditor is adequate** for the principal auditor's purposes, in the context of the **specific assignment**.

**(ii) Audit Documentation**

- **As per SA 230 "Audit Documentation"** and **SQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"**, **unless otherwise specified by law or regulation**, audit documentation is the **property of the auditor**.
- **The Principal auditors** of an enterprise **do not have right of access** to the audit working papers of the **branch auditors**.

- (iii) **In the present case:** - Mr. B requires the branch auditors to **share their working papers** with him for the purpose of review.
- (iv) **Conclusion:** considering the requirements of **SA 600, SA 230 and SQC 1**, principal auditor is **not right in asking for sharing of working papers**.

170.

**Role of Auditor in case of Parent Company and Subsidiary Company**

BETA Ltd is the Subsidiary company of ALPHA Ltd. PQR & Associates has been appointed as auditor of ALPHA Ltd. for the Financial Year 2021-22 and MNO & Associates has been appointed as auditor of BETA Ltd for the year 2021-22. Explain the role of PQR & Associates and MNO & Associates as auditors of the parent company and subsidiary company respectively. **(MTP-Nov-2020)**

**OR**

B Ltd. is the Subsidiary company of A Ltd. ABC & Associates has been appointed as auditor of A Ltd. for the Financial year 2021-22 and XYZ & Associates has been appointed as auditor of B Ltd for the year 2021-22. Explain the role of ABC & Associates and XYZ & Associates as auditors of the parent company and subsidiary respectively. **(Nov-2016)**

Ans.



- (i) **As per SA 600 "Using the Work of Another Auditor"**, there should be **sufficient liaison** between the **principal auditor** (hereinafter referred as auditor of Parent Company) and the **other auditor** (hereinafter referred as auditor of Subsidiary Company).
- (ii) **Role of Principal Auditor** (PQR & Associates- Auditor of Parent Company):
- It is necessary to **issue written communication(s)** as a principal auditor to the other auditor.
  - The principal auditor should **advise the other auditor of any matters** that come to his attention that he thinks may have **an important bearing** on the other auditor's work.
  - When considered necessary by him, the principal auditor may require the other auditor to **answer a detailed questionnaire** regarding matters on which the principal auditor requires **information for discharging his duties**.
- (iii) **Role of Other Auditor** (MNO & Associates- Auditor of Subsidiary Company):
- The other auditor, knowing the context in which his work is to be used by the principal auditor, should **co-ordinate with the principal auditor**. For example, by bringing to the **principal auditor's immediate attention** to any **significant findings** requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc.
  - He should ensure **compliance with the relevant statutory requirements**.
  - The other auditor should **respond to the questionnaire** sent by Principal Auditor on a timely basis.

171.

**Qualification in Branch Auditor's Report-Subsequent Events**

As an auditor, comment on You are a Principal Auditor of Sri Company Limited which has three branches the accounts of which are subject to audit by qualified branch auditors. One of the branch auditors qualified his report for non-provision of doubtful debts which he considered to be material for the company as a whole. Subsequent to their reporting, but before you could sign the audit report on the accounts of the company as a whole, the management informed you that the debt under the subject-matter of qualification in Branch Auditor's report had been fully recovered.

Ans.



- The Branch auditor had **qualified on non-provision of a major debt**. After his report but **before the issue of report by Principal auditor** an event happened which has thrown new light on the **facts that existed** as on the date of balance sheet date.
- **This is a subsequent event** within the meaning of **SA 560 "Subsequent Events"** i.e. event that had taken place between the **date of balance sheet date** and the **date of signing the audit report**.
- **In relation to the cases where the component (i.e. branch) is audited by another auditor**
  - The subsequent event would **include events that had taken place between the date of audit report of the component** and the **date of signing the audit report of the entity as a whole** by the principal auditor.

- On becoming aware of the subsequent events, the auditor should consider whether the accounts had been drawn so as to **give effect to the facts of subsequent events**.
- **Conclusion:** - Accordingly, **the auditor should omit qualification as the debt is no more doubtful in view of its recovery in full**. However, the auditor may check that it has in **fact been received by a substantial vouching** of the subsequent events which had been considered by him to make **himself fully satisfied** about his report in the matter.

## SA-610

### Using the Work of Internal Auditors

172.

#### Using the Work of Internal Auditor

CA Mr. X, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Mr. Y, the statutory auditor of the Company, for his view and reporting. Can CA Mr. Y rely on such report? (MTP-Nov-2018)

OR

CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishore, the statutory auditor of the Company, for his view and reporting. Can CA. Kishore rely on such report?

Ans.



- (i) As per SA 610 “Using the Work of Internal Auditors”, while determining whether the **work of the internal auditors** can be used for the purpose of the audit, **the external auditor shall evaluate-**
- **The extent to which** the internal audit function’s **organizational status** and **relevant policies** and **procedures** support the objectivity of the internal auditors;
  - The **level of competence** of the internal audit function; and
  - Whether the internal audit function applies a **systematic and disciplined approach**, including quality control.
- (ii) **the external auditor shall not use the work of the internal audit function if the external auditor determines that:**
- The **function’s organizational status** and **relevant policies** and procedures do not adequately support the objectivity of internal auditors;
  - The function **lacks sufficient competence**; or
  - The function does not **apply a systematic and disciplined approach**, including quality control.
- (iii) **Conclusion** In the instant case **CA. Kishore should ascertain**
- The **internal auditor’s scope of verification**, area of **coverage** and **method of verification**.
  - He should **review the report on physical verification** taking into consideration these factors.
  - If possible, **he should also test check few items** and he can also observe the procedures performed by the internal auditors.
  - If the statutory auditor is **satisfied about the appropriateness of the verification**, he can rely on the report **but** if he finds that the **verification is not in order**, he has to decide otherwise.
  - **The final responsibility to express opinion** on the financial statement remains with the **statutory auditor**.

173.

#### Using Direct Assistance of Internal Auditor

Moon Ltd. of which you are the statutory auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit. (May-2018-New)

Ans.



## (i) As per SA 610 "Using the Work of Internal Auditor"

**Statutory auditor can take direct assistance of internal auditor subject to following conditions:**

- The external auditor is **not prohibited by law or regulation** from obtaining direct assistance from internal auditors.
- There are **no significant threats to the objectivity** of the internal auditor.
- The internal auditor is **sufficient competent** to perform the proposed work.

## (ii) Precautions to be taken while using direct assistance:

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

- Involve **making significant judgments** in the audit;
- Relate to **higher assessed risks of material misstatement**;
- Relate to **work with which the internal auditors have been involved**; or
- Relate to decisions** the external auditor makes in **accordance with this SA** regarding the **internal audit function** and the use of **its work** or **direct assistance**.

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

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

**3. The external auditor shall direct, supervise and review** the work performed by internal auditors on the engagement **in accordance with SA 220**.

174.

**Direct Assistance from Internal Auditor**

OPQ Ltd is in the software consultancy business. The company had large balance of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2022, in respect of the valuation of accounts receivable, the statutory auditor was assigned with the checking of accuracy of the aging of the accounts receivables and provision based on ageing, to the internal auditor providing direct assistance to him. Comment.

(MTP-Nov-2019)(RTP-May-2019)(MTP-May-2019)

Ans.



**(i) Provision: -As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) shall not use internal auditors to provide direct assistance to perform procedures that:**

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

**(ii) In the present case: -** Statutory auditor assigned internal auditor to provide **direct assistance** regarding checking of the **accuracy of the aging of the accounts receivables** and **provision based on ageing**. Valuation of accounts receivable is assessed as **an area of higher risk**.

**(iii) Conclusion: -Statutory auditor could assign** the checking of the accuracy of the **aging to an internal auditor** providing direct assistance. However, because the **evaluation of the adequacy of the provision** based on the aging would **involve more than limited judgment**, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

175.

**Using Direct Assistance of Internal Auditor & Use in External Confirmation Procedure**

Mr. A is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. B as its internal auditor. The external auditor Mr. A asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

- (a) Discuss whether Mr. A, statutory auditor, can ask direct assistance from Mr. B, internal auditor as stated above in view of auditing standards.
- (b) Will your answer be different, if Mr. A ask direct assistance from Mr. B, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

(RTP-May-2020)

Ans.



- (i) **Provision:** -As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) **shall not use internal auditors** to provide **direct assistance to perform procedures that:**

- Involve making **significant judgments** in the audit;

**Significant judgments include the following:**

- Assessing the **risks of material misstatement**;
- Evaluating the **sufficiency of tests performed**;
- Evaluating the appropriateness of management's use of the **going concern assumption**;
- Evaluating **significant accounting estimates**; and
- Evaluating the **adequacy of disclosures in the financial statements**, and other matters affecting the auditor's report

- Relate to **higher assessed risks of material misstatement** where the judgment required in performing the **relevant audit procedures** or **evaluating the audit evidence** gathered is more than limited;
- Relate to work with which the **internal auditors have been involved** and which has **already** been, or will be, **reported to management or TCWG** by the internal audit function; or
- Relate to **decisions the external auditor makes** in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

- (ii) **In the present case:** - Mr. A asked internal auditor to provide **direct assistance regarding evaluating significant accounting estimates** and assessing the **risk of material misstatements**.

- (iii) **Conclusion:** Evaluation of Accounting estimates and assessing Risk of Material Misstatements involve **significant judgements**, hence **Mr. A should not insists for direct assistance in these areas**.

**Direct Assistance from Internal Auditor in case of External Confirmation Procedures:**

- **SA 610 "Using the Work of Internal Auditor"**, provide relevant guidance in determining the **nature and extent of work** that may be assigned to internal auditors.  
In determining the **nature of work that may be assigned to internal auditors**, the external auditor is **careful to limit such work** to those areas that would be appropriate to be assigned.
- In accordance with **SA 505, "External Confirmation"** the external auditor is required to **maintain control over external confirmation** requests and **evaluate the results of external confirmation** procedures, it would **not be appropriate to assign** these responsibilities to internal auditors.
- **Conclusion:** It would not be appropriate to use **direct assistance w.r.t. obtaining external confirmation requests** and their evaluation. **Assistance may be used in assembling information** necessary for the external auditor to resolve exceptions in confirmation responses

176.

**Using Direct Assistance of Internal Auditor**

Mr. Sheetal is appointed as a statutory auditor of Mahi Ltd. Mahi Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Kunthu as its internal auditor.

The external auditor Mr. Sheetal asked internal auditor to provide direct assistance to him regarding evaluating the sufficiency of tests performed and the adequacy of disclosures in the financial statements and other matters affecting the auditor's report. Discuss whether Mr. Sheetal, statutory auditor, can ask direct assistance from Mr. Kunthu, internal auditor as stated above in view of relevant Standard on Auditing.

(MTP-May-2021)

Ans.



As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use **internal auditors to provide direct assistance** to perform procedures that involve making **significant judgments** in the audit. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

**Significant judgments include the following:**

- Assessing the **risks of material misstatement**;
- Evaluating the **sufficiency of tests performed**;
- Evaluating the appropriateness of **management's use of the going concern assumption**;
- Evaluating **significant accounting estimates**; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

**Conclusion:** -In view of above, Mr. Sheetal **cannot ask direct assistance from internal auditors** regarding evaluating the **sufficiency of tests performed** and the **adequacy of disclosures** in the financial statements and other matters affecting the auditor's report.

177.

#### Direct Assistance from Internal Auditor

Smart Ltd is a manufacturing unit and you are External Auditors of the company. Internal auditors are also appointed as per the provisions of the Companies Act, 2013. As External auditors you want to use the Internal auditors to provide direct assistance for the purposes of audit. State the circumstances where the internal auditors cannot be used to provide direct assistance. What would you include in the audit documentation?

(July-2021-Old)

Ans.



- (a) In the given case of **Smart Ltd, a manufacturing unit**, an external auditor shall not use internal auditors to provide direct assistance as per SA 610, Using the work of Internal Auditor, to perform procedures that:
- (i) Involve making **significant judgments** in the audit;
  - (ii) Relate to **higher assessed risks of material misstatement** where the judgment required in performing the **relevant audit procedures** or **evaluating** the audit evidence gathered is more than limited;
  - (iii) Relate to work with which the **internal auditors have been involved** and which has already been, or will be, reported to **management or TCWG** by the internal audit function; or
  - (iv) Relate to **decisions the external auditor makes** in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.
- (b) **If the external auditor uses internal auditors** to provide **direct assistance** on the audit, the external auditor shall include in the **audit documentation**:
- (1) The evaluation of the **existence and significance of threats** to the objectivity of the internal auditors, and the **level of competence of the internal auditors** used to provide direct assistance;
  - (2) The **basis for the decision** regarding the **nature and extent** of the work performed by the internal auditors;
  - (3) Who reviewed the **work performed** and the **date and extent of that review** in accordance with SA 230, Audit Documentation;
  - (4) The **written agreements obtained** from an authorized representative of the entity and the internal auditors; and
  - (5) The **working papers prepared by the internal auditors** who provided direct assistance on the audit engagement.

**SA-620**
**Using the Work of an Auditor's Expert**

**178.** **Using the Work of an Auditor's Expert**  
 While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. What types of reports/opinions he can obtain and to what extent he can rely upon the same? **(Study Material)**

**Ans.**



**(i) Areas Where Work of An Expert can be Used**

- As per SA 620, "Using the Work of an Auditor's Expert", during the audit, the auditor may seek to **obtain, in conjunction with the client or independently**, audit evidence in the form of reports, opinions, valuations and statements of an expert.
- **While doing audit**, Ram, the auditor **can obtain the following types of reports, or options or statements** of an expert for the purpose of audit evidence:
  - The **valuation of complex financial instruments**, land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
  - The **actuarial calculation of liabilities** associated with insurance contracts or employee benefit plans.
  - The **estimation of oil and gas reserves**.
  - The **valuation of environmental liabilities**, and site clean-up costs.
  - The **interpretation of contracts**, laws and regulations.
  - The **analysis of complex or unusual tax compliance** issues.

**(ii) Extent to which Expert work can be relied upon:**

When the auditor **intends to use the work** of an expert, he shall evaluate

- the adequacy of the auditor's expert's work, including the **relevance and reasonableness of that expert's findings or conclusions**, and their consistency with other audit evidence;
- if that expert's work involves use of significant assumptions and methods, **the relevance and reasonableness of those assumptions and methods** in the circumstances; and
- if that expert's work involves the use of source data that is significant to his work, the **relevance, completeness, and accuracy of that source data**.

**(iii) Conclusion:**

- If the auditor determines that the **work of the auditor's expert is not adequate** for the auditor's purposes, **he shall agree with that expert** on the nature and extent of **further work to be performed** by that expert; or **perform further audit procedures** appropriate to the circumstances.

**179.** **Agreement with Auditor's Expert**  
 X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise. **(MTP-May-2021)(Study Material)(MTP-May-2019)(RTP-May-2019)(MTP-Nov-2018)**

**Ans.**



**(i) As per SA 620 "Using work of Auditor's Expert"**

The auditor shall agree, in writing when appropriate, on **the following matters with the auditor's expert**:

- **Nature, scope & objectives** of Auditor's Expert work (may include relevant technical standards or other professional and industry requirements).
- Respective **roles & responsibilities** of auditors & Auditor Expert.
- **Nature, timing & extent of communication**, including **form of report**.
- Need for Auditor Expert to **observe confidentiality requirements** under ethical requirements or Law and regulation.

- (ii) **In the instant case:** - X Ltd. had various **derivative contracts – options, forward contracts, interest rate swaps etc.** which were required to be **fair valued** for which company got the fair valuation done through an **external third party**. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives.
- (iii) **Conclusion:** Considering the **complexity involved in the valuation** and **volume of derivatives** and also due to the fact that the **auditor and auditor's expert** were new to each other, auditor should have **signed a formal agreement/ engagement letter** with the auditor's expert in respect of the work assigned to him in **accordance with SA 620**.

180.

**Suggested Content of an Agreement between the Auditor and the Auditor's Expert:**

Mr. Mohan, an auditor of K TEN Limited wants to use the work of an expert. With reference to the Standard on Auditing state the factors which suggest the need for detailed and written agreement between the auditor and the auditor's expert. **(Nov-2016)**

Ans.



- (i) **As per SA 620, "Using the work of an Auditor's Expert",** some of the matters may affect the **level of detail and formality** of the agreement between **the auditor and the auditor's expert**, including whether it is appropriate that the **agreement be in writing**.
- (ii) **For example, the following factors may suggest** the need for more a **detailed agreement** than would otherwise be the case, or for the agreement to be set out in writing:
- The auditor's expert will have **access to sensitive or confidential entity information**.
  - The **respective roles or responsibilities** of the auditor and the auditor's expert are different from those normally expected.
  - **Multi-jurisdictional legal or regulatory requirements** apply.
  - The matter to which the **auditor's expert's work relates** is highly complex.
  - The auditor has **not previously used work performed** by that expert.
  - The greater the **extent of the auditor's expert's work**, and **its significance** in the context of the audit.

181.

**Evaluating the Adequacy of the Auditor's Expert's Work**

State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit Purposes. **(Nov-2018-New)**

Ans.



- (i) **As per SA 620 Using the work of an Auditor's Expert,** the auditor shall **evaluate the adequacy of the auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness** of that expert's findings or conclusions, and their **consistency with other audit evidence**, etc.
- (ii) **Specific procedure to evaluate the adequacy of the auditor's expert's work are –**
- **Enquiries** of the auditor's expert.
  - **Reviewing** the auditor's expert's **working papers and reports**
  - **Corroborative procedure such as-**
    - (a) **Observing** the auditor's expert's work
    - (b) Examining the **published data**, such as statistical reports from reputed source
    - (c) Confirming the **relevant matters with third parties**
    - (d) **Performing detailed analytical procedure** to see whether principles of materiality aspects considered
    - (e) **Re performing calculations**
  - **Discussions with another expert** with relevant expertise when, for example, the findings or the conclusion of the auditor's expert are not consistent with other audit evidence.
  - **Discussing the expert's report** with the management.

182.

**Evaluating the Adequacy of the Auditor's Expert's Work**

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

Ans.



(i) **As per SA 620 Using the work of an Auditor's Expert**, the auditor shall **evaluate the adequacy of the auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness** of that expert's findings or conclusions, and their **consistency with other audit evidence**, etc.

(ii) **Specific procedure to evaluate the adequacy of the auditor's expert's work are –**

- **Enquiries** of the auditor's expert.
- **Reviewing** the auditor's expert's **working papers and reports**
- **Corroborative procedure such as-**
  - (a) **Observing** the auditor's expert's work
  - (b) Examining the **published data**, such as statistical reports from reputed source
  - (c) Confirming the **relevant matters with third parties**
  - (d) **Performing detailed analytical procedure** to see whether principles of materiality aspects considered
  - (e) **Re performing calculations**
- **Discussions with another expert** with relevant expertise when, for example, the findings or the conclusion of the auditor's expert are not consistent with other audit evidence.
- **Discussing the expert's report** with the management.

(iii) **Therefore, as per SA 620 on "Using the Work of an Auditor's Expert",**

The auditor shall **evaluate the adequacy of the auditor's expert's work** for the auditor's purposes, including:

- **The relevance and reasonableness** of that expert's findings or conclusions, and their consistency with other audit evidence;
- If that expert's work involves **use of significant assumptions and methods**, the **relevance and reasonableness of those assumptions and methods** in the circumstances; and
- If that expert's work involves the **use of source data** that is significant to that expert's work, the **relevance, completeness, and accuracy** of that source data.

(iv) **Additional Audit Procedure**

If the auditor determines that the **work of the auditor's expert is not adequate** for the auditor's purposes, the auditor shall:

- **Agree with that expert** on the **nature and extent of further work** to be performed by that expert; or
- **Perform further audit procedures** appropriate to the circumstances.

183.

**Auditor's Expert and Joint Auditors**

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2021-22. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

**(Study Material)**

Ans.



## (i) As per SA 620 "Using the Work of an Auditor's Expert"

- The expertise of an expert may be required in the **actuarial calculation of liabilities** associated with **insurance contracts or employee benefit plans etc.**, however, the auditor has **sole responsibility** for the audit opinion expressed, and that responsibility is **not reduced** by the auditor's use of the work of an auditor's expert.
- The auditor shall evaluate the **adequacy** of the **auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness** of that expert's findings or conclusions, and their consistency with other **audit evidence as per SA 500**.
- Further, in view of SA 620, if the expert's work involves **use of significant assumptions and methods**, then the **relevance and reasonableness** of those assumptions and methods must be **ensured by the auditor** and
- If the expert's work involves the **use of source data** that is significant to that expert's work, the **relevance, completeness, and accuracy** of that source data in the circumstances must be **verified by the auditor**.

## (ii) In the instant case:

Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their **own known Actuaries** for **valuation of gratuity scheme**. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred **actuary** has provided the gratuity valuation report, **which later on found faulty**. Further, Mr. Z is **not agreed with this report** therefore he submitted a **separate audit report** specifically for such gratuity valuation.

## (iii) Duty of Joint Auditors

- In such situation, it was **duty of Mr. X, Mr. Y and Mr. Z**, before using the **gratuity valuation report** of Actuary, to ensure the **relevance and reasonableness** of assumptions and methods used.
- They were also required to **examine** the relevance, completeness and accuracy of **source data used** for such report before expressing their opinion.

## (iv) Conclusion:

- Mr. X and Mr. Y will be **held responsible for grossly negligence** and using such **faulty report** without examining the **adequacy of expert actuary's work** whereas
- Mr. Z will not be held liable for the same due to **separate opinion** expressed by him.

184.

**Auditor's Reporting Responsibility**

O Ltd. is in the business of manufacturing of steel. The manufacturing process requires raw material as iron ore for which large stock was maintained by the company at year end – 31st March 2022. The nature of raw material is such that its physical verification requires involvement of an expert. Management hired their expert for stock take and auditors also involved auditor's expert for the stock take.

The auditor observed that the work of the auditor's expert was not adequate for auditor's purposes and the auditor could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor.

Basis above, the auditor concluded that it would be necessary to express a modified opinion in the auditor's report because the auditor has not obtained sufficient appropriate audit evidence. However, the auditor issued a clean report and included the name of the expert in his report to reduce his responsibility for the audit opinion. Comment.

(MTP-May-2019)

Ans.

## (i) As per SA 620, Using the work of an Auditor's Expert,

- If the auditor concludes that the work of the **auditor's expert is not adequate** for the auditor's purposes and the **auditor cannot resolve** the matter through the **additional audit**, which may involve **further work** being performed by **both the expert and the auditor**, or include employing



or **engaging another expert**, it may be necessary to **express a modified opinion** in the auditor's report in **accordance with SA 705** because the auditor has not obtained sufficient appropriate audit evidence

- **In addition, the auditor shall not refer** to the work of an auditor's expert in an **auditor's report containing an unmodified opinion** unless required by **law or regulation** to do so.
- **If such reference is required by law or regulation**, the auditor shall **indicate in the auditor's report** that the reference **does not reduce the auditor's responsibility** for the audit opinion.
- **If the auditor makes reference** to the work of an **auditor's expert** in the auditor's report **because such reference is relevant** to an understanding of a modification to the **auditor's opinion**,
- The auditor **shall indicate in the auditor's report** that such reference **does not reduce the auditor's responsibility** for that opinion.

**(ii) Conclusion:**

- In the given case, the **auditor cannot reduce his responsibility** by referring the **name of auditor's expert** and thereby **issuing a clean report**.
- **Auditor should have issued a modified report** and could have given reference to the **work of an auditor's expert** in that report if such reference was **relevant to understanding of a modification** to the auditor's opinion but **even in that case** the auditor should have indicated in his report that such reference of auditor's expert **does not reduce his responsibility** for that opinion.

### SA-700

#### Forming an Opinion and Reporting on Financial Statements

185.

#### Process of Judgement Formation by Auditor

What is the basis on which the judgement is formed by Auditor to express his opinion after the audit?

(May-2018-Old)

Ans.



- After the audit**, the opinion that the auditor expresses is the result of **exercise of judgement on facts, evidence and circumstances** which he comes across in the course of audit.
- The judgement is formed on the following basis-**
  - Identification of the assertions** to be examined.
  - Evaluation of the assertion** as to relative importance.
  - Collection of the information or evidence** about the assertions to enable him to give an informed opinion.
  - Evaluation of evidence** as valid or invalid, pertinent or not pertinent, sufficient or insufficient.
  - Formulation of judgement** as to the fairness of the assertions under consideration.

186.

#### Auditor's Report for Audits Conducted in accordance with Both SA's Issued by ICAI and ISA

KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2020 after doing all appointment formalities wherein auditors are required to ensure compliance with Standards on Auditing and Internal Standards on Auditing.

As an expert you are required to advise the auditor about the requirements regarding auditor's report for audits conducted in accordance with both Standards on Auditing issued by ICAI and International Standards on Auditing.

**(Study Material)**

**OR**

KPI Ltd. is a company on which International Standards on Auditing are applicable along with Standard on

Auditing issued by the ICAI. The company appointed new auditors for the audit of the financial statements for the year ended 31st March 2022 after doing all appointment formalities. In the auditor's report, auditor referred the International Standard on Auditing in addition to the Standard on Auditing issued by the ICAI. As an expert, you are required to advise the auditor regarding auditor's report for audits conducted in accordance with both the Standards. **(RTP-Nov-2019)**

Ans.



**Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing:**

**As per SA 700, "Forming an Opinion and Reporting on Financial Statements",**

- An auditor may be required to **conduct an audit in accordance with the International Standards on Auditing**, in addition to the **Standards on Auditing** issued by ICAI.
- **If this is the case**, the auditor's report **may refer to Standards on Auditing in addition to the International Standards on Auditing**, but the auditor shall do so **only if**:
  - (a) **There is no conflict between the requirements** in the International Auditing Standards and those in SAs that would lead the auditor:
    - to **form a different opinion**, or
    - **not to include an Emphasis of Matter paragraph or Other Matter paragraph** that, in the particular circumstances, is required by SAs; and
  - (b) **The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation** discussed above when the auditor uses the layout or wording specified by the **Standards on Auditing**.

**When the auditor's report refers to both the ISAs and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.**

187.

**Compare and Explain**

- (i) Reporting to Shareholders vs. Reporting to those Charged with Governance
- (ii) Audit Qualification vs. Emphasis of Matter.

**(Study Material)**

Ans.



- (i) **Reporting to Shareholders vs. Reporting to those Charged with Governance:**

REPORT	
Reporting to Shareholders	Reporting to those Charged with Governance
<b>Section 143 of the Companies Act, 2013</b> deals with the provisions relating to <b>reporting to Shareholders</b> . Thus, it is a <b>Statutory Audit Report</b> which is addressed to the <b>members</b> .	<b>Standard on Auditing 260</b> deals with the provisions relating to <b>reporting to those Charged with Governance</b> .
Statutory Audit Report is on <b>true and fair view</b> and as per prescribed Format.	It is a reporting on matters <b>those charged with governance like</b> scope of audit, audit procedures, audit modifications, etc.
Statutory Audit Reports are in <b>public domain</b> .	Reporting to <b>Those Charged with Governance</b> is an internal document i.e. <b>private report</b> .

- (ii) **Audit Qualification vs. Emphasis of Matter:**

REPORT	
Audit Qualification	Emphasis of Matter
<b>Standard on Auditing 705</b> "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions <b>relating to Audit Qualification</b> .	<b>Standard on Auditing 706</b> "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the <b>provisions relating to Emphasis of Matter</b> .

	<p>Audit Qualifications are also known as “<b>subject to report</b>” or “<b>except that report</b>”.</p>	<p><b>Emphasis of Matter</b> is a paragraph which is included in auditor’s report to <b>draw users’ attention to important matter(s)</b> which are <b>already disclosed in Financial Statements</b> and are <b>fundamental to users’ for understanding</b> of Financial Statements.</p>
	<p><b>Audit Qualifications</b> are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. <b>Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</b> relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.</p>	<p><b>Emphasis of Matter</b> is a paragraph which is issued when there is a <b>uncertainty relating to future outcome of exceptional litigation</b>, regulatory action, etc.; or there is <b>early application</b> (where permitted) of a <b>new accounting standard</b> that has a pervasive effect on the financial statements in advance of its effective date.</p>

**188. Certificate for Special Purpose vs. Audit Report**  
 Differentiate between audit report and audit certificate. (May-2017)  
**OR**  
 Write a short note on certificate for special purpose vs. audit report.

Ans.



**(i) Certificate for Special Purpose**

- A certificate is a **written confirmation of the accuracy of the facts** stated therein and does not involve **any estimate** or opinion. The term ‘certificate’ is, therefore, **used where the auditor verifies the accuracy of facts**.
- An auditor may thus, **certify the circulation figures of a newspaper** or the **value of imports or exports** of a company.
- An auditor’s certificate represents that he has **verified certain figures** and is in a **position to vouch safe their accuracy** as per his examination of documents and books of account.
- Thus, when a **reporting auditor issues a certificate**, he is responsible for the **factual accuracy of what is stated therein**.

**(ii) Audit Report**

- A report, on the other hand, is a **formal statement usually made after an enquiry, examination or review of specified matters** under report and includes the **reporting auditor’s opinion** thereon.
- **When a reporting auditor gives a report**, he is responsible for ensuring that the **report is based on factual data**, that his opinion is in due accordance with facts, and that it is arrived at by the application of **due care and skill**.
- **The ‘report’ involves expression of opinion** which may differ from one professional to another. There is **no question of exactitude in case** of a report since the information contained therein is **based on estimates and involves judgement element**.

**189. Significance of True and Fair**  
 “What constitutes a ‘true and fair view’ is the matter of an auditor’s judgement in particular circumstances of a case.” Do you agree? Enlist the requirements you as an auditor will observe to ensure true and fair view. (Dec-2021-Old)

Ans.

**(i) SA 700 “Forming an Opinion and Reporting on Financial Statements”, requires**

- The auditor to **form an opinion on the financial statements** based on an evaluation of the **conclusions drawn** from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion.



- The auditor is required to express his opinion on the financial statements that **it gives a true and fair view** in conformity with the accounting principles generally accepted in India
  - (a) **in the case of the Balance Sheet**, of the state of affairs of the Company as at March 31, 20XX;
  - (b) **in the case of the Statement of Profit and Loss**, of the profit/ loss for the year ended on that date; and
  - (c) **in the case of the Cash Flow Statement**, of the cash flows for the year ended on that date.

**(ii) In the context of audit of a company: -**

- The accounts of a company **shall be deemed as not disclosing** a true and fair view, if they **do not disclose any matters** which are required to be disclosed by virtue of **provisions of Schedule III** to that Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements.
- Therefore, the auditor will have to see that the **accounts are drawn up in conformity with the provisions of Schedule III** of the Companies Act, 2013 and whether they **contain all the matters required to be disclosed** therein.

**(iii) In case of companies which are governed by special Acts: -**

- The auditor should see whether the **disclosure requirements of the governing Act** are complied with.
- It must be noted that the disclosure requirements laid down by the **law are the minimum requirements**. If certain information is **vital for presenting a true and fair view**, the accounts should disclose it even though there may not be a specific legal provision to do so.

**(iv) Conclusion: -** Thus, what constitutes a **'true and fair' view** is the matter of an auditor's judgment in the particular circumstances of a case. **In more specific terms, to ensure true and fair view, an auditor has to see:**

- (a) that the assets are **neither undervalued or overvalued**, according to the applicable accounting principles,
- (b) no **material asset** is omitted;
- (c) **the charge**, if any, on assets are disclosed;
- (d) **material liabilities** should not be omitted;
- (e) the **statement of profit and loss** discloses all the matters required to be disclosed by Part II of Schedule III
- (f) the balance sheet has been prepared in accordance with **Part I of Schedule III**;
- (g) accounting policies have been **followed consistently**; and
- (h) **all unusual, exceptional or non-recurring items** have been disclosed separately.

## SA-701

### Communicating Key Audit Matters in the Independent Auditor's Report

190.

**Purpose of Communicating KAMs**

Write a short note on: Purpose of communicating key audit matters.

(RTP-Nov-2018)

Ans.



- (i) **As per SA 701 "Communicating Key Audit matters in the Independent Auditor's Report"**  
Key Audit Matters are those matters that, in the **auditor's professional judgment**, were of **most significance in the audit of the F.S.** of the current period. Key audit matters are **selected from matters communicated with TCWG**.
- (ii) **Various purposes of Key audit matters may be listed as:**

- **To enhance the communicative value** of the auditor's report by providing **greater transparency about the audit** that was performed.
- **To provide additional information** to intended users of the financial statements to **assist them in understanding** those matters that, in the auditor's professional judgment, were of most significance in the audit of the F.S. of the current period.
- **To assist intended users in understanding** the entity and areas of **significant management judgment** in the audited F.S.
- **To provide a basis to further engage with management and TCWG** about certain matters relating to the entity, the audited F.S. or the audit that was performed.

191.

**Auditor's Responsibility to Report a KAM**

What is the auditor's responsibility to report a key audit matter for which there are no relevant disclosures in the financial statements? (RTP-May-2022)

Ans.


**As per SA 701 "Communicating Key Audit matters in the Independent Auditor's Report"**

- When **communicating key audit matters**, the fact that there are **no disclosures in the financial statements** related to a matter determined to be a key audit matter does not relieve the auditor from the requirement to communicate it.
- An auditor may determine a **key audit matter** related to the audit for which **relevant disclosure requirements do not exist** in the applicable financial reporting framework.
- **For example**, the implementation of a **new IT system** (or significant changes to an **existing IT system**) during the period may be an **area of significant auditor attention**, in particular, if such a change had a **significant effect** on the auditor's overall audit strategy or related to significant risk (e.g., changes to a system affecting revenue recognition).
- Also, **if an auditor determines that** it is necessary to include **information about the entity** in order to effectively describe a **key audit matter that has not been disclosed by management** and management **does not agree to disclose that information**, the auditor should reconsider the **adequacy of the disclosures** in accordance with applicable financial reporting framework.
- The **auditor should communicate the matter as a key audit matter** unless law or regulation precludes **public disclosure** about the matter or in **extremely rare circumstances**, the auditor determines that the matter should not be communicated in the auditor's report because the **adverse consequences** of doing so would reasonably be expected to **outweigh the public interest benefits of such communication**.

192.

**Determining Key Audit Matters (KAM)**

As an auditor of a listed company for the year ended 31<sup>st</sup> March. 2019, how would you determine the 'Key Audit Matters'? (May-2019-Old)

OR

"The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the key factors". You are required to define key audit matters and briefly discuss the factors determining the key audit matters. (RTP-May-2018)

Ans.


**(i) As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report"**

The auditor shall determine, from **the matters communicated with TCWG**, those matters that required **significant auditor attention** in performing the audit. In making this determination, the **auditor shall take into account the following**:

- **Areas of higher assessed risk of material misstatement**, or **significant risks** identified in accordance with **SA 315**, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- **Significant auditor judgments** relating to areas in the financial statements that involved **significant management judgment**, including **accounting estimates** that have been identified as having **high estimation uncertainty**.

- The effect on the audit of **significant events or transactions** that occurred during the period.

**Conclusion:-** The auditor shall determine **which of the matters determined above** were of **most significance** in the audit of the financial statements of the current period and **therefore are the key audit matters**.

193.

### Determining Key Audit Matters

AKY Ltd. is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is ₹ 40,000 crores with profits of ₹ 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. The company's contracts with its various customers are quite complicated and different. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. This matter was also discussed with management at various stages of audit. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner. After completion of audit for the year ended 31 March 2022, the audit partner was discussing significant matters with the management wherein they also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management did not agree with revenue recognition to be shown as key audit matter in the audit report. Comment. **(MTP-Nov-2019)**

Ans.



#### (i) SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report"

- Deals with the **auditor's responsibility** to communicate **key audit matters in the auditor's report**. It is intended to address both the **auditor's judgment** as to what to communicate in the auditor's report and the **form and content of such communication**.

#### (ii) Determination of KAM

The auditor shall determine, from **the matters communicated with TCWG**, those matters that required **significant auditor attention** in performing the audit. In making this determination, the **auditor shall take into account the following**:

- **Areas of higher assessed risk of material misstatement**, or **significant risks** identified in accordance with SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- **Significant auditor judgments** relating to areas in the financial statements that involved **significant management judgment**, including **accounting estimates** that have been identified as having **high estimation uncertainty**.
- The effect on the audit of **significant events or transactions** that occurred during the period.

The auditor shall determine **which of the matters determined in accordance with above were of most significance** in the audit of the financial statements of the current period and therefore are the **key audit matters**.

#### (iii) In the instant case:

- **AKY Ltd., a listed company** engaged in the business of software and its contracts with its various customers are also quite complicated and different.
- **Further, the audit team spends significant time on audit of revenue** and efforts towards audit of revenue also involve significant involvement of senior members of the audit team including audit partner during audit.
- **This matter was also discussed with management** at various stages. After completion of audit, the audit partner **communicated the management** regarding inclusion of **paragraph on revenue recognition** as key audit matter in his audit report.

**(iv) Conclusion:** -In view of SA 701, **the assessment of the auditor is valid** as above matter **qualifies to be a key audit matter** in the opinion of auditor. Hence, **it should be reported accordingly** by the auditor in his audit report.

194.

**Determining Key Audit Matter**

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2021-22, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit. During F.Y. 2021-22, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay and also told him that such a matter may be a key audit matter to be reported in the audit report.

Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements and so there was no need to disclose such matter as a key audit matter. Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?  
**(RTP-Dec-2021)**

Ans.


**(i) As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report'**

The auditor shall determine, from the **matters communicated with those charged with governance**, those matters that required **significant auditor attention** in performing the audit. In making this determination, the auditor shall take into account the following:

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

**(ii) Audit Procedure & Analysis**

- a) The auditor shall determine which of the aforesaid matters **considered were of most significance** in the audit of the financial statements of the current period and **therefore are the key audit matters**.
- b) These aforesaid considerations **focus on the nature of matters communicated** with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.
- c) The fact that these considerations are **required is not intended to imply that matters related to them are always key audit matters**; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit
- d) **In addition to matters that relate to the specific required considerations**, there may be other matters communicated with **those charged with governance** that required significant auditor attention and that therefore may be determined to be **key audit matters**.
- e) **Such matters may include, for example:** - Matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements.

**For example:** - The implementation of a **new IT system** (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

**(iii) In the given case:** - There was **implementation of ERP system** in the company due to which some of its **business processes got automated** and which had a **significant effect** on the auditor's overall audit strategy during the period. Accordingly, **such a matter can be considered as a key audit matter** if according to Mr. Hemant, such a matter required **significant attention** that had affected his **overall audit strategy**.

**(iv) Conclusion:** - Thus, the **contention of Mr. Vishay is not proper** as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant attention of the auditor which had an impact on its audit.

195.

**KAM in Case of Closure of Business**

TBR Limited has plan of its business being closed due to huge loss incurred due to the recent outbreak of global pandemic, within a short period from the close of the accounting year ended on 31st March, 2022. The Financial Statements for the said year have been prepared on the same basis as in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above

**(Nov-2020-Old)****OR**

Choti Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31<sup>st</sup> March, 2022. The Financial Statements for the year ended 31/03/2022 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

**(MTP-May-2020)****OR**

Toddle Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March, 2022. The Financial Statements for the year ended 31/03/2022 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be 'disposed, off in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

**(May-2018-New)****Ans.****(i) As per SA 570 "Going Concern"**

- **Management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern.**
- **As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists,**
- **The auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.**
- **Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.**

**(ii) As per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report"**

- **when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a key audit matter.**
- **SA 701 also emphasises on auditor's responsibility to communicate key audit matters in the auditor's report.**

**(iii) As per the facts given in the case**

- **Intention of TBR Limited has a plan of its business being closed as huge loss is incurred due to the recent outbreak of global pandemic, within short period from 31st March 2022. However, financial statements for the year ended 31.03.2022 have been prepared on the same basis as it had been in earlier periods with an additional note.**

**(iv) Conclusion:**

- Thus, **management intentions to liquidate** the entity or to cease operations is **one of the event or condition** that may cast significant doubt on the **entity's ability to continue** as going concern is a **key audit matter**.
- **Therefore, the auditor is required to Communicate the Key Audit Matters** in accordance with **SA 570** in above stated manner.
- **Simple reference as to a possible cessation of business and making of adjustments**, if any, be made at the time of cessation only by the **auditor in his report is not sufficient**.

196.

**Communicating Key Audit Matters in the Auditor's Report**

CA. Amar has come across certain key matters while auditing the accounts of PR Ltd. for the financial year 2021-22. He, being the associate of your firm, seeks your advice on "Communicating Key Audit Matters" in the Auditor's Report. Guide him. (Nov-2018-Old)

Ans.


**(i) As per SA 701 "Communicating Key Audit matters in the Independent Auditor's Report"**

The auditor shall **describe each key audit matter**, using an **appropriate subheading, in a separate section of the auditor's report** under the heading **"Key Audit Matters"**.

**The introductory language in this section of the auditor's report shall state that:**

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

**(ii) The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:**

- **Why the matter was considered** to be one of **most significance** in the audit and therefore determined to be a **key audit matter**; and
- **How the matter was addressed** in the audit.

**(iii) The auditor shall describe each key audit matter in the auditor's report unless:**

- **Law or regulation precludes public disclosure** about the matter; or
- **In extremely rare circumstances**, the **auditor determines** that the matter **should not be communicated** in the auditor's report because the **adverse consequences of doing so** would reasonably be expected to **outweigh the public interest** benefits of such communication. This shall not apply **if the entity has publicly disclosed information** about the matter.

**(iv) KAM in case of modification**

- The auditor **shall not communicate a matter in the Key Audit Matters** section of the auditor's report when the auditor would be **required to modify the opinion** in accordance with **SA 705 (Revised)** as a result of the matter.

197.

**KAMs in the Independent Auditor's Report**

While auditing the complete set of consolidated financial statements of J Ltd., a listed company, using a fair presentation framework, PQR & Co., a Chartered Accountant firm, discovered that the consolidated financial statements are materially misstated due to the non-consolidation of one of the subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements could not be determined because it was not practicable to do so. Thus, PQR & Co. decided to provide an adverse opinion for the same and further determined that, there are no key audit matters other than the matter to be described in the Basis for Adverse Opinion section. Comment whether PQR & Co. needs to report under SA 701 'Communicating Key Audit Matters in the Independent Auditor's Report'? (Dec-2021-Old)

Ans.



- (i) SA 700 establishes requirements and provides guidance on **forming an opinion on the financial statements**. Communicating key audit matters is **not a substitute for disclosures** in the financial statements that the applicable **financial reporting framework** requires management to make, or that are otherwise necessary to achieve fair presentation.
- (ii) SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”
- Addresses circumstances in which the auditor concludes that there is a material misstatement relating to the **appropriateness or adequacy of disclosures** in the financial statements.
  - When the auditor expresses a **qualified or adverse opinion** in accordance with SA 705, presenting the description of a matter giving **rise to a modified opinion** in the **Basis for Qualified (Adverse) Opinion** section helps to promote **intended users’ understanding** and to identify such circumstances when they occur.
  - Separating the communication** of this matter from other key audit matters described in the Key Audit Matters section, therefore, gives it the appropriate prominence in the auditor’s report.
  - Further, when the auditor expresses a qualified or adverse opinion**, communicating other key audit matters would still be relevant to **enhancing intended users’ understanding** of the audit, and therefore the requirements to determine key audit matters apply.
  - However, as **an adverse opinion is expressed in circumstances** when the auditor has concluded that misstatements, individually or in the aggregate, are **both material and pervasive** to the financial statements depending on the significance of the matter(s) giving rise to an adverse opinion, the auditor may determine that **no other matters are key audit matters**.
- (iii) **In the given situation:** - J Ltd., a **listed company**, has **not consolidated one of its subsidiary**. Further, Consolidated Financial Statements of J Ltd. are **materially misstated** due to such non-consolidation. The material misstatement is also **deemed to be material and pervasive** and effect of the failure to consolidate have not been determined. In the given situation **it is appropriate to give Adverse Opinion** by PQR & Co., a Chartered Accountant Firm.
- (iv) **Conclusion:** - Since, in the given case, **Adverse Opinion is being expressed thus PQR & Co. can communicate Key Audit Matter in given below manner:**
- Key Audit Matters:** Except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communicate in our report.

198.

### Placement of the KAMs in Audit Report

Where should the placement of the key audit matters section be in the auditor’s report? **(RTP-May-2022)**

Ans.



- ❖ Generally, the **Key Audit Matters** section is required to be **placed after the Basis for Opinion paragraph** and **before the Management’s Responsibility** paragraph.
- ❖ In case, ‘**Material uncertainty relating to going concern**’ section is required as **per SA 570 (Revised)**, then KAM section is **placed after that section**.
- ❖ Further, regarding placement of KAM section, **SA 706 (Revised)**, “**Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report**” provides as under: When a Key Audit Matters section is presented in the **auditor’s report**, an **Emphasis of Matter (EOM)** paragraph may be presented either directly before or after the Key Audit Matters section, based on the **auditor’s judgment** as to the relative significance of the information included in the Emphasis of Matter paragraph.
- ❖ **The auditor may also add further context to the heading** “Emphasis of Matter”, such as “**Emphasis of Matter – Subsequent Event**”, to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.

**SA-705**
**Modifications to the Opinion in the Independent Auditor's Report**
**199.**
**Limitation after the Auditor has Accepted the Engagement**

After accepting the statutory audit M/s All in One Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may and result in your inability to bruin sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences and your response to the limitations imposed by the management on your scope. **(MTP-May-2022)(May-2019-New)**

**Ans.**

**(i) As per SA 705, Modification to the Opinion in the Independent Auditor's Report"**

- If, after accepting the engagement, the auditor becomes aware that **management has imposed a limitation** on the **scope of the audit** that the auditor considers likely to result in the **need to express a qualified opinion** or to **disclaim an opinion** on the financial statements, the auditor shall request that management **remove the limitation**.
- If management refuses to remove the limitation, the auditor shall **communicate the matter to TCWG**, unless **all of TCWG** are involved in **managing the entity**, and determine **whether it is possible to perform alternative procedures** to obtain SAAE.

**(ii) Unable to obtain SAAE**

If the auditor is **unable to obtain sufficient appropriate audit evidence**, the auditor **shall determine the implications as follows**:

- (a) If the auditor concludes that the **possible effects** on the financial statements of **undetected misstatements**, if any, could be **material but not pervasive**, the auditor shall **qualify the opinion**; or
- (b) If the auditor concludes that the **possible effects** on the financial statements of **undetected misstatements**, if any, could be **both material and pervasive** so that a **qualification of opinion would be inadequate** to communicate the gravity of the situation, the auditor shall:
  - **Withdraw from the audit**, where practicable and not prohibited by **law or regulation**; or
  - If Withdrawal from the audit before issuing the auditor's report is **not practicable** or **possible**, **disclaim an opinion** on the financial statements

If the **auditor withdraws as discussed above paragraph**, before withdrawing, the auditor shall **communicate to TCWG any matters regarding misstatements** identified during the audit that would have given rise to a **modification of the opinion**

**200.**
**Situation in which Auditor unable to obtain SAAE**

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

- (i) Circumstances beyond the control of the entity;
- (ii) Circumstances relating to the nature or timing of the auditor's work; or
- (iii) Limitations imposed by management.

Explain with the help of examples.

**(RTP-May-2020)**
**Ans.**

**The auditor's inability to obtain sufficient appropriate audit evidence may arise from:**

- (i) Circumstances **beyond the control of the entity**;
- (ii) Circumstances relating to the **nature or timing of the auditor's work**; or
- (iii) Limitations **imposed by management**.
  - An inability to perform a specific procedure **does not constitute a limitation on the scope** of the audit if the auditor is **able to obtain sufficient appropriate audit evidence** by performing **alternative procedures**.

- **Limitations imposed by management** may have other implications for the audit, such as **for the auditor's assessment of fraud risks** and consideration of **engagement continuance**.
- (i) **Examples of circumstances beyond the control of the entity include when:**
- The entity's **accounting records** have been **destroyed**.
  - The **accounting records** of a significant component have been **seized indefinitely** by governmental authorities.
- (ii) **Examples of circumstances relating to the nature or timing of the auditor's work include when:**
- The entity is required to **use the equity method of accounting** for an associated entity, and the auditor is unable to obtain **sufficient appropriate audit evidence** about the **latter's financial information** to evaluate whether the equity method has been appropriately applied.
  - The timing of the auditor's appointment is such that the **auditor is unable to observe the counting of the physical inventories**.
  - The auditor determines that performing **substantive procedures** alone is **not sufficient**, but the entity's controls are **not effective**.
- (iii) **Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:**
- Management prevents the auditor from **observing the counting** of the **physical inventory**.
  - Management prevents the auditor from **requesting external confirmation** of specific account balances.

**201.** What are the professional obligations of the auditor who has resigned from the audit before completion of his term due to non co-operation of the Management in completing certain audit procedures?

**Ans.** **Resignation due to Management Imposing Limitation on the Scope of Audit:**



- (i) **As per SA 705 "Modifications to the Opinion in the Independent Auditor's Report"**
- The consequence of an **inability to obtain SAAE due to a management – imposed limitation after the auditor** has accepted the engagement. The **practicability of resigning** from the audit may depend upon the **stage of completion** of the engagement at the time that management imposes the scope limitation.
  - **When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation** from the engagement to regulators or the entity's owners.
- (ii) **As per Companies Act-2013**
- **In the case of resignation from the company**, provisions of the **Companies Act, 2013 applies**.
  - **Section 140(2)** of the Companies Act, 2013, requires the auditor, **who has resigned from the company**, to file within a period of **30 days from the date of resignation**, a statement with the **company and the registrar**, and
  - **In case of government companies**, the auditor shall file such statement with **the Comptroller and Auditor-General of India**, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor will be liable for penal provisions.
- (Alternatively, answer may be given as per SA 210 "Agreeing the Terms of Audit Engagements".)

**SJ Note: - In case of listed company LODR Provision will also apply**

**202.** **Circumstances that may Result in other than an Unqualified Opinion -**  
 What are the circumstances that may result in other than an unqualified opinion on the Financial Statements by an auditor?  
**(Nov-2017)**

Ans.


**(i) Limitation on scope by MGT:**

- If, after accepting the engagement, the auditor becomes aware that **management has imposed a limitation** on the scope of the audit that the auditor considers **likely to result in the need to express a qualified opinion** or to **disclaim an opinion** on the financial statements, the auditor shall request that management to **remove the limitation**

**(ii) When management refuses**

- If management refuses to remove the limitation, the **auditor shall communicate the matter to TCWG** and determine whether **it is possible to perform alternative procedure** to obtain SAAE.

**(iii) Unable to obtain SAAE**

If the auditor is **unable to obtain sufficient appropriate audit evidence**, the auditor **shall determine the implications as follows:**

- If the auditor concludes that the **possible effects** on the financial statements of **undetected misstatements**, if any, could be **material but not pervasive**, the auditor shall **qualify the opinion**; or
- If the auditor concludes that the **possible effects** on the financial statements of **undetected misstatements**, if any, could be **both material and pervasive** so that a **qualification of opinion would be inadequate** to communicate the gravity of the situation, the auditor shall:
  - **Resign from the audit**, where practicable and not prohibited by **law or regulation**; or
  - If resignation from the audit before issuing the auditor's report is **not practicable** or **possible**, **disclaim an opinion** on the financial statements. If the **auditor resigns as contemplated by the above paragraph**, before resigning, the auditor shall **communicate to TCWG any matters regarding misstatements** identified during the audit that would have given rise to a **modification of the opinion**

**(iv) Disagreement with Management:**

- The **auditor may disagree with management** about matters such as the **acceptability of the accounting policies** selected the method of their application, or the **adequacy of disclosures in the financial statements**.
- **If such disagreements are material** to the financial statements, the auditor shall express a **qualified or an adverse opinion**

**(v) Other considerations relating to an Adverse Opinion or Disclaimer of Opinion**

- When the auditor **considers it necessary to express an adverse opinion or disclaim an opinion** on the financial statements, the auditor's report shall not also include **an unmodified opinion** with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement.
- **To include such an unmodified opinion** in the same report in these circumstances would **contradict the auditor's adverse opinion or disclaimer of opinion** on the financial statements as a whole.

203.

**Limitation on the Auditor**

While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation? (Jan-2021-Old)

Ans.



- As per SA 705, "**Modifications to the Opinion in the Independent Auditor's Report**", if, after accepting the engagement, the auditor becomes aware that management has **imposed a limitation on the scope of the audit** that the auditor considers likely to result in the need to **express a qualified opinion** or to **disclaim an opinion** on the financial statements, the auditor shall request that management remove the limitation.

- **If management refuses to remove the limitation**, the auditor shall communicate the matter to **those charged with governance**, unless all of those charged with governance are **involved in managing the entity**, and determine whether it is possible to perform **alternative procedures** to obtain sufficient appropriate audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall **determine the implications as follows**:

- (1) If the auditor concludes that the **possible effects on the financial statements** of undetected misstatements, if any, could be **material but not pervasive**, the auditor shall **qualify** the opinion; or
- (2) If the auditor concludes that the **possible effects on the financial statements** of undetected misstatements, if any, could be **both material and pervasive** so that a **qualification of the opinion** would be inadequate to communicate the gravity of the situation, the auditor shall:
  - (i) Withdraw from the audit, where **practicable and possible** under **applicable law or regulation**; or
  - (ii) If withdrawal from the audit **before issuing the auditor's report is not practicable or possible**, **disclaim an opinion** on the financial statements.

If the auditor withdraws, before withdrawing, the **auditor shall communicate to those charged with governance any matters** regarding misstatements identified during the audit that would have given rise to a **modification** of the opinion.

204.

#### Circumstances in which a Modified Opinion may be issued

ADKS & Co LLP are the newly appointed statutory auditors of PKK Ltd. During the course of audit, the statutory auditors have come across certain significant observations which they believe could lead to material misstatement of financial statements. Management has a different view and does not concur with the view of the statutory auditors. Considering this the statutory auditors are determining as to how to address these observations in terms of their reporting requirement. Please advise. **(Study Material) (MTP-May-2019)**

OR

Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report? **(Study Material)**

OR

Explain the circumstances which require a modification to the Auditor's Opinion.

**(Nov-2017)**

Ans.



#### (i) As per SA 705-"Modifications to the Opinion in the Independent Auditor's Report"

- If the auditor concludes that, **based on the audit evidence** obtained, the financial statements as a **whole are not free from material misstatement** or the **auditor is unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement, the **auditor shall modify the opinion in his report**.

#### (ii) The auditor in such a case needs to determine the modification as follows:

##### (a) **Qualified Opinion:** The auditor shall express a **qualified opinion** when:

- The auditor, having **obtained SAAE**, concludes that **misstatements**, individually or in the aggregate, are **material, but not pervasive**, to the financial statements; or
- The auditor is **unable to obtain SAAE** on which to **base the opinion**, but the auditor **concludes that the possible effects** on the FSs of undetected misstatements, if any, **could be material but not pervasive**.

##### (b) **Adverse Opinion:**

- The auditor shall **express an adverse opinion** when the auditor, having **obtained SAAE**, concludes that **misstatements**, individually or in the aggregate, are **both material and pervasive** to the financial statements

##### (c) **Disclaimer of Opinion:**

- The auditor shall **disclaim an opinion** when the auditor is **unable to obtain SAAE** on which to **base the opinion**, and the **auditor concludes** that the **possible effects** on the FSs of

undetected misstatements, if any, **could be both material and pervasive**.

- The auditor shall **disclaim an opinion** when, in **extremely rare circumstances** involving multiple uncertainties, the auditor concludes that, notwithstanding **having obtained SAAE** regarding each of the **individual uncertainties**, **it is not possible to form an opinion** on the FSs **due to the potential interaction of the uncertainties** and their possible cumulative effect on the financial statements.
- **If, after accepting the engagement**, the auditor becomes aware that **management has imposed a limitation** on the **scope of the audit** that the auditor considers likely to result in the **need to express a qualified opinion** or to **disclaim an opinion** on the financial statements, the auditor shall request that management **remove the limitation**.
- **If management refuses to remove the limitation**, the auditor shall **communicate the matter to TCWG**, unless **all of TCWG** are involved in **managing the entity**, and determine **whether it is possible to perform alternative procedures** to obtain SAAE.

205.

### Adverse Opinion –Drafting

As an auditor of XYZ Limited, in view of given circumstances, you are required to draft Adverse Opinion and basis for adverse opinion due to a Material Misstatement of the Consolidated Financial Statements.

- Audit of a complete set of consolidated financial statements of a listed company (incorporated under the Companies Act, 2013) using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., SA 600 applies).
- The consolidated financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in SA 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- SA 701 applies; however, the auditor has determined that there are no key audit matters other than the matter described in the Basis for Adverse Opinion section.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

(MTP-May-2018)

Ans.

### Adverse Opinion



We have audited the accompanying **consolidated financial statements of XYZ Company Limited** (hereinafter referred to as the "Holding Company") and **its subsidiaries** (the Holding Company and its subsidiaries together referred to as "the Group"), its **associates and jointly controlled entities**, which comprise the **consolidated balance sheet as at March 31, 2XXX**, the **consolidated statement of profit and Loss**, (consolidated statement of changes in equity){where applicable} and the **consolidated statement of cash flows** for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the "consolidated financial statements").

**In our opinion and to the best of our information and according to the explanations given to us**, because of the significance of the matter discussed in the **Basis for Adverse Opinion** section of our report, the accompanying **consolidated financial statements do not give a true and fair view** in conformity with the accounting principles **generally accepted in India**, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, **as at March 31, 20XX**, of its consolidated profit/loss, (consolidated position of changes in equity) ){where applicable} and the consolidated cash flows for the year then ended.

#### **Basis for Adverse Opinion**

**As explained in Note X**, the Group has not consolidated **subsidiary PQR Company** that the Group acquired during 20XX because it has **not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities** at the acquisition date.

**This investment is therefore accounted for on a cost basis.** Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts.

**Had PQR Company been consolidated, many elements** in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the **failure to consolidate have not been determined.**

**We conducted our audit in accordance with Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013.** Our responsibilities under those Standards are further described in the **Auditor's Responsibilities for the Audit of the Consolidated Financial Statements** section of our report.

**We are independent of the Group, its associates and jointly controlled entities**, in accordance with the **Code of Ethics and provisions of the Companies Act, 2013** that are relevant to our audit of the consolidated financial statements in India **under the Companies Act, 2013**, and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics and the requirements under the Companies act, 2013.

**We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion**

206.

#### **Qualified Opinion-Drafting**

As an auditor of ABC Limited, in view of given circumstances, you are required to draft qualified opinion and basis for qualified opinion due to the departure from the applicable Financial Reporting Framework:

- Audit of a complete set of financial statements of a company other than a listed company (registered under the Companies Act, 2013) using a fair presentation framework.
- The financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- A departure from the applicable financial reporting framework resulted in a qualified opinion. • The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701.

- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013. **(MTP-Nov-2018)**

**Ans.**

**Qualified Opinion:**

We have audited the **standalone financial statements of ABC Limited** ("the Company"), which comprise the **balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended**, and notes to the financial statements, including a **summary of significant accounting policies** and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches))<sup>2</sup>.

**In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section** of our report, the aforesaid financial statements present **fairly, in all material respects, or give a true and fair view in conformity with the accounting principles generally accepted in India** of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

**Basis for Qualified Opinion**

The Company's **short-term marketable securities** are carried in the statement of financial position at xxx. Management has **not marked these securities to market** but has instead **stated them at cost**, which constitutes a departure from the **Accounting Standards prescribed in section 133 of the Companies Act, 2013**. The Company's records indicate that had **management marked the marketable securities to market**, the Company would have recognized an **unrealized loss of ₹ xxx in the statement of comprehensive income** for the year. The carrying amount of the securities in the statement of financial position would have been **reduced by the same amount** at March 31, 20X1, and **income tax, net income and shareholders' equity would have been reduced** by ₹ xxx, ₹ xxx and ₹ xxx, respectively.

**We conducted our audit in accordance with Standards on Auditing (SAs)**. Our responsibilities under those standards are further described in the **Auditor's Responsibilities for the Audit of the Financial Statements** section of our report. We are independent of the Company in accordance with the **ethical requirements** that are relevant to our audit of the financial statements **under the provisions of the Companies Act, 2013**, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the **ICAI's Code of Ethics**.

**We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.**

207.

**Modified Opinion - Special Considerations**

"When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." As an expert you are required to brief the special considerations required for expressing:

- Qualified Opinion;
- Adverse Opinion and
- Disclaimer of Opinion.

**(RTP-May-2020) (RTP-Nov-2018) (Study Material)**
**Ans.**

**(i) Special consideration required for expressing Qualified Opinion:**

When the auditor expresses a **qualified opinion** due to a material misstatement in the FSs, the auditor shall state that, in the auditor's opinion, **except for the effects of the matter(s) described** in the Basis for **Qualified Opinion** section:

- When reporting in accordance with a **fair presentation framework**, the accompanying financial statements **present fairly, in all material respects** (or give a true and fair view of) [...] in accordance with [the **applicable financial reporting framework**]; or

- When reporting in accordance with a **compliance framework**, the accompanying financial statements have been **prepared, in all material respects, in accordance with** [the applicable financial reporting framework]. When the modification arises from an inability to obtain SAAE, the auditor shall use the corresponding phrase “**except for the possible effects of the matter(s) ...**” for the modified opinion.

**(ii) Special consideration needed for expressing Adverse Opinion:**

When the auditor expresses an **adverse opinion**, the auditor shall state that, in the auditor’s opinion, because of the **significance of the matter(s)** described in the **Basis for Adverse Opinion section**:

- When reporting in accordance with a **fair presentation framework**, the accompanying financial statements **do not present fairly** (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- When reporting in accordance with a **compliance framework**, the accompanying financial statements **have not been prepared, in all material respects**, in accordance with [the applicable financial reporting framework].

**(iii) Special consideration is required for expressing Disclaimer of Opinion:**

When the auditor **disclaims an opinion** due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

- State that the auditor **does not express an opinion** on the accompanying financial statements;
- State that, because of the **significance of the matter(s) described** in the Basis for Disclaimer of Opinion section, the **auditor has not been able to obtain SAAE** to provide a **basis for an audit opinion** on the financial statements; and
- Amend the statement required in SA 700 (Revised)**, which indicates that the **FSs have been audited**, to state that the auditor was engaged to audit the financial statements.
- Unless required by law or regulation**, when the auditor **disclaims an opinion** on the financial statements, the auditor’s report **shall not include a Key Audit Matters** section in accordance with **SA 701**.

208.

**Resignation Due to Management Imposing Limitation on the Scope of Audit**

What are the professional obligations of the statutory auditor who has resigned before completion of his term due to non co-operation of the Management in completing certain audit procedures? **(Nov-2020-Old)**

Ans.



**(i) As per SA: -SA 705 "Modifications to the Opinion in the Independent Auditor's Report" provides :**

- The consequence of an **inability to obtain sufficient appropriate audit evidence** due to a management - **imposed limitation** after the auditor has accepted the engagement.
- The **practicability of resigning** from the audit may depend upon the **stage of completion of the engagement** at the time that management Imposes the scope limitation.
- When the auditor concludes** that resignation from the audit is **necessary** because of a **scope limitation**, there may be a **professional, regulatory or legal requirement** for the auditor to communicate matters relating to the resignation from the engagement to **regulators or the entity's owners**.

**(ii) In the case of resignation from the company: - Provisions of the Companies Act, 2013 apply.**

- Section 140(2) of the Companies Act, 2013**, requires the auditor, **who has resigned** from the company to file **within a period of 30 days**. from the **date of resignation**, a statement with the company and the registrar, and
- In case of government companies: -** the auditor shall file such statement with the **Comptroller and Auditor-General of India**, indicating the **reasons and other facts as** may be relevant with regard to his resignation.
- In case of failure the auditor will be **liable for penal provisions**.

209.

**Qualification in Report as per AS-1**

What are the circumstances in which auditors are required to qualify their reports of companies for matters related to AS-I 'Disclosure of Accounting Policies'? **(Jan-2021-Old)**

Ans.



- While discharging their **attest function**, the members of the Institute **may keep the following in mind** with regard to mandatory Accounting Standards.
- **As per AS 1 - Disclosure of Accounting Policies**, in the case of a **company**, members should **qualify their audit reports in case**:
  - **Accounting policies** required to be disclosed under **Schedule III** or any other provisions of the Companies Act, 2013, **have not been disclosed**, or
  - Accounts have not been prepared **on accrual basis**, or
  - The fundamental accounting assumption of going concern has **not been followed** and this fact **has not been disclosed** in the financial statements, or
  - **Proper disclosures** regarding changes in the accounting policies have **not been made**.

210.

**Contingent Liability & Reporting**

MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. for the F.Y. 2021-2022. The Company is into the business of yarn manufacturing. For this purpose, cotton ginning is also done within the factory premises. Raw cotton is purchased from local market and processed in-house. The Company received a notice from the State Government to deposit market development fee for the last 5 years to the tune of ₹ 10.00 crores. The Company and all other organizations in the same business has not deposited the market development fee, taking shelter of an old circular issued by the Government. The trade association met with the government officials to resolve the matter and agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial year. The Company, however, disclosed the same in notes to accounts, as contingent liability, without quantifying the effect and proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements **(July-2021-New)**



Ans.



- (i) As per Ind AS 37: - "Provisions, Contingent Liabilities and Contingent Assets"**, an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable .
- (a) an estimate of its financial effect, measured in the standard;
  - (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
  - (c) the possibility of any reimbursement.
- (ii) As per SA – 700 - Forming an opinion and reporting on financial statements:**  
 The auditor shall evaluate **whether in view of the requirements of the applicable financial reporting framework –**
- (i) The financial statements **adequately disclose** the significant accounting policies **selected and applied**;
  - (ii) The accounting policies selected and applied are **consistent** with the applicable financial reporting framework and are appropriate;
  - (iii) The accounting estimates made by the management are **reasonable**;
  - (iv) The information presented in the financial statements is **relevant, reliable, comparable and understandable**;
  - (v) The financial statements provide **adequate disclosures** to enable the intended users to **understand the effect of material transactions and events** on the information conveyed in the financial statements.
- If financial statements prepared in accordance with the requirements of a **fair presentation framework** do not achieve **fair presentation**, the auditor shall discuss the matter with **management** and, depending on the requirements of the **applicable financial reporting framework** and how the matter is resolved, shall determine whether it is **necessary to modify the opinion** in the auditor's report in accordance with SA 705.
- (iii) Conclusion:** -In the present case, auditor may consider **modifying his opinion** considering the financial effect of liability not disclosed properly.

## SA-706

## Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

211.	<b>Emphasis of Matter Paragraph in Audit Report</b> Write a short note on Emphasis of matter paragraph in Audit Reports. <span style="float: right;">(Study Material)</span>
<b>Ans.</b> 	<p><b>(i) Emphasis of Matter paragraph:</b></p> <ul style="list-style-type: none"> <li>A paragraph <b>included in the auditor's report</b> that refers to a <b>matter appropriately presented or disclosed</b> in the financial statements that, in the <b>auditor's judgment</b>, is of such importance that it is <b>fundamental to users' understanding</b> of the financial statements.</li> <li>If the auditor considers it necessary to <b>draw users' attention to a matter</b> presented or disclosed in the financial statements, the auditor <b>shall include an Emphasis of Matter paragraph</b> in the auditor's report <b>provided:</b> <ul style="list-style-type: none"> <li>(a) The auditor would <b>not be required to modify the opinion</b> in accordance with <b>SA 705</b> as a result of the matter; and</li> <li>(b) <b>When SA 701 applies</b>, the matter <b>has not been determined to be a key audit matter</b> to be communicated in the auditor's report.</li> </ul> </li> </ul> <p><b>(ii) These circumstances may include:</b></p> <ul style="list-style-type: none"> <li>When a <b>financial reporting framework</b> prescribed by <b>law or regulation</b> would be unacceptable but for the fact that it is prescribed by law or regulation.</li> <li><b>To alert users that the financial statements</b> are prepared in accordance with a <b>special purpose framework</b>.</li> <li><b>When facts become known to the auditor</b> after the <b>date of the auditor's report</b> and the auditor provides a <b>new or amended auditor's report</b> (i.e., subsequent events).</li> </ul>
212.	<b>Emphasis of Matter Paragraph in Audit Reports</b> Enumerate certain important matters which can be included in 'Emphasis of Matter paragraph' in an auditor's report. <span style="float: right;">(Nov-2019-Old)</span>
<b>Ans.</b> 	<p><b>(i) Provision: - SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"</b>, deals with additional communication in the auditor's report when:</p> <ul style="list-style-type: none"> <li>The auditor considers it necessary to <b>draw user's attention</b> to a matter <b>presented or disclosed</b> in the financial statements that,</li> <li>In the <b>auditor's judgment</b>, is of such importance that <b>it is fundamental to user's understanding</b> of the financial statements,</li> <li>The auditor shall <b>include an Emphasis of Matter paragraph</b> in the auditor's report provided:             <ul style="list-style-type: none"> <li>➤ The auditor has obtained <b>sufficient appropriate audit evidence</b> that the matter is <b>not materially misstated</b> in the financial statements.</li> <li>➤ Such a paragraph <b>shall refer only to information presented or disclosed</b> in the financial statements.</li> </ul> </li> </ul> <p><b>(ii) Specific requirements for the auditor to include EOM paragraphs in certain circumstances include:</b></p> <ul style="list-style-type: none"> <li>When a <b>financial reporting framework</b> prescribed by <b>law or regulation</b> would be unacceptable but for the fact that it is prescribed by law or regulation.</li> <li><b>To alert users</b> that the <b>financial statements</b> are prepared in accordance with a <b>special purpose framework</b>.</li> <li>An <b>uncertainty</b> relating to the <b>future outcome of exceptional litigation</b> or regulatory action.</li> <li>A <b>significant subsequent event</b> that occurs between the date of the financial statements and the date of the auditor's report.</li> </ul>

- **Early application of a new accounting standard** that has a material effect on the financial statements.
- **A major catastrophe** that has had, or **continues to have**, a significant effect on the entity's financial position. However, a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication about such matters.

213.

**Emphasis of Matter & Modification in the Opinion**

AKB Associates, a renowned audit firm in the field of CA practice for past two decades. The firm was appointed to conduct statutory audit of Rica Ltd. an unlisted company, which is engaged in the business of paper manufacturing. It decided to commence the audit for the recently concluded financial year. Once after making significant progress in the audit, the auditors made the following observations:

**Observation 1:** The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

**Observation 2:** Due to flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material. You are required to advise, whether AKB Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported? **(RTP-Nov-2020)**

Ans.

**Reporting of observations by the AKB Associates**
**(i) Observation-1**

- **As per SA 706:** - "**Emphasis of Matter Paragraph & Other Matter Paragraph** in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to **matter appropriately disclosed** in the financials, that in the auditor's **judgement is of such importance** that it is **fundamental to users' understanding** of the financials.
- **In the given case:** - The management had **disclosed in the financials** that, during the year, **one of the warehouses** of the Company was affected due to a **major flood**. As a result of the same, the **Company had incurred some losses**. But the **management was of the view that it was not material**.
- **Conclusion:** -Hence, in this case, the **auditor shall report** about the **consequences of the flood** which affected the Company's warehouse **under Emphasis of Matter Paragraph**.

**(ii) Observation-2**

- **As per SA 705:** - "**Modification to Opinion in the Independent Auditor's Report**", where the auditor is **unable to obtain sufficient and appropriate** audit evidence and where such matter is **material but not pervasive**, the auditor shall issue a **qualified opinion**.
- **In the given case:** -Due to flood, few **records maintained by the Company** with respect to a particular transaction was **completely destroyed** and there was **no duplicate record** maintained by the Company. However, those details were **not pervasive, but material**.
- **Conclusion:** -Thus, in the given situation, **on account of flood** few records pertaining to particular transactions was **completely destroyed** and in the **absence of duplicate records**, the auditor was unable to **obtain sufficient and appropriate audit evidence** and those details were **material but not pervasive**. Therefore, in accordance with **SA 705, the auditor is required to issue qualified opinion**.

213A.

**Reporting - Emphasis of Matter or Other matter paragraph**

Difficult Books Limited is engaged in manufacturing of active pharmaceutical ingredients. Due to change in laws and regulations, every company engaged in manufacturing in active pharmaceutical ingredients would now require production capacity license which will restrict the production of companies. Management of the company assessed the impact of the change in law over the financial position of company and appropriately disclosed the same in the financial statement. Audit Team of the company evaluated management's disclosure and found it appropriate and sufficient. However, considering the said matter as most important and fundamental to users understanding regarding financial statement the audit team decided to disclose the same in Other Matter Paragraph. You as an Engagement Partner are required to guide the Audit Team with respect to reporting of the said matter in Audit Report. **(MTP-Nov-2022)**



Ans.



(a) As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"

- If the auditor considers it necessary to draw **users' attention to a matter presented or disclosed** in the financial statements that, in the auditor's judgment, is of such importance that it is **fundamental to users' understanding** of the financial statements,
- **The auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:**
  - (i) The auditor would **not be required to modify the opinion** in accordance with SA 705 as a result of the matter; and
  - (ii) **When SA 701 applies**, the matter has **not been determined to be a key audit matter** to be communicated in the auditor's report.

(b) In the instant case: -

- Since Difficult Books Limited is **engaged in manufacturing of active pharmaceutical ingredients**, would now require **production capacity license** which will restrict the production of companies, due to change in laws and regulations.
- **Management of the Difficult Books Limited** assessed the **impact of the change in law** over the financial position of company and **appropriately disclosed** the same in the financial statement.
- **Audit team of the Difficult Books Limited** evaluated **management's disclosure** and found it appropriate and sufficient. **However, considering the said matter as most important and fundamental to users understanding** regarding financial statement the audit team decided to disclose the same.
- **The said matter is already disclosed and presented appropriately** in financial statement and is of such importance that is fundamental to the users understanding of the financial statement and hence, it required to be disclosed under **Emphasis of Matter paragraph**.

(c) **Conclusion:** -Therefore, **decision of audit team to disclose** the same in Other Matter Paragraph **is not in order**, it should be disclosed in Emphasis of Matter Paragraph.

### SA-710

### Comparative Information – Corresponding Figures and Comparative Financial Statements

214.

#### Auditor's Responsibilities- Comparatives:

You as a statutory auditor had audited the financial statements of A Ltd., a listed company, for F.Y. 2020-21. The company has included the comparative financial information in the financial statements prepared for the current F.Y. 2021-22. You as an auditor want to obtain sufficient appropriate audit evidence that comparative financial information has been presented, in all material aspects, in accordance with the requirements in the applicable financial reporting framework. List out audit procedures, as specified in relevant SA, which you are required to follow for the purpose.

(Dec-2021-Old)

OR

Auditor's responsibilities regarding comparatives.

(RTP-Nov-2018)

Ans.



(i) SA 710, "Comparative Information Corresponding Figures and Comparative Financial Statements",

- SA-710 Establishes standards on the **auditor's responsibilities regarding comparatives**.
- The auditor shall **determine whether the financial statements include the comparative information** required by the **applicable financial reporting framework** and
- Whether **such information is appropriately classified**.

(ii) **For the above purpose, the auditor shall evaluate whether:**

- The comparative information **agrees with the amounts and other disclosures** presented in the prior period; and
- The **accounting policies** reflected in the **comparative information are consistent** with those applied in the current period or,