CA IPC
AUDITING AND ASSURANCE
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STANDARDS ON AUDITING

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Questions on Standards on Auditing - IPC:
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Question 1: “The auditors should consider the effect of subsequent events on the financial statement and on auditor’s report” according to SA 560 – Comment.

Answer: Effect of Subsequent Events: SA 560 “Subsequent Events”, establishes standards on the auditor’s responsibility regarding subsequent events.

According to it, ‘subsequent events’ refer to those events which occur between the date of financial statements and the date of the auditor’s report, and facts that become known to the auditor after the date of the auditor’s report. It lays down the standard that the auditor should consider the effect of subsequent events on the financial statements and on the auditor’s report.

The auditor should obtain sufficient appropriate evidence that all events upto the date of the auditor’s report requiring adjustment or disclosure have been identified and to identify such events. The auditor should-

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

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

Examples of inquiries of management on specific matters are:

- 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 there have been any developments regarding contingencies.
- Whether there have been any developments regarding risk areas and contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
Whether any events have occurred or are likely to occur which will bring in to 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.

Read 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.

Read the entity’s latest subsequent interim financial statements, if any.

Read the entity’s latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.

Inquire, or extend previous oral or written inquiries, of the entity’s legal counsel concerning litigation and claims.

When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements. If such events have not been considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

**Question 2: Standards collectively known as the Engagements Standards issued by AASB under the authority of the council of ICAI—Discuss.**

**Answer**

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

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

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

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

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

Question 3: The auditor shall communicate all significant findings with those charged with Governance.

(a) Communication of Findings with Those Charged with Governance: As per SA-260 “Communication with Those Charged with Governance”, the auditor shall communicate the following significant findings from the audit, with those charged with governance-

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

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

(iii) Unless all of those charged with governance are involved in managing the entity:

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

(2) Written representations the auditor is requesting; and

(iv) Other matters, if any, arising from the audit that, in the auditor’s professional judgment, are significant to the oversight of the financial reporting process.
Question 4: What are the factors affecting form, contents and extent of audit?

Factors Affecting Form, Contents and Extent of Audit: As per SA-230 on “Audit Documentation”, the form, content and extent of audit documentation depend on the following factors:

(i) The size and complexity of the entity.
(ii) The nature of the audit procedures to be performed.
(iii) The identified risks of material misstatement.
(iv) The significance of the audit evidence obtained.
(v) The nature and extent of exceptions identified.
(vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
(vii) The audit methodology and tools used.

Question 5: What are the Risk Factors while applying Sampling Techniques:

Answer: As per SA 530 “Audit Sampling”, sampling risk is the risk that the auditor’s conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

- In the case of tests of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Question 6: What are the Auditor’s Responsibilities in Respect of Corresponding Figures:

As per SA 710 “Comparative Information—Corresponding Figures and Comparative Financial Statements”, in respect of corresponding figures, the auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting standards.
framework and whether such information is appropriately classified. For this 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, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period’s financial statements, the auditor shall also follow the relevant requirements of SA 560 “Subsequent Events”.

As required by SA 580, “Written Representations”, the auditor shall request written representations for all periods referred to in the auditor’s opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year’s Statement of Profit and Loss.

**Question 7: How to Identify Significant Related Party Transaction Outside Business:**

As per SA 550 on “Related Parties”, for identified significant related party transactions outside the entity’s normal course of business, the auditor shall:

(i) **Inspect the underlying contracts or agreements**, if any, and evaluate whether:

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

   (2) The terms of the transactions are consistent with management’s explanations; and

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

(ii) **Obtain audit evidence that the transactions** have been appropriately authorized and approved.

**Question 8 Explain Self-revealing Errors:**
These are such errors the existence of which becomes apparent in the process of compilation of accounts.

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

| (i) | Omission to post a part of a journal entry to the ledger. | Trial balance is thrown out of agreement. |
| (ii) | Wrong totaling of the Purchase Register. | Control Account (e.g., the Sundry Creditors Account) balances and the aggregate of the balances in the personal ledger will disagree. |
| (iii) | A failure to record in the cash book amounts paid in to or withdrawn from the bank. | Bank reconciliation statement will show up error. |
| (iv) | A mistake in recording amount received from X in the account of Y. | Statements of account of parties will reveal mistake. |

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

**Question 9 How to identify Non-compliance of Laws and Regulations by Management?**

As per SA 250 on “Consideration of Laws and Regulation in an Audit of Financial Statements”, the following are examples or matters indicating to the auditor about non-compliance with laws and regulations by management-

(i) **Investigations by regulatory organisations** and government departments or payment of fines or penalties.
(ii) **Payments for unspecified services or loans to consultants**, related parties, employees or government employees.
(iii) **Sales commissions or agent’s fees that** appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
(iv) **Purchasing at prices significantly** above or below market price.
(v) Unusual payments in cash, purchases in the form of cashiers’ cheques payable to bearer or transfers to numbered bank accounts.
(vi) Unusual payments towards legal and retainership fees.
(vii) Unusual transactions with companies registered in tax havens.
(viii) Payments for goods or services made other than to the country from which the goods or services originated.
(ix) Payments without proper exchange control documentation.
(x) Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
(xi) Unauthorised transactions or improperly recorded transactions

Question 10: What are the Operating Conditions Casting Doubt about Going Concern Assumption:
The following are examples of operating events or conditions that, may cast significant doubt about the going concern assumption-
- 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 principals supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Question 11: Explain Professional Scepticism:
- As per SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, professional scepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- Therefore, professional scepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance.
- It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in
the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

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

- This requirement is also designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

**Question 12: What are the Information which assist the Auditor in accepting and continuing of relationship with Client?**

As per SA 220, “Quality Control for an Audit of Financial Statements” the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

(i) The integrity of the principal owners, key management and those charged with governance of the entity;

(ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;

(iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and

(iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

**Question 13: What are the Significant Difficulties Encountered During the Audit?**
As per SA 260 “Communication with Those Charged with Governance”, significant difficulties encountered during the audit may include such matters as:

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditor by management.
- Management’s unwillingness to make or extend its assessment of the entity’s ability to continue as a going concern when requested.

Question 14 How to Identify Significant Risks as per SA 315?

SA 315 “Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment” defines ‘significant risk’ as an identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor’s judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(i) Whether the risk is a risk of fraud;
(ii) Whether the risk is related to recent significant economic, accounting or other developments like changes in regulatory environment etc. and therefore requires specific attention;
(iii) The complexity of transactions;
(iv) Whether the risk involves significant transactions with related parties;
(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

Question 15 What are the Factors that may affect the Identification of an Appropriate Benchmark in Determining Materiality?
As per SA 320 “Materiality in Planning and Performing an Audit”, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its lifecycle, and the industry and economic environment in which the entity operates;
- The entity’s ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets and claims on them, than on the entity’s earnings); and
- The relative volatility of the benchmark.

Question 16 Explain Accounting Estimates

According to the SA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosure”, accounting estimate means an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. SA 540 addresses only accounting estimates involving measurement at fair value, the term “fair value accounting estimates” is used.

Some accounting estimates involve relatively lowest uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.
- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded. Additional examples of accounting estimates are:
- Allowance for doubtful accounts.
Inventory obsolescence.
Warranty obligations.
Depreciation method or asset useful life.
Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
Outcome of long term contracts.
Financial Obligations/Costs arising from litigation settlements and judgments.

Question 17 Explain Analytical Procedures

- As per SA 520, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
- Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.
- The auditor’s choice of procedures, methods and level of application is a matter of professional judgement.
- Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example: comparable information for prior periods; anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation; and similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.
- Analytical procedures also include consideration of relationships, for example: among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages; and between financial information and relevant non-financial information, such as payroll costs to number of employees.
- Analytical procedures are used for the following purposes:
  (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
  (b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the
financial statements are consistent with the auditor’s understanding of the entity.

Question 18: Explain Materiality

According to SA 320 “Materiality in Planning and Performing an Audit”, financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor’s perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

(1) Such a discussion, if present in the applicable financial reporting framework, provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred above provides the auditor with such a frame of reference.

(2) The auditor’s determination of materiality is a matter of professional judgment, and is affected by the auditor’s perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
(b) Understand that financial statements are prepared, presented and audited to levels of materiality;
(c) Recognize the uncertainties inherent in the measurement of amounts
Question 19 What are the various Assertions used by the auditor to consider the different types of potential misstatements?

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

Assertions about account balances at the period

(i) Existence—assets, liabilities, and equity interests exist.
(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.
(iv) Valuation and allocation—assets, liabilities, and equity interests are included in the Financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(c) Assertions about presentation and disclosure:
   (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
   (ii) Completeness—all disclosures that should have been included in the financial statements have been included.
(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.
(iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

**Question 20 Explain Audit sampling and various types of sampling?**

“Audit Sampling” means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

There are many methods of selecting samples. The principal methods are as follows:

(a) **Random selection** (applied through random number generators, for example, random number tables).

   **Systematic selection**, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.

(c) **Monetary Unit sampling** is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

(d) **Haphazard selection**, in which the auditor selects the sample without following a structured technique.

(e) **Block selection** involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

**Question 21 Write a short note on Knowledge of Client's business.**

**Answer**

Knowledge of Client’s Business: An auditor can obtain this information from-

(i) Clients annual report to shareholders;
(ii) Minutes of shareholders/board of directors;
(iii) Internal financial management reports of current & previous year;
(iv) Previous year audit working papers;
(v) Discussion with client;
(vi) Clients policy and procedure manual;
(vii) Publications like trade journals, magazines, newspapers; and
(viii) Visit to client’s premises.

**Question 22** What are the Procedures to be performed by the Auditor in Expressing Opinion on 'Going Concern' Assumption:

As per SA 570, “Going Concern”, the following are the relevant procedures that are relevant in this connection-

(i) Analyse and discuss cash flow, profit and other relevant forecasts with management.
(ii) Analyse and discuss the entity's latest available interim financial statements.
(iii) Read the terms of debentures and loan agreements and determine whether any have been breached.
(iv) Read minutes of the meetings of shareholders, the board of directors and important committees for reference to financing difficulties.
(v) Inquire the entity’s legal counsel regarding the existence of litigation and claims; and the reasonableness of management’s assessments of their outcome and the estimate of their financial implications.
(vi) Confirm the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds.
(vii) Evaluate the entity's plan to deal with unfilled customer orders.
(viii) Perform audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity’s ability to continue as a going concern.
(ix) Confirm the existence, terms and adequacy of borrowing facilities.
(x) Obtain and review reports of regulatory actions.
(xi) Determine the adequacy of support for any planned disposals of assets.

**Question 23** What are Factors Governing Modes of Communication of Auditor with Those Charged with Governance?
As per SA 260, “Communication with Those Charged with Governance”, the form of communication (e.g. whether to communicate orally, or in writing, the extent of detail or summarisation in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:-

(i) Whether the matter has been satisfactorily resolved.
(ii) Whether management has previously communicated the matter.
(iii) The size, operating structure, control environment, and legal structure of the entity.
(iv) In the case of an audit of special purpose financial statements, whether the auditor also audits the entity’s general purpose financial statements.
(v) Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
(vi) The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
(vii) The amount of ongoing contact and dialogue the auditor has with those charged with governance.

Question 24 What are the Issue of Audit Engagement Letter in Recurring Audits?

As per SA 210, “Agreeing the Terms of Audit Engagements”, on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

It is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement. However, in the following situations it is appropriate to revise the terms of the audit engagement or to remind the entity of existing terms-

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

Question 25 Discuss with reference to SA 510, “Initial Audit Engagement – Opening Balances”, the procedures the auditor should undertake in respect of opening balances for a new audit engagement.

Answer

- Audit Procedures in respect of Opening Balances for a New Audit Engagement: As per SA 510 “Initial Audit Engagements – Opening Balances”, the auditor should undertake the following procedures in respect of opening balances in case of new audit engagement:
  a. The auditor shall read the most recent financial statements, if any, and the predecessor auditor’s report thereon, if any, for information relevant to opening balances, including disclosures.

b. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by:

- Determining whether the prior period’s closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year’s Statement of Profit and Loss;
- Determining whether the opening balances reflect the application of appropriate accounting policies; and
- Performing one or more of the following:
  - Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
  - Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
  - Performing specific audit procedures to obtain evidence regarding the opening balances.
If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period’s financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period’s financial statements. If the auditor concludes that such misstatements exist in the current period’s financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Question 26: Distinguish between absolute and reasonable assurance. Identify the type of assurance that is expected in an audit of the financial statements, clearly outlining the reasons to justify your point of view.

1. Absolute assurance is the highest level of assurance an auditor can give, if he check each and every transaction. Therefore, absolute assurance is the level of assurance that can only be given if the auditor does not perform sampling testing. However, it is not possible to give absolute assurance because of time and cost involved. Therefore, auditors give reasonable assurance. Reasonable assurance is less than absolute assurance.

2. As per SA-200 overall objectives of the independent auditor, in conducting an audit of financial statements, one of the objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

3. As the basis for the auditor’s opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance.

4. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.
5. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.

Question 27: State the analytical review procedures normally carried out in the audit of inventories.

The auditor can adopt the following analytical procedures to verify the inventory of inventories-

- Quantitative reconciliation of opening inventories, purchases, production, sales and closing inventories.
- Comparison of closing inventory quantities and amounts with those of the previous year.
- Comparison of the inventory turnover ratios for the current year with that of the previous year and with industry standards if available.
- Comparison of the closing inventory (Raw materials, closing work-in-progress and finished goods are percentage of total inventories) with the corresponding figures of the previous year.
- Comparison of current year gross profit ratio with that of the previous year.
- Comparison of actual inventory, purchase and sales figures with the budgeted figures if available.
- Comparison of raw material yield/wastage with previous year figures.
Question 28: What is an Emphasis of Matter paragraph, when it is used, and manner of its use in an audit report?

(a) Sometimes 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 the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.

Examples - when it is used:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.

Manner of its use in Audit Report: As per SA 706 “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report”, the inclusion of an Emphasis of Matter paragraph in the auditor’s report does not affect the auditor’s opinion. When the auditor includes an Emphasis of Matter paragraph in the auditor’s report, the auditor shall:

(i) Include it immediately after the Opinion paragraph in the auditor’s report;
(ii) Use the heading “Emphasis of Matter”, or other appropriate heading;
(iii) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
(iv) Indicate that the auditor’s opinion is not modified in respect of the matter emphasised.
Question 29: “Inquiry is used extensively throughout the audit in addition to other audit procedures”. Explain.

1. Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.

2. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

3. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

4. Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management’s intent may be limited.

5. In these cases, understanding management’s past history of carrying out its stated intentions, management’s stated reasons for choosing a particular course of action, and management’s ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

6. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.
Question 30: What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors.

As per SA 505 “External Confirmations”, external confirmation is an audit evidence obtained as a direct written response to the auditor from a third party. The auditor should determine whether the use of external confirmation is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions.

(i) Bank balances and other information from bankers
(ii) Account receivables balances
(iii) Inventory held by third parties
Account payable balances.

Question 31: “The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time”. Explain.

1. The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time.

2. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

3. Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity’s data retention policies to request retention of some information for the auditor’s review or to perform audit procedures at a time when the information is available.
Question 32: Discuss the matters the auditor may consider in determining the extent of tests of controls.

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.

Question 33 Explain The factors for overall Audit strategy:

(i) Identify the characteristics of the engagement that define its scope;
(ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
(iii) Consider the factors that, in the auditor’s professional judgment, are significant in directing the engagement team’s efforts;
(iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
(v) Ascertain the nature, timing and extent of resources necessary to perform the engagement.
Question 34: Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered.” Explain.

1. According to SA 315 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment”, risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence.

2. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

Question 35: Advantages of Statistical Sampling in Auditing:

The advantages of using statistical sampling technique in auditing are-

(i) Sample size does not increase in proportion to the increase in the size of population.

(ii) Sample selection is more objective and based on law of probability.

(iii) This provides a means of estimating the minimum sample size associated with a specified risk and precision level.

(iv) It also provides a means for deriving a calculated risk and corresponding precision.

(v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistake are not large.
Question 36 Quality Control for Audit Work at Firm Level – Explain

SA 220 on Quality Control for an Audit of Financial Statements deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. Quality control systems, policies and procedures are the responsibility of the audit firm. Within the context of the firm’s system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm’s system of quality control relating to independence. The requirements are-

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

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

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

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

(ii) **Engagement Performance:** The engagement partner shall take responsibility for the direction, supervision and performance of the audit engagement. He shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures and shall take responsibility for the engagement team
undertaking appropriate consultation on difficult or contentious matters. For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall determine that an engagement quality control reviewer has been appointed. Further, if differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm’s policies and procedures for dealing with and resolving differences of opinion.

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

Question 37: Procedure for External Confirmation – SA 505

(i) Determining the Information to be confirmed or Requested: External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.

(ii) Selecting the Appropriate Confirming Party: Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

(iii) Designing Confirmation Requests: The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
(iv) **Follow-Up on Confirmation Requests:** The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

**Question 38: Explain Compilation Engagement:**

1. An engagement in which a practitioner applies accounting and financial reporting expertise to assist management in preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework and reports as required by the SRS.

2. Since, a compilation engagement is not an assurance engagement; a compilation engagement does not require the practitioner to verify the accuracy or the completeness of the information provided by management for the compilation or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of financial information.

**Question 39: Audit Trail:**

- An audit trail refers to a situation where it is possible to relate ‘one-to-one’ basis, the original input along with the final output. The work of an auditor would be hardly affected if “Audit Trail” is maintained i.e. if it were still possible to relate, on a ‘one-to-one’ basis, the original input with the final output. A simplified representation of the documentation in a manually created audit trail.

- **For example,** the particular credit notes may be located by the auditor at any time he may wish to examine them, even months after the balance sheet date. He also has the means, should he so wish, of directly verifying the accuracy of the totals and sub-totals that feature in the control listing, by reference to individual credit notes. He can, of course, check all detailed calculations, casts and postings in the accounting records, at any time.
In first and early second-generation computer systems, such a complete and trail was generally available, no doubt, to management’s own healthy skepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor.

It is once iterated that there is an abundance of documentation upon which the auditor can use his traditional symbols of scrutiny, in the form of colored ticks and rubber stamps.

**Question 40:** Discuss the factors relevant to the auditor’s judgment, about whether a control, individually or in combination with others, is relevant to the audit.

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

1. **Materiality.**
2. **The significance of the related risk.**
3. **The size of the entity.**
4. **The nature of the entity’s business, including its organisation and ownership characteristics.**
5. **The diversity and complexity of the entity operations.**
6. **Applicable legal and regulatory requirements.**
7. **The circumstances and the applicable component of internal control.**
8. **The nature and complexity of the systems that are part of the entity’s internal control, including the use of service organisations.**
9. **Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.**

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**All the Best!!**

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