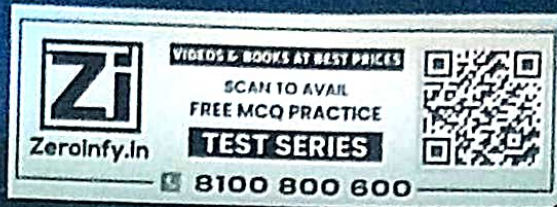


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AUDIT KE सवाल

Question Book

ADVANCED AUDITING, ASSURANCE & PROFESSIONAL ETHICS

for CA FINAL (New Syllabus 2023)

Applicable for May 2024 and onwards Examinations

Key Highlights

- Update with all Relevant Amendments
- Reference to RTPs and MTPs Questions
- Author's views for Conceptual Clarity
- Charts for Cross References

6th
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Khushboo G. Sanghavi is member of ICAI & visiting faculty of WIRC of ICAI having practical knowledge in the field of Auditing & Assurance. She is also a Proficient orator and speaker, has been teaching at CA Final& Intermediate level since more than 10 years.

She, being from audit background, brings real life examples to classroom to help students understand intricacies conceptually.

She is the proprietress of **Khushboo Girish Sanghavi and Co.** & is the Co-founder & Director of “Eduveda Edtech Pvt Ltd.” which provides online video lectures using 3D animation to retain and reproduce maximum. Currently, more than 25,000 students have benefited her lectures over **YouTube** and has more than 60,000 subscribers on the channel.

Being a speaker, she has been part of many regional & national conferences organized by ICAI and author of many other books for the students of CA field. She has also taken many motivational seminars for various institutions, trusts and colleges.

-----Preface-----

It gives as immense pleasure to launch this book “Audit Ke Sawaal” for CA FINAL aspirants. The main aim of this book is to make application of the core concepts of CA Final – Advanced Auditing, Assurance & Professional Ethics easy.

Learners at CA Final level face issues in interpreting the questions & answering it correctly. Understanding the problem, the team has compiled & created a set of question bank and has categorized it on the basis of concepts it belongs to. We highly recommended to read the provision either from our handwritten notes “Audit सार” or ICAI study material before solving questions from this book.

Out of experience we have marked few questions as important & unique, aspirants should add more focus to it.

Practice makes human perfect so warriors let's start practicing.

Happy Learning,

Team CA Khushboo Girish Sanghavi

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CHAPTER 1

Quality Control

SQC 1 – QUALITY CONTROL OF FIRMS THAT PERFORM AUDIT AND REVIEWS HISTORICAL INFORMATION AND OTHER ASSURANCE RELATED SERVICE ENGAGEMENTS

| | |
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| Q1. | PQR & Associates are statutory auditors of a listed company. There arose an issue during the course of audit relating to related party transactions. The engagement partner wants to consult engagement quality control reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss. |
| ANS. | It is necessary to maintain objectivity of reviewer. Therefore, participation in engagement or making decisions for engagement team is to be avoided at all costs. However, engagement partner may consult engagement quality control reviewer during the engagement so as not to compromise his objectivity and eligibility to perform the role. |
| Q2. | Beta Private Limited has approached a firm of Chartered accountants to assist them in preparation of financial statements and issue a compilation report in this regard. Does CA firm have responsibility in relation to quality control for above said engagement? Discuss with reasons. |
| ANS. | Such kind of services fall in category of "related services". SQC 1 is applicable to all type of engagements including engagement pertaining to "related services". |
| Q3. | MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also, been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1. |
| | RTP May 2019 |
| ANS. | As per SQC 1, the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved. With regard to the integrity of a client, matters that the firm considers include, for example: <ol style="list-style-type: none"> i) The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance. ii) The nature of the client's operations, including its business practices. iii) Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment. iv) Whether the client is aggressively concerned with maintaining the firm's fees as low as possible. v) Indications of an inappropriate limitation in the scope of work. vi) Indications that the client might be involved in money laundering or other criminal activities. vii) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm. The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client. |
| Q4. | M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that |

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| | <p>M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period.</p> <p>Accordingly, a complaint was filed against NK & Co. in relation to this matter.</p> <p>You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC).</p> |
| ANS: | <p>In the given question, NK & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements",</p> <p>(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:</p> <ol style="list-style-type: none"> Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and Allegations of non-compliance with the firm's system of quality control. <p>(ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.</p> <p>(iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.</p> <p>(iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.</p> <p>(v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.</p> |
| Q5. | <p>HK & Co. Chinned Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H. partner of the firm. has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion. what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control Or not.</p> |
| ANS: | <p>Para 27 of SQC 1" Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a pre-defined period, normally not more than seven years.</p> <p>An engagement quality control review for audits of financial statements of listed entities includes considering the following:</p> <ul style="list-style-type: none"> The engagement team's evaluation of the firm's independence in relation to the specific engagement. Significant risks identified during the engagement and the responses to those risks. |

- Judgments made, particularly with respect to materiality and significant risks.
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
- The appropriateness of the report to be issued.

SA 220 - QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

Q6. Rishikumar & Co. has been appointed as an auditor of PK Ltd. for the financial year 2016 -17. CA. Kumar, one of the partners of M/s Rishikumar & Co., completed entire routine audit work by 29th May, 2017. Unfortunately, on the very next morning, while roving towards office of PK Ltd. to sign final audit report, he met with a road accident and died. CA. Rishi, another partner of M/s Rishikumar & Co., therefore, signed the accounts of PK Ltd., without reviewing the work performed by CA. Kumar. Advise, whether CA. Rishi is right in expressing an opinion on financial statements the audit of which is performed by another auditor.

[MTP Apr 18]/IMPORTANT

ANS: Relying on Work Performed by Another Auditor: As per SA 220 “Quality Control for an Audit of Financial Statements”, an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed; the work performed supports the conclusions reached and is appropriately documented; the evidence obtained is sufficient and appropriate to support the auditor’s report; and the objectives of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor’s professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.

However, the auditor should carefully direct, supervise and review work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

Fact:

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Kumar. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Rishi signed the report relying on the work performed by CA. Kumar.

Conclusion: Here, CA. Rishi is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Kumar provided he further exercises adequate skill and due care and review the work performed by him as required in compliance with SA 220.

Q7. Ramanujan, a CA final student, feels that engagement file in audit engagement should be ready prior to issue of audit report. Discuss whether Ramanujan’s view is in order.

ANS. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. Engagement files

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| | should be completed in not more than 60 days after date of auditor's report in case of audit engagements. Thus, view of Ramanujam is not in order. |
| Q8. | BNE & Co. are in midst of audit process of a listed company. During the course of audit, an issue arose relating to revenues from contracts with customers in terms of Ind AS 115. The engagement partner took a certain stand. However, engagement quality control reviewer recommended otherwise after review. The engagement partner is not willing to accept recommendations of reviewer. How can the stalemate be ended? |
| ANS. | In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. The audit report should be issued only after resolution of matter. |
| Q9. | OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment. |
| ANS: | <p style="text-align: right;">[MTP-OCT-18]</p> <p>Review by Engagement Partner: As per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:</p> <ul style="list-style-type: none"> • Determine that an engagement quality control reviewer has been appointed; • Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and • Not date the auditor's report until the completion of the engagement quality control review. SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained. <p>Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.</p> <p>Facts: OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.</p> <p>Conclusion: Thus, in the given case, signing of auditor's report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.</p> |
| Q10. | During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the |
| IMP | |

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| | <p>Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.</p> <p style="text-align: right;">RTP May 2019, MTP-OCT-19 , May 22/STUDY MATERIAL</p> |
| ANS: | <p>As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:</p> <ul style="list-style-type: none"> • <u>Obtain relevant information</u> from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence; • Evaluate information on identified breaches, if any, of the firm’s independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and • <u>Take appropriate action to eliminate</u> such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action. • Engagement Partner <u>shall take responsibility for reviews being performed</u> in accordance with the firm’s review policies and procedures. <p>As per SA 220, “Quality Control for Audit of Financial Statements”, for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team’s evaluation of the firm’s independence in relation to the audit engagement.</p> <p>Conclusion: Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.</p> |
| Q11. | <p>The firm’s system of quality control should include policies and procedures addressing each element. Explain</p> |
| Ans: | <p>The firm’s system of quality control should include policies and procedures addressing each of the following elements:</p> <ol style="list-style-type: none"> (a) Leadership responsibilities for quality within the firm. (b) Ethical requirements. (c) Acceptance and continuance of client relationships and specific engagements. (d) Human resources. (e) Engagement performance. (f) Monitoring. |
| Q12. Imp | <p>The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.</p> <p style="text-align: right;">(RTP NOV 2019)</p> |
| Ans: | <p>The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements.</p> <p>The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:</p> <ol style="list-style-type: none"> (a) Adherence to professional standards and regulatory and legal requirements; |

- (b) Whether the quality control system has been appropriately designed and effectively implemented, and
- (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- (d) Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

Q13. CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which information, he should obtain before accepting an engagement?
OR

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. Explain

(MTP DEC 21/PAST PAPER MAY 2019 - 5 Mks)

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

- (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.

EXAMINER COMMENTS ON THIS QUESTION

Information required before accepting and continuing an audit engagement: Many Examinees explained only the disqualifications of an auditor and also wrongly focused on describing Management Responsibility etc. which was not required.

Q14. The engagement partner shall take the responsibility for the overall 'quality on each audit engagement to which that partner is assigned. Discuss with reference to SA 220 "Quality Control for an audit of financial statements"

(PAST PAPER NOV 2019 - 3 Mks)

Ans: As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- (a)** The importance to audit quality of:
 - (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals; and
- (b)** The fact that quality is essential in performing audit engagements

EXAMINATION COMMENTS ON THIS QUESTION

Most of the examinees mentioned only the points about firm's Quality control policy or the procedure of doing audit in an effective manner. They did not explain the Quality Control for an Audit of Financial Statements like complying with legal requirements or professional standards.

Q15. The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain

(MTP DEC 21)

Ans. The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- the accounts have been drawn up with reference to entries in the books of account;
- the entries in the books of account are adequately supported by sufficient and appropriate evidence;
- none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- the information conveyed by the statements is clear and unambiguous;
- the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Q16. SS Ltd. Is a company listed in India. The Company has appointed M/s Z & Co. as auditors. Mr. Q CA has recently joined the firm and has been appointed as the engagement partner for the first time. He understands that it is necessary to ensure the compliance of independence for the audit team as per standard audit practices. But he could not find as such, any policies and procedures available with the firm in documented form.

Why do you think that the firm should have policies and procedures to ensure the independence of the firm in every assignment? How does an engagement partner ensure the compliance of independence? Discuss with reference to relevant SAs.

(EXAM Q NOV 23)

Ans. Observance of "Independence" in all engagements is the founding requirement. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to: -

- a. Communicate its independence requirements to its personnel
- b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.

At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

Note

CHAPTER 2

General Auditing Principles and Auditor's Responsibilities

SA 240 - THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

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| Q1. | MN & Associates are the statutory auditors of ABC Ltd. for the FY2021-2022. During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. How should the audit team deal with the situation? |
| ANS. | <p>During the course of audit, the engagement partner, Mr. Manohar notices a misstatement resulting from a suspected fraud that brings into question the audit team's ability to continue performing the audit. In such a situation the audit team should:</p> <ul style="list-style-type: none"> ➤ Determine the <u>professional and legal responsibilities</u> applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; ➤ Consider whether it is <u>appropriate to withdraw</u> from the engagement, where withdrawal from the engagement is legally permitted; and ➤ If the auditor withdraws: - ➤ <u>Discuss with the appropriate level of management</u> and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal and ➤ Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, <u>to regulatory authorities</u>, the auditor's withdrawal from the engagement and the reasons for the withdrawal. |
| Q2 | <p>M/s Innocent Limited has entered into a transaction on 25th February, 2018, near year-end, whereby it has agreed to pay Rs. 5 lakhs per month to Mr. Yuvraj as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2018.</p> <p>Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Innocent Limited, what would be your approach?</p> <p style="text-align: right;">RTP Nov 2019</p> |
| ANS: | <p>As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.</p> <p>Facts: Keeping in view the above, it is clear that Company has passed fictitious journal entries near year end to manipulate the operating results. Also Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable.</p> <p>Accordingly, the auditor would adopt the following approach-</p> <p>If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:</p> |

- a. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- b. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- c. If the auditor withdraws:
 - i. Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - ii. Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is Rs. 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs. 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (xi) of Paragraph 3 of CARO, 2020, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

Q3

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

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ANS:

In the given case, management of Quick Ltd has made intentional misstatements to deceive the users in order to meet market expectations. Auditor is suspecting such intentional behavior of the management and in such situations, SA 240 discusses how fraudulent financial reporting may be accomplished and also discusses techniques of committing fraud by management overriding controls.

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" **Fraudulent financial reporting may be accomplished by the following:**

- i. Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- ii. Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
- iii. Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- i. **Recording fictitious journal entries**, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- ii. **Inappropriately adjusting assumptions** and changing judgments used to estimate account balances.
- iii. **Omitting, advancing or delaying recognition** in the financial statements of events and transactions that have occurred during the reporting period.

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| | <p>iv. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.</p> <p>v. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.</p> <p>vi. Altering records and terms related to significant and unusual transactions.</p> |
| Q4 | <p>M/s Kumar & Co. Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA. Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA. Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.</p> <p>Guide CA Kumar with respect to Risk Factor related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing.</p> |
| ANS: | <p>Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.</p> <p><i>Incentives/Pressures</i></p> <p>Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.</p> <p>Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:</p> <ul style="list-style-type: none"> ➤ Known or anticipated <u>future employee layoffs</u>. ➤ Recent or <u>anticipated</u> changes to employee <u>compensation or benefit plans</u>. ➤ Promotions, compensation, or other rewards <u>inconsistent with expectations</u>. <p><i>Opportunities</i></p> <p>Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:</p> <ul style="list-style-type: none"> ➤ <u>Large amounts of cash</u> on hand or processed. ➤ Inventory items that are <u>small in size</u>, of <u>high value</u>, or in <u>high demand</u>. ➤ Easily <u>convertible assets</u>, such as bearer bonds, diamonds, or computer chips. ➤ <u>Fixed assets</u> which are small in size, <u>marketable</u>, or lacking observable identification of ownership. <p><i>Attitudes/Rationalizations</i></p> <ul style="list-style-type: none"> ➤ <u>Disregard for the need</u> for monitoring or reducing risks related to misappropriations of assets. ➤ Disregard for <u>internal control</u> over misappropriation of assets by overriding existing controls or by <u>failing to take appropriate</u> remedial action on known deficiencies in internal control. ➤ Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee. ➤ Changes in <u>behavior or lifestyle that</u> may indicate assets have been misappropriated. ➤ Tolerance of petty theft. |

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| Q5 | <p>Saburi Yarns Ltd is engaged in manufacturing and trading of yarns of different types. Its huge amount is locked up in account receivables. Moreover, Management of Saburi Yarns Ltd is worried about its Internal Control system over receipts from account receivables and other receipts. Management wants to understand from you as an auditor few techniques as to how receipts can be suppressed resulting into frauds and finally incurring losses.</p> |
| Ans: | <p style="text-align: right;">[Jan 21]</p> <p>Few Techniques of how receipts are suppressed are:</p> <ol style="list-style-type: none"> (1) <u>Teeming and Lading</u>: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him. (2) <u>Adjusting unauthorised or fictitious rebates</u>, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them. (3) <u>Writing off as debts in respect</u> of such balances against which cash has already been received but has been misappropriated. (4) Not accounting for cash sales fully. (5) Not accounting for miscellaneous receipts, e.g., sale of scrap, quarters allotted to the employees, etc. (6) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds. |
| Q6 | <p>Misappropriation of Assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in way s that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways. Analyse and Explain</p> <p style="text-align: right;">(RTP NOV 2018)</p> <p style="text-align: center;"><u>OR</u></p> <p>"Theft of an entity's assets is often perpetrated by employees in relatively small and immaterial amounts." Explain the various ways in which the same can be accomplished?</p> <p style="text-align: right;">(PEQ JAN, 2021)</p> |
| Ans. | <p>Misappropriation of Assets involves:</p> <p>It involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:</p> <ul style="list-style-type: none"> • Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts). • Stealing physical assets or intellectual property (for Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment). • Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees). • Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party) • Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. |
| Q7 | <p>Discuss the different ways in which defalcation of cash may take place.</p> <p style="text-align: right;">(RTP MAY 2019)</p> |

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| <p>Ans.</p> | <p>Defalcation of Cash: Defalcation of cash has been found to perpetrate generally in the following ways:</p> <p>A) By inflating cash payments. Examples of inflation of payments:</p> <ol style="list-style-type: none"> (1) Making payments against fictitious vouchers. (2) Making payments against vouchers, the amounts whereof have been inflated. (3) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner. (4) Casting a larger totals for petty cash expenditure and adjusting the excess in the totals of the detailed columns so that cross totals show agreement. <p>B) By suppressing cash receipt Refer Q.5</p> <p>C) By casting wrong totals in the cash book.</p> |
| <p>Q8</p> | <p>Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence. Explain stating clearly how this type of fraud is generally committed.</p> <p style="text-align: right;">(RTP NOV 2019)</p> |
| <p>Ans.</p> | <p>Manipulation of Accounts: Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:</p> <ol style="list-style-type: none"> a. Inflating or suppressing purchases and expenses; b. Inflating or suppressing sales and other items of income, c. Inflating or deflating the value of closing inventory; d. Failing to adjust outstanding liabilities or prepaid expenses; and e. Charging items of capital expenditure to revenue or by capitalizing revenue expenses. |
| <p>SA 250 - CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS.</p> | |
| <p>Q9</p> | <p>You are auditor of a social media company. Of late, government has tightened noose around companies operating in this segment by bringing in a maze of regulatory legislations to protect interests of users. How you can proceed to verify that company is compliant with new regulatory requirements? Besides, what does above situation underscore to you as an auditor?</p> |
| <p>ANS.</p> | <p>It needs to be verified that the company has put in place systems and procedures to meet with new regulatory requirements. The same can be verified by examining policies and procedures developed by company in this regard like devising appropriate system of internal control, sensitizing employees regarding new rules, engaging legal advisors etc.</p> <p>Further, financial stability of the company may be threatened due to new regulatory requirements. The management may be under pressure. It is also a fraud risk factor and may need to be evaluated by auditor.</p> |
| <p>Q10</p> | <p>Discuss why the potential effects of inherent limitations of an auditor's ability to detect material misstatements described in SA 200 are far greater in respect of non-compliance with laws and regulations?</p> |
| <p>ANS.</p> | <p>In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following: -</p> <ul style="list-style-type: none"> ➤ There are many laws and regulations, relating principally to the operating aspects of an entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting. ➤ Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor. ➤ Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law. |
| <p>Q11</p> | <p>CA Anand is the engagement partner for the audit assignment of NHT Ltd. engaged in manufacture of Iron and Steel bars. The company has its plants in the state of Sikkim. While verifying the wages record of the company, CA Anand found that maximum of the labour</p> |

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| | <p>employed in the plants of the company was child labour. He questioned the management of the company about the same to which the management replied that looking into the compliance of such law is outside his scope of financial audit. Give your comments with respect to such situation.</p> <p style="text-align: center;">Or</p> <p>While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.</p> <p style="text-align: right;">MAY 2018 RTP</p> |
| ANS. | <p>Compliance with Other Laws: As per SA 250 "Considerations of Laws and Regulations in an Audit of Financial Statements", the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.</p> <p>For the compliance with provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, the auditor's responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations.</p> <p>For other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the business, the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.</p> <p>Facts: In the instant case, maximum of the labour employed in the plants of the company was child labour. When CA Anand questioned the management of the company about the same, the management replied that looking into the compliance of such law is outside his scope of financial audit. Such reply by the management is not acceptable as such situation may have a material effect on the financial statements.</p> <p>Conclusion: Therefore, CA Anand should ensure as to whether any penal provisions will be there for non-compliance of such law and also whether the same has been duly disclosed by the company. If CA Anand concludes that such non-compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements by the company, he shall express an adverse or a qualified opinion on the financial statements.</p> |
| Q12 | <p>As an Auditor of TRP Ltd., you are suspicious that there might be non-compliance with laws and regulations to which the Company is subject to. Indicate the possible areas or aspects where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire.</p> <p style="text-align: right;">May 2018</p> <p style="text-align: center;">OR</p> <p>R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non-compliance with Laws and Regulations.</p> <p style="text-align: right;">STUDY MATERIAL</p> |
| ANS: | <p>Indications of Non-Compliance with Laws and Regulations: When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations, possible areas or aspects to look out for forming an opinion are:</p> <ul style="list-style-type: none"> ➤ Investigations by regulatory organisations and government departments or payment of fines or penalties. |

- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
 - 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.
 - Purchasing at prices significantly above or below market price.
 - Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
 - Unusual payments towards legal and retainership fees.
 - Unusual transactions with companies registered in tax havens.
 - Payments for goods or services made other than to the country from which the goods or services originated.
 - Payments without proper exchange control documentation.
 - Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
 - Unauthorised transactions or improperly recorded transactions.
- Adverse media comment.

Q13 During the course of audit of CT Ltd. for the financial year 2017-18, it is noticed that Rs. 3.00 lakhs of employee contribution and Rs. 7.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 5.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor

OR

During the course of audit of GST Ltd. for the financial year 2017 -18, it has noticed that Rs. 3.00 lakhs of employee contribution and Rs. 8.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 4.50 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor.

MTP-Aug-18

ANS: **Non-Compliance of Laws and Regulations & Reporting Requirements:** As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non - compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under clause (vii) of Para 3 of CARO, 2020 whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding