

CA INTER **AUDIT** QUESTION BANK

For May 2024 & Onwards



BY
CA SHUBHAM
KESWANI

CA INTER

For May-2024 & Onwards

AUDIT QUESTION BANK

Including
MCQs

CA Shubham Keswani



AUDIT QUESTION BANK

By CA Shubham Keswani

Edition : December, 2023

Price : Rs 500/-

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Published & Distributed by :



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Test your Understanding

1. Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct?

An audit does not provide assurance to investor in shares regarding safety of his money. Share prices of securities are affected by range of factors. An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. Hence, thinking of Lalji Bhai is not correct.

2. Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit?

Proper disclosure of financial information is well within scope of audit.

3. A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report?

Appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. It is an investigation and not in nature of audit report.

4. Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm.

However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with accountant through banking channel.

The partners of firm blame auditors for futile audit exercise. Are partners of firm correct in their view point? Imagine any probable reason for such a situation.

It is example of failure of internal controls of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is

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very nature of financial reporting that management is responsible for devising suitable internal controls. This is an inherent limitation of audit.

5. The management of Exotic Tours and Travels Limited requests its auditor Raja & Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures. Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?

Such report would be in nature of "review". However, auditors would have to obtain sufficient appropriate evidence.

6. CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing.

Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

He is required to document how alternative procedures performed achieve the purpose of required procedure. Reason for departure has to be documented unless it is clear. His report should draw attention to such departure.

7. The auditors of a company have only relied upon management representation letter regarding treatment of certain tax matters under appeal by the company. The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditors in such a situation?

In the given case, auditors have relied only upon management representation letter regarding treatment of certain tax matters under appeal by the company. No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors. It shows lack of "professional skepticism" on part of auditors.

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

[ICAI SM]

(i) The basic objective of audit does not change with reference to nature, size or form of an entity

Correct: An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

(ii) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements

Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in

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the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

(iii) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

(iv) According to Mr. H, one of the team members of the auditor of Very Essential Limited was of the view that no relation exists between accounting and auditing from the point of view of a company.

Incorrect: The viewpoint of Mr. H is incorrect because there exists a proper relation between accounting and auditing from the point of view of a company. Audit is conducted for financial statements of a company and those financial statements are prepared with the help of books of accounts of that company. In order to properly conduct an audit of a company, an auditor is required to be aware of accounting principles and accounting policies of that company.

(v) The term "Engagement Standards" refer to Standards on Auditing only.

Incorrect: Engagement Standards refer not only to Standards on auditing but also to Standards on review engagements, Standards on assurance engagements and Standards on related services.

(vi) There is no difference between "audit" and "review." [RTP Nov-22]

Incorrect: "Audit" and "Review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement

(vii) For auditor's opinion, reasonable assurance is an absolute level of assurance.

Incorrect: Reasonable assurance is a high level but 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

(viii) Historical financial information relates to financial information based on assumptions about occurrence of future events and possible actions by an entity [Nov-22]

Incorrect: Historical financial information relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in **past periods**. Whereas financial information based on assumptions about occurrence of future events and possible actions by an entity relates to prospective financial information.

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Descriptive Questions

1. "Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies. [SM]

Choosing of appropriate accounting policies is responsibility of management.

The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

2. Assurance engagements are not restricted to audit of financial statements alone. Discuss. [SM]

Type of assurance engagement

- **Audit of financial Statements:** Reasonable assurance engagement
- **Review of financial Statements:** Limited assurance engagement
- **Examination of Prospective financial information:** Provides assurance regarding reasonability of assumptions forming basis of projections and related matters
- **Report on controls operating at an organization:** Provides assurance regarding design and operation of controls

3. An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement. [SM]

A three party relationship involving a practitioner, a responsible party, and intended users. An assurance engagement involves abovesaid three parties.

A **practitioner** is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

A **responsible party** is the party responsible for preparation of subject matter.

Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

4. A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. [SM]

It is not a reasonable assurance engagement. It is in nature of **investigation**.

5. An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. [SM]

Nature of Audit procedures

The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence.

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For example, an auditor **does not test all transactions and balances**. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.

The **management may consist of dishonest and unscrupulous people** and may be, itself, involved in **fraud**. It may be engaged in concealing fraud by designing **sophisticated and carefully organized schemes** which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.

We have already discussed under section on scope of audit that an auditor is not an expert in authentication of documents. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents.

It is quite possible that entity may have entered into **some transactions with related parties**. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

6. The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing. [RTP May-20 + MTP Oct-21] OR

"An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. [MTP Oct-19 + ICAI SM]

"An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon." Analysis of the Definition

1. Audit is **Independent examination** of Financial information.
2. of any entity – that **entity may be profit oriented or not** and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business.
On the other hand, Audit of NGO – not profit oriented.
3. The **objective of the audit is to express an opinion** on the financial statements.

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

- (i) the accounts have been **drawn up with reference to entries** in the books of account;
- (ii) the entries in the books of account are adequately **supported by sufficient and appropriate evidence**;
- (iii) **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;
- (iv) the information conveyed by the statements is **clear and unambiguous**;
- (v) the financial statement amounts are properly classified, described and disclosed in **conformity with accounting standards**; and

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(vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

7. Explain the objectives of an Audit as per SA 200. [RTP May-22]

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain **reasonable assurance** about whether the financial statements as a whole are free from material misstatement; and
- (b) To **report on the financial statements**, and communicate as required by the SAs, in accordance with the auditor's findings.

8. PACE is proprietorship firm of Mr Abhinav engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 50 crores. It has also availed cash credit limit of Rs. 5 crores from Axis Bank. In the year 2017-18, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches CA Mahesh about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited. [MTP Mar-19]

- Audited accounts provide **high quality information**. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.
- In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their **interest is safeguarded** by an audit.
- An audit acts as a **moral check on employees** from committing frauds for the fear of being discovered by audit.
- Audited financial statements are **helpful to government authorities** for determining tax liabilities.
- Audited financial statements can be **relied upon by lenders, bankers** for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
- An audit may also **detect fraud or error or both**.
- An audit **reviews existence and operations of various controls** operating in any entity. Hence, it is useful at pointing out deficiencies.

9. CA N is the auditor of SR Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements or not. In your opinion, whether CA N has complied with objectives of audit considering the applicability of relevant SA? [May-22]

Overall Objectives of the Independent Auditor: As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (i) 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; and
- (ii) To **report on the financial statements**, and **communicate** as required by the SAs, in accordance with the auditor's findings.

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In the given case of SR Ltd, CA N expressed his opinion on the financial statements of SR Ltd without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that CA N did not comply with the objective of audit as stated in SA 200.

10. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism. Explain. [RTP Nov-22]

The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:

- ✓ Audit evidence that **contradicts** other audit evidence obtained.
- ✓ Information that brings into **question the reliability of documents and responses to inquiries** to be used as audit evidence.
- ✓ Conditions that may indicate **possible fraud**.
- ✓ Circumstances that suggest the **need for audit procedures in addition** to those required by the SAs.

Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:

- ✓ **Overlooking** unusual circumstances.
 - ✓ **Over generalising** when drawing conclusions from audit observations.
 - ✓ **Using inappropriate assumptions** in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.
-
- Professional skepticism is necessary to the critical assessment of audit evidence. 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.
 - The auditor may **accept records and documents as genuine** unless the auditor has reason to believe the contrary.
 - Nevertheless, the auditor is required to **consider the reliability of information** to be used as audit evidence. In **cases of doubt** about the reliability of information or indications of possible fraud, the SAs require that the auditor **investigate further** and determine what modifications or additions to audit procedures are necessary to resolve the matter.
 - The auditor **cannot be expected to disregard past experience of the honesty and integrity** of the entity's management and those charged with governance.
 - Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

11. Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.

[RTP May-22]

It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information".

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- ✓ Remember that **Standards on auditing** apply in "audit" of historical financial information which is a **reasonable assurance engagement** whereas **Standards on Review Engagements** apply in "review" of historical financial information which is a **limited assurance engagement** only.
- ✓ "Historical financial information means" information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
- ✓ Here, we have to broadly understand that "audit" and "review" are two different terms.
- ✓ **Audit is a reasonable assurance engagement**, and its objective is **reduction in assurance engagement risk to an acceptably low level** in the circumstances of the engagement.
- ✓ However, "**review**" is a **limited assurance engagement**, and its objective is a **reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement**.
- ✓ Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are :

- (i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- (ii) SA 230 Audit Documentation
- (iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- (iv) SA 500 Audit Evidence
- (v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

12. There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. Explain. [MTP Oct-20]

There are two interlinked perspectives of independence of auditors , one, independence of mind; and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:
"Independence is:

- (i) **Independence of mind** – the state of mind that permits the provision of an opinion **without being affected by influences** allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
- (ii) **Independence in appearance** – the avoidance of facts and circumstances that are so significant that a **third party would reasonably conclude** an auditor's integrity, objectivity or professional skepticism had been compromised."

13. "Integrity" and "Objectivity" are among the fundamental principles of professional ethics relevant to an auditor enshrined in IESBA code. Distinguish between the two. [SM]

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The principle of "Integrity" requires auditor to be straight forward and honest in all professional and business relationships. It implies fair dealing and truthfulness. It effectively means that he shall not be associated with reports, returns communications or other informations which he believes contains a materially false or misleading statement; contains statements or informations provided recklessly or omits required information where such omission could be misleading

The principle of objectivity requires auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

Hence, integrity requires auditor to be involved in fair dealing and truthfulness with client and not be associated with materially false or misleading statements, reports, returns or communications. However, objectivity requires auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

Case Study 1

Rohit, Gurpreet, Ali and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media.

They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. Goreti has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.

During one informal get together, their discussions centred around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti.

Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies.

Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.

Based on above, answer the following questions: -

1. Gurpreet was of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide?

- (a) It provides reasonable assurance meaning a moderate level of assurance.
- (b) It provides reasonable assurance meaning a low level of assurance.
- (c) It provides reasonable assurance meaning a high level of assurance.
- (d) It provides reasonable assurance meaning an absolute level of assurance.

2. Rohit added that auditor can force an employee of the company to provide him required information and documents. Can he do so?

- (a) Yes, he can do so. It is necessary to obtain audit evidence.
- (b) Yes, he can do so. There are express rights given to him in this respect.
- (c) No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.

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(d) No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.

3. Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?

- (a) Only view of Ali is correct.
- (b) Only view of Goreti is correct.
- (c) Views of both Ali and Goreti are correct.
- (d) Views of both Ali and Goreti are incorrect.

4. All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?

- (a) Since auditing is connected to future events, audited information can be easily relied upon by users.
- (b) Errors or frauds may be discovered during audit.
- (c) Government authorities can make use of audited accounts for different purposes.
- (d) It can help in bringing out deficiencies in maintenance of financial records.

5. Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?

- (a) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
- (b) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
- (c) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
- (d) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.

1. (c) 2. (c) 3. (d) 4. (a) 5. (c)

Case Study 2

Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labour payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management.

The management approaches CA P, who has qualified recently and started practising. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard.

Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

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1. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?
 - (a) Standards on Review Engagements
 - (b) Standards on Auditing
 - (c) Standards on Related Services
 - (d) There are no standards for issuing report in such situation.

2. Which of the following statements is MOST APPROPRIATE in given case situation?
 - (a) CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
 - (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
 - (c) CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.
 - (d) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.

3. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement: -
 - (a) Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.
 - (b) Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
 - (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement.
 - (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.

- 4 The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?
 - (a) Standards on Review Engagements
 - (b) There are no standards for issuing such type of reports.
 - (c) Standards on Related Services
 - (d) Standards on Assurance Engagements

5. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of `100 crore for the next year, `150 crore & `200 crore for following years respectively as compared to present turnover of `25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation: -
 - (a) CA P has to satisfy himself regarding arithmetical accuracy of projected data.
 - (b) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
 - (c) CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
 - (d) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation.

1. c 2. c 3. c 4. d 5. d

Individual MCQs

1. Which of the following is not an advantage of audit?
 - (a) It provides high quality financial information.
 - (b) It acts as a moral check on employees.
 - (c) It enhances risk of management bias.
 - (d) It helps in safeguarding interests of shareholders.

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2. Which of the following is NOT TRUE about an assurance engagement?

- (a) It relates to providing assurance about historical financial information only.
- (b) The practitioner obtains sufficient appropriate evidence.
- (c) There is some information to be examined by practitioner.
- (d) A written assurance report in appropriate form is issued by practitioner.

3. Which of the following is TRUE about Engagement Standards?

- (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
- (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
- (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
- (d) Engagement standards ensure savings in resources of clients.

4. Consider following statements in relation to "Limited assurance engagement":-

Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.

Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

- (a) Statement I is correct. Statement II is incorrect.
- (b) Both Statements I and II are correct.
- (c) Both Statements I and II are incorrect.
- (d) Statement I is incorrect. Statement II is correct.

5. Which of the following is TRUE about Standards on auditing?

- a. These deal mainly with voluntary responsibilities of auditors.
- b. These deal mainly with mandatory responsibilities of auditors.
- c. Their sole purpose is to help government authorities in augmenting revenues.
- d. These deal mainly in carrying out audit according to legal provisions.

1. (c) 2. (a) 3. (c) 4. (d) 5. (b)

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SA 210: Agreeing the Terms of Audit Engagement

Test your Understanding

1. Chirag, as part of articled training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report. He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

Engagement letter includes reference to expected form and content of audit report. It merely states that auditor would provide opinion in this form. However, engagement letter also includes statement that the form and content of report may need to be amended in the light of audit findings. Therefore, if in light of audit findings, auditor needs to give a modified opinion, he shall do so.

2. The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

It is necessary for management to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. It is a necessary precondition for an audit in accordance with SA 210. If the preconditions for an audit are not present, the auditor shall discuss the matter with management.

Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement: -

- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- (b) If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

Unless required by law or regulation to do so, such a refusal on the part of auditor is necessary as management is not willing to accept its responsibility for preparation of financial statements in accordance with applicable financial reporting framework. An audit is conducted on this basic premise according to SA 210. When basic premise on which audit is conducted is not fulfilled, refusal by auditor is necessary.

Correct/Incorrect

(i) The audit engagement letter is sent by the client to auditor.

Incorrect: As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.

Past Exams/RTPs/MTPs/SM Questions

1. 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. The auditor may decide not to send a new audit engagement letter or other written agreement each period. Explain

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the factors an auditor considers to be appropriate to revise the terms of the audit engagement or to remind the entity of existing terms. [RTP May-21]

OR

A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210. [SM]

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.

The auditor may decide not to send a new audit engagement letter or other written agreement each period.

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

- 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 of senior management**.
- 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**.

2. Discuss preconditions for an audit as per SA 210. Explain how would an auditor proceed to establish the presence of pre conditions for an audit. [Dec-21 & RTP May-21]

As per SA 210 "Agreeing the Terms of Audit Engagements", preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the **financial reporting framework is acceptable**; and
- (b) Obtain the **agreement of management** that it acknowledges and understands its responsibility:
 - (i) For the **preparation of the financial statements** in accordance with the applicable financial reporting framework;
 - (ii) For the **internal control** as management considers necessary; and
 - (iii) To provide the auditor with:
 - **Access to all information** such as records, documentation and other matters;
 - **Additional information** that the auditor may request from management for the purpose of the audit; and
 - **Unrestricted access** to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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3. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain the circumstances which may contribute towards a request from the client for the auditor to change the engagement.

[RTP Nov-22 + Nov-22]

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

A request from the client for the auditor to change the engagement may result from

1. a **change in circumstances** affecting the need for the service,
2. a **misunderstanding** as to the nature of an audit or related service originally requested.
3. a **restriction on the scope** of the engagement, whether imposed by management or caused by circumstances.