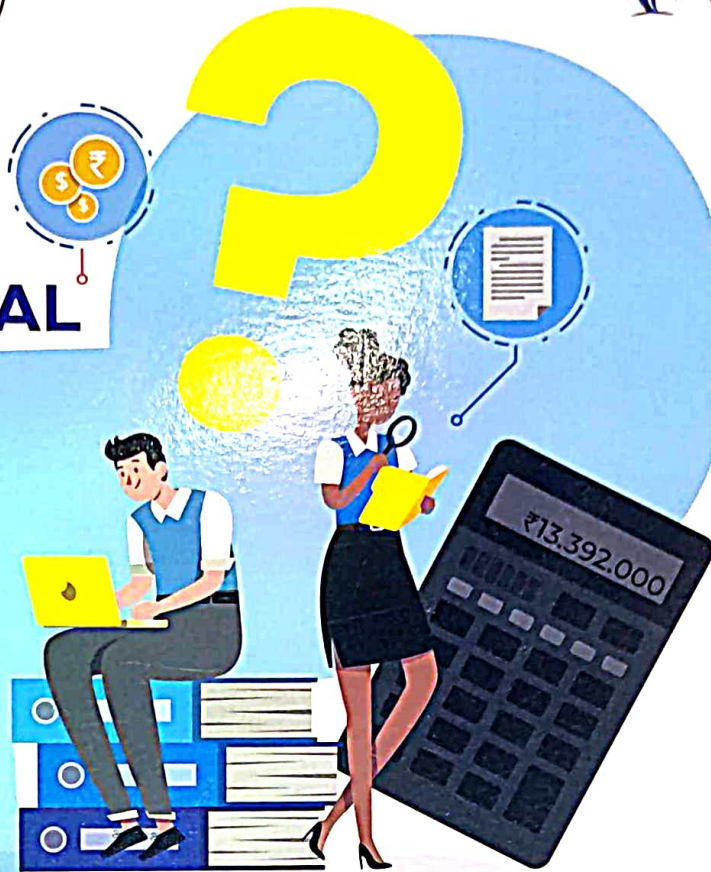


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# Question Bank

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**SQC-1 "Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information, and Other Assurance & Related Services Engagements"**

1. 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.

(Nov-19 New + RTP May 19)

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

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- 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.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

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

(Mar-21 MTP)

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", review responsibilities are determined on the basis that more experienced team members, including the engagement partner, review work performed by less experienced team members.

In the given situation, Mr. Jay, engagement partner assigned review responsibilities to two of the engagement team members who were the most experienced team members. While reviewing the work performed by less experienced members of the engagement team, both the more experienced Reviewers should consider whether:

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



## Ch-1 Standards on Auditing

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3. 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 M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period. Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC). (Jan-21 New)

### Complaints and Allegations in a Firm:

(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

- (a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
- (b) Allegations of non-compliance with the firm's system of quality control.

(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.

(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.

(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.

(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.

4. HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H and her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards and regulatory and legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas and also comment whether firm is complying with Standard on Quality Control or not. (July-21)

Compliance with Standard on Quality Control on review of audit work - As per SQC 1, reviewer should consider following:

- i) The work has been performed in accordance with professional standards and regulatory and legal requirements;
- ii) Significant matters have been raised for further consideration;
- iii) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- iv) There is a need to revise the nature, timing and extent of work performed;
- v) The work performed supports the conclusions reached and is appropriately documented;



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- vi) The evidence obtained is sufficient and appropriate to support the report; and
- vii) The objectives of the engagement procedures have been achieved.

**The firm should establish policies and procedures:**

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

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a predefined period, normally not more than seven years.

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

5. PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q and CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 and CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review and is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited? [MTP May-21]

As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the review does not reduce the responsibilities of the engagement partner. Hence, contention of CA P that after engagement quality control review by CA R, his responsibility will be reduced, is not correct.

However, CA R needs to consider the following aspect while performing Engagement

**Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:**

- 1) The engagement team's evaluation of the firm's independence in relation to the specific engagement.
- 2) Significant risks identified during the engagement and the responses to those risks.
- 3) Judgments made, particularly with respect to materiality and significant risks.
- 4) 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.
- 5) The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- 6) The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- 7) Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
- 8) The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations

6. AP & Associates, Chartered Accountants, are Statutory Auditors of XP Limited for the last four years. XP Limited is engaged in the manufacture and marketing of FMCG Goods in India. During 2021-22, the Company has diversified and commenced providing software solutions in the area of "e-commerce" in India as well as in certain European



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countries. AP & Associates, while carrying out the audit for the current financial year, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise and infrastructure to carry out the audit of this diversified business activities and accordingly wishes to withdraw from the engagement and client relationship. Discuss the issues that need to be addressed before deciding to withdraw. [Nov-22]

**Acceptance and Continuance of Client Relationships and Specific Engagements:** As per SQC 1, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the firm should establish **policies and procedures for the acceptance and continuance of client relationships and specific engagements**, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it is competent to perform the engagement and has the capabilities, time and resources to do so.

In the given case, AP & Associates, Chartered Accountants, statutory auditors of XP Limited for the last four years, came to know that the company has expanded its operations into a new segment as well as new geography. AP & Associates does not possess necessary expertise for the same, therefore, AP & Associates wish to withdraw from the engagement and client relationship.

Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- **Discussing** with the appropriate level of the client's management and those charged with its governance regarding the **appropriate action that the firm might take based on the relevant facts and circumstances.**
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance **withdrawal** from the engagement or from both the engagement and the client relationship, and the **reasons for the withdrawal.**
- Considering whether there is a **professional, regulatory or legal requirement** for the firm to remain in place, or for the firm to **report the withdrawal** from the engagement, or from both the engagement and the client relationship, **together with the reasons for the withdrawal, to regulatory authorities.**
- **Documenting** significant issues, consultations, conclusions and the basis for the conclusions.

AP & Associates should address the above issues before deciding to withdraw.

7. CA Ragini is offered an appointment to act as Engagement Quality Control Reviewer (EQCR) for the audit of the financial year 2022-23 of XPM Limited, a listed company operating from a small town. She is also based in the same town and was not engaged previously to conduct an audit of a listed entity. She accepts the appointment to act as EQCR. She performs the review by ticking a Yes/No checklist and signing on some of the working papers prepared by the engagement team. The audit file does not contain any material misstatement which shows that the work of EQCR is separate from the work of the engagement team. Do you agree with the approach adopted by EQCR? Comment. [MTP Nov-23]

As per SQC 1 engagement quality control reviewer can be a partner, other person in the firm (member of ICAI), suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

It also states that the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.



## Ch-1 Standards on Auditing

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In addition, the work of EQCR involves objective evaluation of the significant judgments made by the engagement team and ensuring that the conclusions reached by the team in formulating audit report are appropriate.

It is necessary for EQCR to have the requisite technical expertise and experience to enable her to perform the assigned role of evaluating the work of engagement team so that any possible misstatement can be avoided. Without ensuring the appropriate technical expertise and experience, the whole purpose of EQCR is defeated. Therefore, it was not appropriate for her to accept appointment as EQCR for listed entity.

Further, SA 220 states that the engagement quality control reviewer shall document, for the audit engagement reviewed, that the procedures required by the firm's policies on engagement quality control review have been performed.

It also states that it shall also be documented that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

In the given situation, CA Ragini is offered an appointment to act as Engagement Quality Control Reviewer (EQCR) for the audit of the financial year 2022-23 of XPM Limited, a listed company operating from a small town. She has accepted the appointment and performed the review by ticking a Yes / No checklist and signing on some of the working papers prepared by the engagement team. In the instant case, there are no working papers to show that evaluation has been done by EQCR on conclusions reached by engagement team.

Mere ticking of a Yes/No checklist and signing on some working papers of engagement team shows that no such evaluation and review of work performed by engagement team has been made by EQCR. Therefore, her approach was not proper in performing work of EQCR.

8. SS Ltd. is a company listed in India. The Company has appointed M/s Z & Co. as auditors. Mr. Q, a 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.

[Nov-23]

As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (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:**

- i) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and
- ii) 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.



## Ch-1 Standards on Auditing

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- i) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- ii) 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
- iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.

The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

**9. TPX & Co., Chartered Accountants is a large audit firm. It maintains audit documentation both electronically and in physical form (hard files). The physical files are neither scanned and incorporated into electronic files nor cross-referenced to the electronic files. Further, there are many instances where audit working papers do not contain details as to whether information was obtained from client or prepared by engagement team. How do you view above situation from point of view of quality control system in audit firm? Analyse. [MTP May-24]**

In accordance with SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements" the firm should establish policies and procedures designed to maintain confidentiality, safe custody, integrity, accessibility & retrievability of engagement documentation.

In the given situation, the physical files are neither scanned and incorporated in the electronic files nor cross-referenced to the electronic files.

Inability to do so shows that firm has not established policies and procedures to maintain integrity of engagement documentation.

Lack of ensuring the same makes it difficult to demonstrate completeness of audit files and whether these were assembled within 60 days time frame stipulated in SQC 1.

Where engagement documentation is in paper, electronic, or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged.

One of the reasons for designing and implementing appropriate controls for engagement documentation in this regard is the protection of the integrity of information at all stages of engagement.

For the practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files.

In that case, the firm implements appropriate procedures requiring engagement teams to:

- a) Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross references and annotations;
- b) Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
- c) Enable the scanned copies to be retrieved and printed as necessary.



## Ch-1 Standards on Auditing

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It has also been stated that there are many instances where audit working papers do not contain details as to whether information was obtained from the client or prepared by the engagement team. It is important to **identify the source of the document** and the information used as audit evidence to ensure its **reliability**. It could have potential risks of non-compliance with standards on auditing.

### ICAI SM New Questions

1. ABC & Associates, Chartered Accountants has a policy to accept the clients wherein the risk evaluation is conducted with respect to the Company and the promoter. XYZ Limited approached ABC & Associates. Promoter of XYZ Limited is a close associate and family friend of Mr. A, Managing Partner of ABC & Associates. XYZ Limited is in news in the previous year for certain inquiries from the regulatory authorities in relation to certain matters. The existing auditor of XYZ Limited has resigned and has created a casual vacancy. XYZ Limited is ready to offer 25% more than the existing fees and has approached ABC & Associates for appointment as Auditor. Mr. A has strong recommendation to the Firm to accept the audit. What is your understanding of the functioning of the tone at the top of the Firm ABC & Associates, Chartered Accountants.? What are the considerations one should exercise to uphold Quality of the Firm?

The given situation indicates that **proposed client is a new one whose promoter is close associate and family friend of managing partner** of M/s ABC & Associates. However, previous auditor of proposed client has resigned and company is offering hike in audit fees in comparison to audit fees paid to previous auditor. Besides, there are also regulatory inquires against the company. In spite of all this, managing partner of firm Mr. A has recommended for acceptance of offered audit of the company.

It reflects **poorly regarding functioning at top of the firm** as regards to quality control. SQC 1 requires that firm should establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards and legal and regulatory requirements. It further requires that firm's business strategy is subject to overriding requirement of firm to achieve quality in all engagements. However, in the given situation, **commercial considerations seem to be overriding factor**.

The managing partner of firm is close associate and family friend of promoter. The matter should have been brought to knowledge of firm in accordance with requirements of SQC 1 as it **involves issue of independence of managing partner** of the firm with respect to proposed audit engagement. Further, matters of inquiries from regulators and resignation of previous auditor **raise question about integrity of the proposed client**. SQC 1 further requires firm to consider before acceptance of an engagement that client does not lack integrity. All these factors need to be taken into consideration before accepting engagement.

Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm.

**Following considerations should be taken into account while upholding quality of firm: -**

- i) The firm **assigns its management responsibilities** so that commercial considerations do not override quality of work performed
- ii) The firm's **policies and procedures in relation to its personnel** are designed to demonstrate its overriding commitment to quality.
- iii) The firm **devotes sufficient resources** for development and documentation of its quality control policies and procedures
- iv) A firm **before accepting an engagement should acquire vital information about the client**. Such an information should help firm to decide about integrity of Client, promoters and key managerial personnel, competence (including capabilities, time and resources) to perform engagement and compliance with ethical requirements.



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2. MNP & Co., a firm of auditors, is appointed by a bank to conduct stock audit of a borrower. It deputed one of its paid Chartered accountant employees, Sudhanshu, to conduct above said stock audit. He leverages it as an opportunity to prevail upon the client to get the accounts audited from their firm. He also assures the client of a clean stock audit report without adverse comments as a quid pro quo. Is approach of Sudhanshu proper? How does it reflect upon quality control system of firm?

Approach of Sudhanshu is not proper. Such practices blatantly violate code of ethics and its spirit. It reflects poorly upon quality control system of firm envisaged in SQC 1 which requires that quality control policies and procedures should be documented and communicated to the firm's personnel. It shows that firm's personnel are not properly sensitized regarding requirements of SQC 1.

3. CA M is introduced to a prospective client in a social function. He assures to visit office of CA M very soon in relation to professional work. During discussions over a cup of coffee next week, it transpires that there was a search by Enforcement Directorate in his premises about a month back resulting in recovery of huge sum of cash. The income tax department had also searched his premises in relation to bogus capital gains on penny stocks. Lamenting poor quality of services provided by his present auditor, he offers appointment as tax auditor of his five family-owned firms to CA M in lieu of handsome fees. What are the factors to be evaluated by CA M if he wants to take up the engagement?

As per SQC 1, before accepting a new engagement, integrity of client should be considered including matters that indicate involvement in money laundering or criminal activities. There has been search of ED on the said party leading to recovery of huge amount of cash. The above coupled with actions of income tax department relating to bogus capital gains on penny stocks indicates that client might be involved in money laundering activities. Therefore, offer should not be accepted.

4. GVN & Associates are auditors of a listed company involved in "fin-tech" sector. The engagement team is stuck up with some issue pertaining to a particular Ind-AS applicable to the company. They have framed a query and sent to ICAI for expert opinion on the matter. The issue was resolved upon receipt of expert opinion. Since expert opinion was provided by ICAI, engagement team was of the view that appointment of engagement quality control reviewer has lost its relevance. Do you agree?

Engagement quality control review in listed entities is a mandatory requirement. Expert opinion of ICAI pertains to issue of interpretation. The appointment of reviewer is a separate and mandatory requirement in audits of listed companies.

5. RST & Co., a firm of Chartered accountants, are auditors of a listed company engaged in manufacturing of heavy machinery components. The audit report for year 2021-22 also included report on matters listed in CARO, 2020. While reporting under clause vii(a) of the said order relating to regularity of undisputed statutory dues by the company, the auditors have commented that company is "generally regular" in depositing statutory dues to appropriate authorities. Is above reporting qualitative and in line with requirements of SA-220?

Such type of reporting is not qualitative. It is not in accordance with SA 220. One of the objectives of the auditor, as per SA 220, is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that the audit complies with professional standards and regulatory and legal requirements. The reporting under CARO, 2020 is not proper. Hence, the audit does not comply with regulatory and legal requirements.

6. 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



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reviewer on this matter during the course of audit process itself. Can he consult with engagement quality control reviewer? Discuss.

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.

**7. 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.**

Such kind of services fall in category of "related services". ISQC 1 is applicable to all type of engagements including engagement pertaining to "related services"

**8. 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.**

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 should be completed in not more than 60 days after date of auditor's report in case of audit engagements. Thus, view of Ramanujan is not in order.

**9. 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?**

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.

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

**1. M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement?**

**Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations. (July-21 New)**

Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -



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As per SA 200 - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and as per SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence.

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

**In view of above, it can be concluded that auditors did not give correct statement.**

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant.

Such assertions or subject matters include:

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

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

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

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

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

**Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above. [MTP Apr-22]**

As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is required:- "To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework."



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Reasonable assurance is a high level of assurance and is less than absolute assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

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. The inherent limitations of an audit arise from:

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

### SA 210: Agreeing the Terms of Audit Engagement

1. T & Co, a firm of Chartered Accountants has not revised the terms of engagements and obtained confirmation from the clients for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement. (Nov-19 Old)

**Circumstances that may Warrant the Revision in Terms of Engagement :** As per SA 210 on "Agreeing the Terms of Audit Engagements", 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. Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal? Also advise, whether Mr. Ram should accept the proposed audit engagement? (RTP Nov-19)

As per SA 210 "Agreeing the Terms of Audit Engagements", in order to establish whether the preconditions for an audit are present, the auditor shall:

- Determine whether the FRF to be applied in the preparation of the financial statements is acceptable; and
- Obtain the agreement of management that it acknowledges and understands its responsibility
  - For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and



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(iii) To provide the auditor with:

- Access to all information** of which management is aware that is relevant to the preparation of the financial statements 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.

Further, if management or TCWG impose a limitation on scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor **disclaiming an opinion** on the financial statements, the auditor **shall not accept** such a limited engagement as an audit engagement, **unless required by law or regulation** to do so.

In addition if the preconditions for an audit are not present, the auditor shall **discuss the matter with management**. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

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

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

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

[SM +RTP May-23]

As per SA 210 'Agreeing the Terms of Audit Engagements', the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- The **objective and scope of the audit** of the financial statements;
- The **responsibilities of the auditor**;
- The **responsibilities of management**;
- Identification of the **applicable financial reporting framework** for the preparation of the financial statements; and
- Reference to the **expected form and content of any reports to be issued by the auditor** and a statement that there may be circumstances in which a report may differ from its expected form and content.

### SA 220: Quality Control for an Audit of Financial Statements

**1. Ace Limited (manufacturer of textile goods) got an order of manufacturing of PPE kits in December 2020. But there was shortage of machinery and manpower to accomplish the ordered requirement of PPE kits. Ace Ltd. approached another manufacturing unit Jack Limited for purchase of the unit. Jack Limited was interested in the sale of unit, so the deal went through and Ace Limited acquired ninety five percent shares of Jack Limited. The new management of Jack Limited proposed and appointed NKB Associates, Chartered Accountants, (already auditors of Ace Limited) as new auditors of Jack Limited. NKB Associates accepted the assignment without considering**



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information whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. Comment with respect to appropriate Standard on Auditing what type of information assists the engagements partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate or not?

[Nov-21 Old + MTP Sep-22]

**Acceptance and Continuance of Client Relationships and Audit Engagements :** As per SA 220, "Quality Control for an Audit of Financial Statements" , SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The **integrity** of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is **competent** to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant **ethical requirements**; and
- **Significant matters** that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

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

(RTP May-19 + MTP Oct-19 + SM)

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:

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

**Engagement Partner shall take responsibility** for reviews being performed in accordance with the firm's review policies and procedures.

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.

In the given case, **Engagement Partner is not right**. The Independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.



3. 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 April-18)

**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.

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. 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.

4. 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. (MTP Mar-19)



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As per SA 220, 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:

- 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 also 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.

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.

In the given case, the signing of auditors' report before completion of review of engagement quality control review is not right.

### Integrated Case Scenario

CA Mritunjay is statutory auditor of a listed company engaged in providing services relating to "tourism sector". He is practicing in sole-proprietorship capacity. The audit of abovesaid listed company was conducted by his proprietary firm and report was issued for year 2021-22. Subsequently, audit report was selected by NFRA to oversee quality of service and compliance with Standards. Necessary information was called from auditor towards above objective.

It was required of him to produce audit working papers to show that audit was carried out in accordance with Standards on auditing. Details of the audit plan and details of risk assessment procedures carried out to identify and assess risk of material misstatement in financial statements were called. It was also required to show how response to assessed risks was designed and implemented and communicated with those charged with governance.

Audit working papers sent by him through email included procedures on how some balances in financial statements were verified. Also included in working papers were procedures performed by him relating to verification of inventories, trade receivables and trade payables.

The working papers sent by him to the authority did not include details on audit plan and manner of identifying and assessing risks of material misstatement. On being asked to respond, it was reasoned by him that audit was properly planned and required procedures were carried out in relation to material items on test check basis.

It has been further clarified by him to the authority that audit was carried out in accordance with Standards and it was practically not feasible for a firm of small size to make a detailed audit plan. It was also put on record with authority that he had assessed risk of material misstatement to be low based upon his understanding of the company. He has further reasoned that assessing risks is a matter of professional judgment. Representation has also been made by him stating that communications as necessary were made orally with those charged with governance. It was also pointed out to him that engagement quality control review was not carried out. He has answered that no contentious matter arose during the course of audit and therefore, no need was felt to carry out this exercise.



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Attention was also drawn to the fact that financial statements of company were required to be prepared on basis of Ind-AS. However, at some places in notes to accounts, reference is made to accounting standards which are not applicable to the company. These errors have been attributed to data feeding entry errors by junior staff.

Based upon above, answer the following questions: -

**(1) It has been contended by auditor that audit was properly planned. He has further stated that it was practically not feasible for firm of small size to prepare a detailed audit plan.**

**Which of the following views is most appropriate in this regard?**

- (a) Audit was, in fact, planned as evidenced by auditor's submissions.
- (b) Although auditor has no record of audit plan, it does not affect compliance with SA 220.
- (c) Since auditor has no record of audit plan, it goes on to show non-compliance with SA 220.
- (d) Audit was, in fact, planned as evidenced by auditor's submissions. However, there is an exemption for small CA firms doing away with cumbersome documentation in relation to audit plan.

**(2) The auditor has reasoned that risk of material misstatement has been assessed to be low based upon his understanding of the company and it is a matter of professional judgment. Identify the most appropriate statement from below in this regard.**

- (a) Assessing risks of material statement is a matter of professional judgment. It cannot be demanded from him how his judgment was arrived at.
- (b) Although auditor has not submitted record of how risk of material misstatement was arrived at, it does not affect compliance with SA 220.
- (c) Since auditor has no record of how risk of material misstatement was arrived at, it goes on to show non-compliance with SA 220.
- (d) Such a query, itself, is outside the mandate of authority.

**(3) Considering auditor's point of view regarding engagement quality control review, identify the most appropriate statement from below: -**

- (a) Engagement quality control review is mandatory in such type of engagement. It was not proper for auditor to bypass such review. He has violated mandatory requirement of SA 220.
- (b) Engagement quality control review is optional in such type of engagement. Therefore, question of not following SA 220 does not arise.
- (c) No contentious matter arose during the course of engagement. Therefore, question of not following SA 220 does not arise in respect of engagement quality control review.
- (d) Engagement quality control review is dependent upon benchmarks established under SQC 1. If those benchmarks are satisfied, such a review is necessary.

**(4) Considering auditor's reply regarding errors in data feeding entry by junior staff in relation to accounting standards, which of the following statements is proper?**

- (a) Such are examples of clerical errors encountered during preparation of reports. There is no question of non-compliance with SA 220.
- (b) Such are examples of clerical errors encountered during preparation of reports. There is no effect on auditor's opinion and consequently question of non-compliance with SA 220 does not arise.
- (c) Such are examples of serious lapses on part of auditor showing non-compliance with SA 220.



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(d) Such are examples of serious lapses on part of auditor. However, these are not related to compliance with SA 220.

(5) On your overall reading of the case study, which of the following statements appears to be true?

- (a) The firm has an effective system of quality control described in SQC 1. Audit engagement has also been performed in accordance with SA-220.
- (b) The firm does not have effective system of quality control described in SQC 1. Audit engagement has also not been performed in accordance with SA 220.
- (c) SQC 1 is not applicable in the case. Audit engagement has not been performed in accordance with SA 220.
- (d) SQC 1 is not applicable in the case. Audit engagement has been performed in accordance with SA 220.

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

### SA 230: Audit Documentation

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

(RTP May-20)

**Factors Influencing the amount of Working Papers:** As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

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

2. You are the team leader of 10 members for an audit of a Multinational company. All the team members are concerned about Audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned, In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard on Auditing. [May-22]

As per SA 230, "Audit Documentation" it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file.

**For example:**

- ✓ The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- ✓ The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.