

STANDARDS ISSUED BY AASB UNDER THE AUTHORITY OF THE COUNCIL OF ICAI

Engagement Standards

- i. Standards on Auditing (SAs), to be applied in the audit of **historical** financial information.
- ii. Standards on Review Engagements (SREs), to be applied in the **review** of historical financial information.
- iii. Standards on Assurance Engagements (SAEs), to be applied in **assurance engagements**, other than historical financial information.
- iv. Standards on Related Services (SRSs), to be applied to engagements involving application of agreed upon procedures to information, compliance engagements and other related services engagements, as may be specified by the ICAI.

Q. How is Standard on Auditing framed by AASB?

Q. Different between Standards, Statements and Guidance Notes.

Q. Steps in Auditing:

1. Planning 2. Execution 3. Reporting

1. → Knowledge of Business of Industry

→ KOB client

→ Study/ evaluate the internal control client company

→ Risk Assessment of the Procedures

2. Auditor carries out procedures to obtain sufficient appropriate audit evidence. He records evidences obtained in his working papers. He also takes help of others while conducting Audit.

Eg: if a debtor's balance is to be checked than only internal records cannot be seen. Auditors also ask for external Confirmation

QUESTIONS ON SA 200

Q1. "Auditor is only concerned with accounts and not with business operations of the client." Comment

Ans. False. If an auditor is not having knowledge about business operations, he cannot assess their financial impact in effective manner. Hence his purview is not restricted only to accounts, but he should have a knowledge about the business operation of the client.

Q2. "Auditor guarantees that financial statements are free from material misstatements." Comment

Ans. False. Auditor expresses **reasonable** assurance that financial statements are free from material statements.

Q3. Auditor must never disclose confidential matters of his client.

Ans. False. As per SA-200 on Basic principles governing audit, auditor should never disclose confidential matters of his client to any person. But there are exceptions

1) When the law requires such disclosures

2) With the permission of the client, auditor can disclose confidential matters to any other party.

Q4. "Auditor does not require soft skills." Comment

Ans. False. Soft skills mean communication skills. An auditor has to interact with third parties for external confirmation and various outside agencies. Hence he should possess good written and communication skills.

Q5. "Disclosure of accounting policy, which is adopted while preparing financial statements, is required so that readers of financial statements can understand the view" Comment.

Ans. The above statement is true.

Q6. Specific disclosure is not required when all three fundamental accounting assumptions as per AS 1 are being followed in preparation and presentation of financial statements.

Ans. The above statement is true.

Q7. "Investigation and auditing are same concepts" Comment.

Ans. False. Auditing is a broader concept than Investigation.

- (i) Auditing is expression of opinion whether financial statements are showing a true & fair view whereas investigation is critical and indepth examination for a stated purpose.
- (ii) Investigation starts with a pre-conceived notion that there is something negative. But auditing never starts with pre-conceived notion.
- (iii) In investigation report is made to the authority ordering investigation but in auditing report is given to shareholders.

Q8. CARO 2016 and Tax Audit reports require disclosure of certain violations. Is it possible for an auditor to take shelter under the confidentiality clause and not report the same?

Ans : An auditor should not disclose the information acquired in the course of an audit, unless he is duty bound by law or where the client consents to such a disclosure. In this case, both CARO 03 and Tax Audit, demands certain disclosures, which are statutory provisions. Hence an auditor cannot take shelter under confidentiality clause.

Q9. "An auditor is considered to have lack of independence, if the partner of the audit firm owns the building in which the client's business is situated" Comment.

Ans. As per Guidance Note issued by the ICAI on "Independence of Auditors", "Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or for him own self interest. "Thus in this case of renting of building to the client does not affect the independence of the auditor.

Q10. What are various types of audit report?

- Ans.**
- i. **Clear report** – When financial statements are showing a True & fair view. True & fair view means compliance of all the following
 - (a) Proper Books of Accounts are kept
 - (b) Compliance with Accounting Standards
 - (c) Compliance with Schedule VI.
 - ii. **Qualified report** – When financial statements are showing True & fair view **subject to certain reservations**. (Example – Depreciation overcharged, provision for bad & doubtful debts shown in excess).
 - iii. **Adverse Report** – When financial statements are **not** showing True & fair view. (Example – When company is no longer a going concern but no disclosure is made).
 - iv. **Disclaimer of opinion** – When auditor **could not arrive** at any opinion due to a material limitation on the scope of audit. (Example when auditor is not allowed to check any records by the client).

Q11. What do you mean by **Internal Control**?

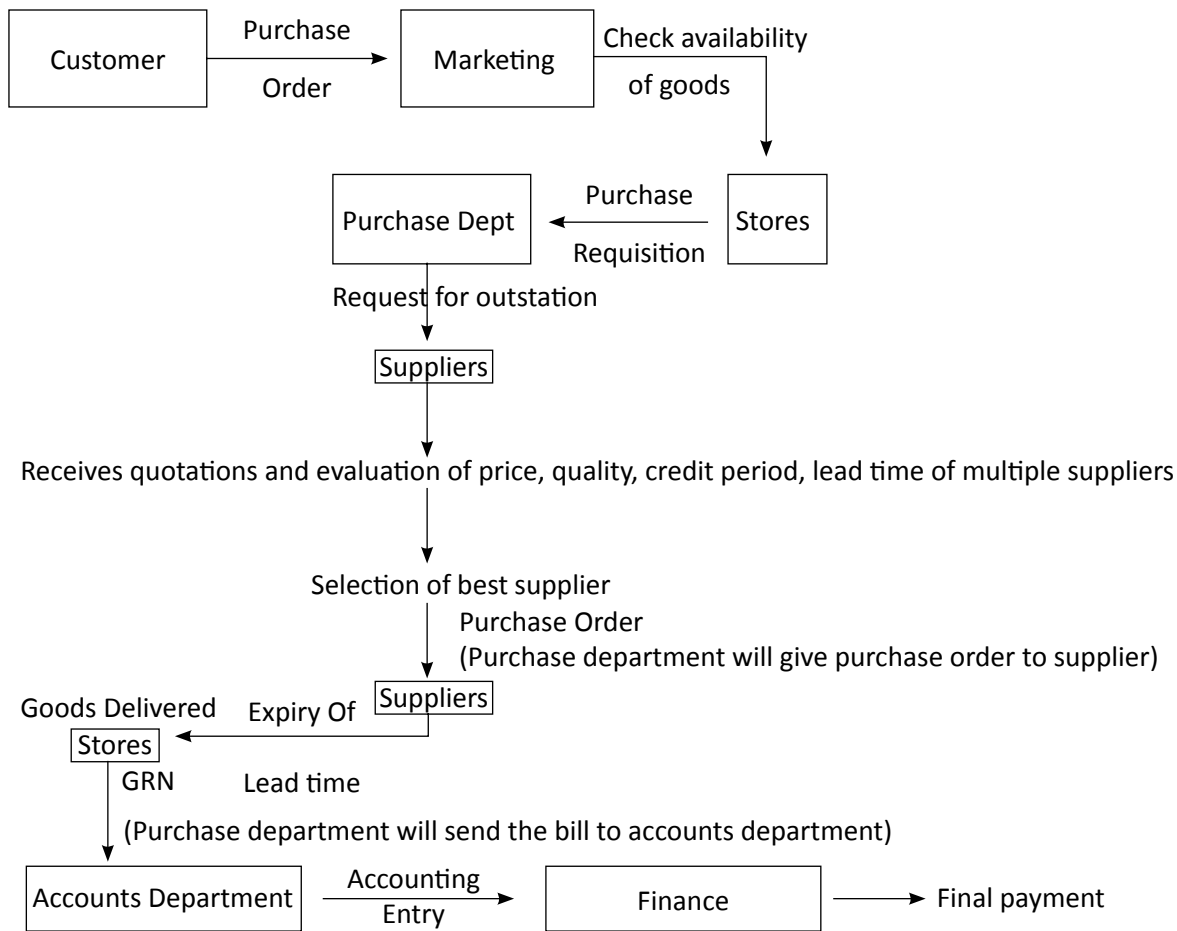
Ans. Internal control refers to plans, policies and procedures, framed by management to achieve its objectives and prevent fraud and error. Internal control is **framed by management** and **evaluated by auditor**. Internal control is **found in each and every** functional area. (Example – in purchase, sales, finance etc.) Many **corporate scandals** have taken place due to weakness in design or operation of internal control system.

Q12. What is Emphasis of Matter Paragraph?

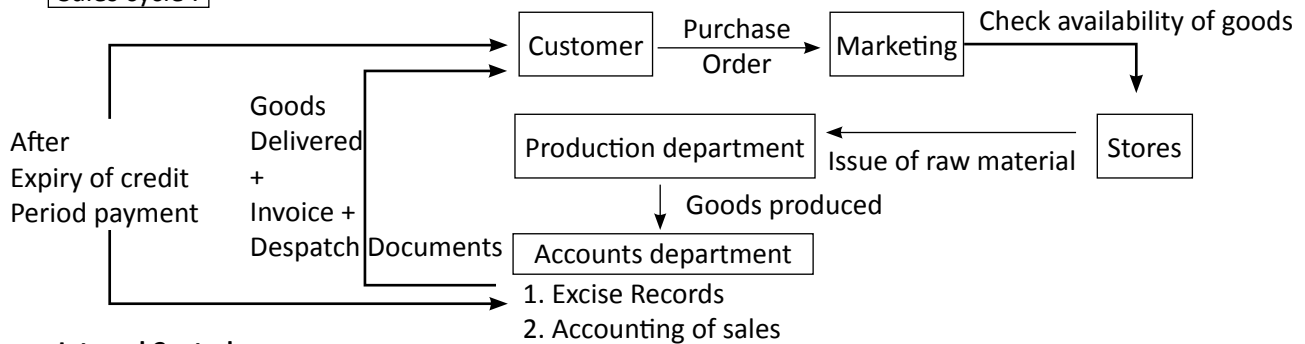
Ans. It is a paragraph in the audit report which **highlights a particular fundamental problem without qualifying** the report. **Example** – Threat to going concern is highlighted in EOM para but the report is **still clear**.

INTERNAL CONTROL

Purchase Cycle :



Sales cycle :



Internal Control areas

1. Quotation whether RPT Transaction are at arm's length.
2. GRN Note to see whether goods received or not after generating GRN
3. A/c entry to ensure no unrecorded purchases
4. Bank statement to track payment

Sales

1. Purchase order (3rd party purchase order) Ext Evidence
2. Excise Records (Ex duty pay)
3. LR Note (Despatch Document) Ext Evidence Bill of lading AR receipt

SA 200 (REVISED)

OVERALL OBJECTIVES OF THE AUDITOR

Financial Reporting Framework

Set of rules, regulations, guidelines, formats that govern the preparation and presentation of financial statement. Management agrees to prepare financial statements as per:

- Applicable Laws & regulations
- Proper disclosures

Financial statements includes

P/L, B/S, Cash Flow Statement, Notes to Accounts etc.

True and fair view represents that financial statements are

- i. Prepared and presented correctly
 - Presentation and disclosure of financial information is **adequate for users of financial statements and is not misleading**

Audit Premises(Assumptions)

Management is responsible to

- a. Prepare and present first as per financial reporting framework
- b. Design, implement, & monitor (DIM) Internal Control

Management will provide auditor

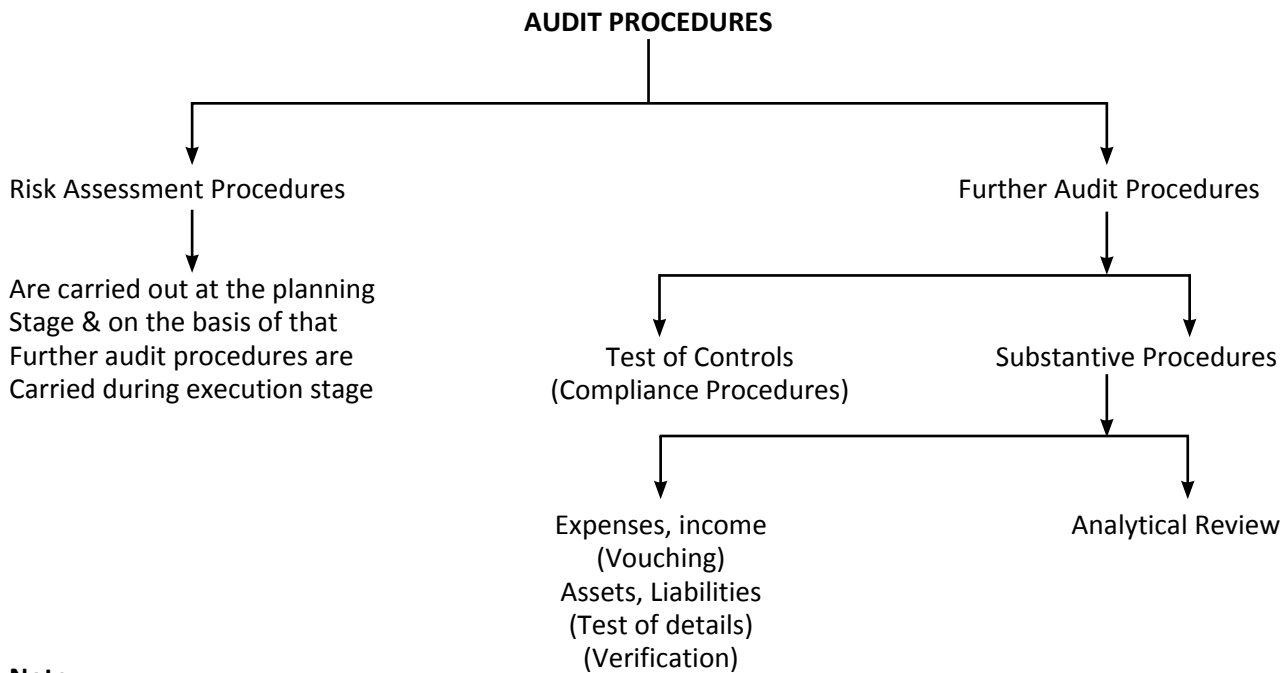
- a. All necessary information
- b. Explanations necessary for audit

Inherent Limitations of Audit

1. Due to financial reporting process management develops accounting estimates, choice of accounting policy by the management
2. Audit related
 - Audit evidence is persuasive and not conclusive
 - Auditing is based on sampling

Those charged with Governance TCWG responsible for strategic direction & NOT involved in day to day management Example: Audit Committee, Independent Directors

Professional Skepticism	Professional Judgement
Cross examination critical assessment of evidences and further investigation when suspicion arises	Application of knowledge + skill + practical experience of Auditor in the context of
	→ Relevant ethical Accounting & Accounting Standards taken by the auditor relating to circumstances faced during audit.
	Example : It may be applied in determining
	<ul style="list-style-type: none"> • Materiality levels • Sampling methods

**Note:**

RAP: to assess the risk of Material Misstatement due to fraud/errors at overall financial statement level/in individual items

If RAP is high \uparrow then FAP \uparrow RAP is low \downarrow FAP \downarrow

3 steps RAP

I \rightarrow Inquiry employer, Management TCWG

A \rightarrow Analytical (Compare)

C \rightarrow Inspect

Q. How is Audit evidence obtained?

Ans. Audit evidence is obtained through performance of

A. Substantive Procedures

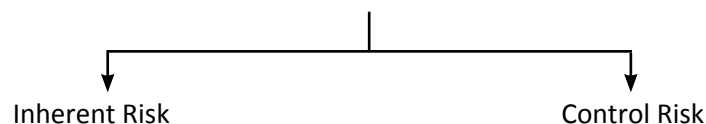
1. Vouching
2. Verification
3. Analytical review

B. Compliance Procedures (Test of Controls)

Audit Risk is a risk that auditor expresses inappropriate audit opinion when financial statements are materially misstatement

Ex \rightarrow He gives a clear audit report when financial statement is materially misstatement

$$\text{Audit Risk} = \text{Risk of Material Misstatement} + \text{Detection Risk}$$



Inherent Risk → Are chances that certain classes of transactions/balances/disclosures will be materially misstated in **spite of** internal controls due to nature of business/item

Control Risk → is the risk that material misstatement cannot be **prevented/detected/corrected** on a timely basis by client's **internal control system**

Detection Risk → is the risk that material misstatement cannot be revealed **by auditors substantive procedures**.

The Code establishes the following as the fundamental **principles of professional ethics relevant** to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles;

- a. Integrity;
- b. Objectivity;
- c. Professional competence and due care;
- d. Confidentiality; and
- e. Professional behaviour.

Scope of an Audit

1. The scope of an audit of financial statements will be determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.

Q. "The objective of auditor is to detect errors and frauds" Comment.

Ans. False, The objective of auditor is to express opinion whether financial statements are showing true and fair view and not to detect errors and frauds. The objective of auditor is broader and cannot be narrow like to detect errors and frauds.

Q. The scope of statutory auditor is determined by Management?

Ans. False

QUESTIONS ON SA 200A

Q1. Areas in which different Accounting Policies are adopted

Discuss the areas in which different accounting policies may be adopted.

Ans. Areas in which Different Accounting Policies are adopted: Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

There is no single list of accounting policies which are applicable to all circumstances. The different circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise require for considerable judgment by the management of the enterprise.

The following are examples of the areas as given in A-1, Disclosure of Accounting Policies in which different accounting policies may be adopted by different enterprises.

- i. Method of depreciation, depletion and amortization
- ii. Valuation of fixed assets.
- iii. Valuation of inventories.
- iv. Valuation of goodwill.
- v. Valuation of investment.
- vi. Treatment of retirement benefits.

(The above list is not exhaustive. There may be other examples as well.)

Q2. Audit required under Law

Discuss the types of **audits required under Law**.

Ans. Audit required under Law: Audit is not legally obligatory for all types of business organisations or institutions. On the basis audits may be of two broad categories i.e. audit required under law and voluntary audits.

The organizations which require audit under law are the following:

- i. Companies governed by the Companies Act, 2013;
- ii. Banking companies governed by the Banking Regulation Act, 1949;
- iii. Electricity supply companies governed by the Electricity Supply Act, 1948;
- iv. Co- operative societies registered under the Co-operative Societies Act, 1912;
- v. Public and charitable trusts registered under various Religious and Endowment Acts;
- vi. Corporation's setup under an Act of Parliament or state legislature such as the Life Insurance Corporation of India.
- vii. Specified entities under various sections of the Income Tax Act, 1961.
- viii. Audit required under Sales tax and VAT by various State Governments.

SA 500 - AUDIT EVIDENCE (REVISED)

Corresponding Old AAS - 5 (w.e.f 1st April, 2009)

QUESTIONS ON SA 500

Q1. The auditor of a limited company has given a clean report on the financial statement on the basis of Xerox copies the books of accounts, Vouchers and other records which were taken away by the income-tax Department in search under Section 132 of the I.T. Act, 1961.

Ans : **Reliability of Audit Evidence :** The degree of reliance which can be placed by the auditor on the documentary audit evidence available in the present case will be considerably increased if the Xerox copies of account books and vouchers are certified to be true copies by the Income Tax Department. **If the tax authorities refuse to certify the same, the auditor should get the certificate to this effect from the management of the company.**

The auditor should use procedure like **confirmation of balances from third parties, inspection of tangible assets, etc.** and **obtain evidence which corroborates the documentary evidence available.** In any case, the auditor has **to satisfy himself that he has obtained sufficient and appropriate audit evidence to support the figures contained in the financial statements and formulate his opinion accordingly.** Under such circumstances, the auditor should have appropriately modified his report and bring this fact to the attention of shareholders. In case he was satisfied, a simple paragraph of information was enough but in case the auditor failed to establish the reliability of evidence available, he would be required to a disclaimer of opinion.

QUESTIONS ON SA 315

Q2. What do you mean by Risk Assessment Procedures? How does an auditor perform RAP?

Q3. What procedures are carried out after ROMM is assessed?

Q4. What are assertions? How does auditor evaluate assertions?

Q5. Short note on Internal Control and its components.

Q6. What are the limitations of Internal control?

SA 315, SA 330 - IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT (w.e.f 1st April, 2008)

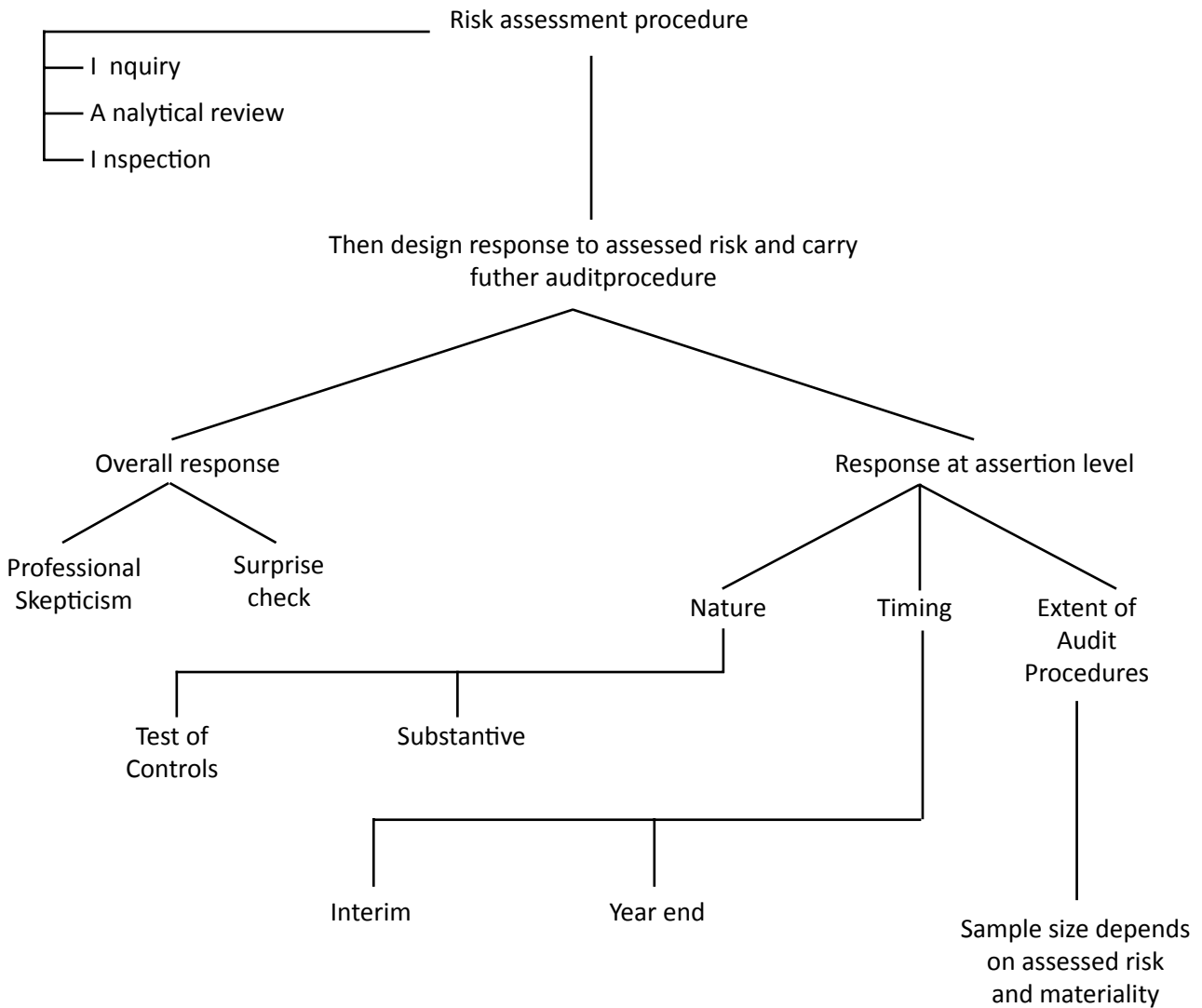
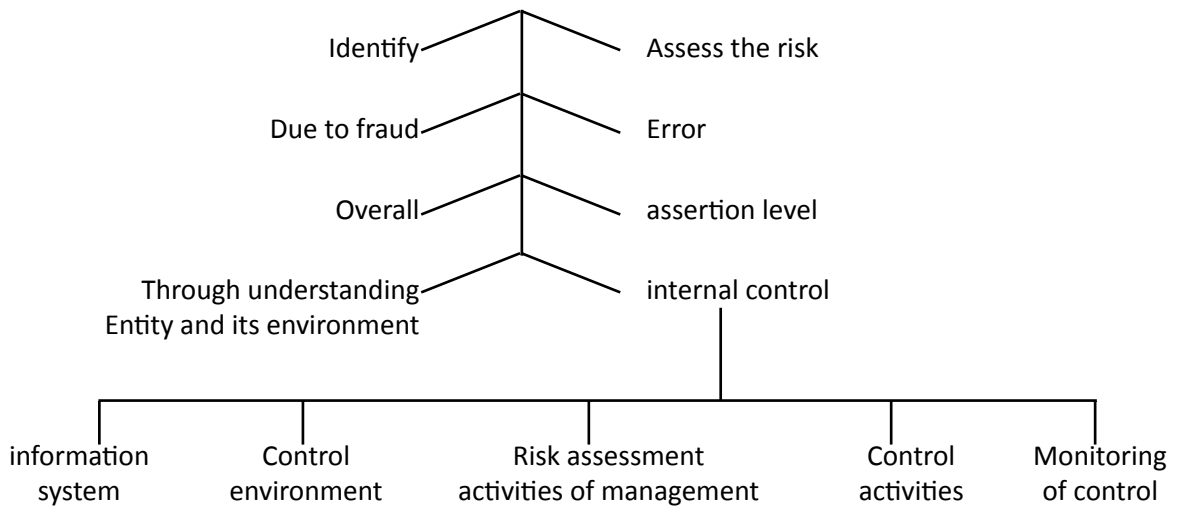
Definitions

- d. **Risk assessment procedures** – The audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- **Risk Assessment Procedures and Related Activities.**
Risk assessment procedures by themselves, however, **do not provide** sufficient appropriate audit evidence on which to base the audit opinion.
The risk assessment procedures shall include the following :
 - a. **Inquiries of management** and of others **within the entity who** in the auditor’s judgment may have information that is likely to assist in identifying risks of material misstatements due to fraud or error.
 - b. Analytical **procedures**.
 - c. Observation and **inspection**.

Assertions are representation made by Management in financial statements

Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:

- a. Assertions about classes of **transactions** and events for the period under audit :
 - i. **Occurrence**—transactions and events that have been recorded have occurred and pertain to the entity.
 - ii. **Completeness**—all transactions and events that should have been recorded.
 - iii. **Accuracy**—amounts and other data relating to recorded transactions and events have been recorded appropriately.
 - iv. **Cut-off**—transactions and events have been recorded in the correct accounting period.
 - v. **Classification**—transactions and events have been recorded in the proper accounts.
- b. Assertions about account **balances at** the period end:
 - i. **Existence**—assets, liabilities, and equity interests exist.
 - ii. **Rights and obligations**—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - iii. **Completeness**—all assets, liabilities and equity interests that should have been recorded.
 - iv. **Valuation and allocation**—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
- c. Assertions about **presentation and disclosure** :
 - i. **Occurrence and rights and obligations**—disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - ii. **Completeness**—all disclosures that should have been included in the financial statements have been included.
 - iii. **Classification and understandability**—financial information is appropriately presented and described, and disclosures are clearly expressed.
 - iv. **Accuracy and valuation**—financial and other information are disclosed fairly and at appropriate amounts.



Q. What are Limitations of Internal Control ?**Limitations of internal control**

1. Most controls are not cost effective.
2. Most controls cannot handle transactions of unusual nature.
3. Manipulation by persons who framed internal control.
4. Controls are sometimes static.

Negative Assertion

A specific mention is required about these things for a proper appreciation of the item and the financial position. Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is no contingent liability it would be an expressed negative assertion, on the other hand if in the balance sheet there is no item as "building", it would be an implied negative assertion that the entity did not own any building on the balance sheet date.

SA 330 - THE AUDITOR'S RESPONSES TO ASSESSED RISK

(w.e.f 1st April, 2008)

QUESTIONS ON SA 330

Q1. In the audit planning process of X Ltd. you would like to consider audit risk at the financial statement level. What are the factors can influence your decision?

Ans. Audit risk at financial statement level

The following factors will be considered for determination of audit risk at financial statement level.

1. Integrity of management
2. Management experience, knowledge and changes during the period.
3. Unusual pressures on the Management.
4. Nature of entity's business.
5. Factors affecting the industry in which the entity operates.

Q2. In the course of audit of Z Ltd. its auditors wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test controls.

Ans. As per SA-330 on "The Auditor's Response to Assessed Risk", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued Reliance.

The Auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgement. In addition, the length of time between retesting such controls is also factors that may warrant a re-test of controls are:-

1. A deficient control environment.
2. Deficient monitoring of controls.
3. A significant manual element to the relevant controls.
4. Personnel changes that significantly affect the application of the control.
5. Changing circumstances that indicate the need for changes in the control.
6. Deficient general IT-controls.

SA 320 - MATERIALITY IN PLANNING AND PERFORMING AN AUDIT (REVISED)

Corresponding Old AAS - 13 (w.e.f 1st April, 2010)

Q. Explain concept of materiality and factors which act as guiding factors to this concept.

Ans. Concept of Materiality: SA 320, "Materiality in Planning and Performing an Audit", establishes standards on the concept of materiality and the relationship with audit risk while conducting an audit. Hence, the auditor requires more reliable evidence in support of material items. SA 320 defines material items as relatively important and relevant items i.e. items the knowledge of which would influence the decision of the user of financial statements. Financial statements materially affect if such statement is erroneously stated or omitted to be stated there in and economic decision of the users taken on the basis of such information is influenced by such misstatements or omissions. The auditor has to ensure that such items are properly and distinctly disclosed in the financial statements. The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not. There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

Factors to be considered for determining materiality:

- i. Item of materiality may be determined individually or in aggregate
- ii. The materiality depends on the regulatory or legal considerations
- iii. Materiality is not often reckoned with respect to quantitative details above. It has qualitative dimensions as well.
- iv. Even insignificant items in terms of quality may be material in special circumstances.
- v. Sometimes the materiality of an item in terms of quantity is described in law itself. For example: Schedule III required disclosure of items of expenditures which are in excess of one percent of the revenue from operations or Rs.1,00,000, whichever is higher
- vi. An item whose impact is insignificant at present, but in future it may be significant, may be material item.

QUESTIONS ON SA 320

Q1. State with reasons your views on the following :

'An assistant of X & Co., Chartered accountants detected an error of Rs. 5 per interest payment which recurred number of times. The General Manager (finance) of T Ltd., advised him not to request for passing any adjustment entry as individually the errors were of small amounts. The company had 2,000 deposit accounts and interest was paid quarterly',

Ans. 'Auditor should also remember that items of misstatement of relatively small amounts if taken together, could have a material effect on the financial statements.'

In forming his opinion, the auditor should **consider the effect of aggregate of uncorrected misstatements in the financial statements as to its materiality**. If the aggregate of uncorrected misstatements approaches the materiality level he should consider requesting the management to adjust the financial information or extend his audit procedure.

If the management refuse to adjust the financial statement and the results of extended procedures

do not enable the auditor to conclude that the aggregate of uncorrected misstatements not material, the auditor should express a qualified or adverse opinion.

Q2. "Small misstatements should be ignored" Comment.

Ans. False. The aggregate effect of uncorrected small misstatements can have a material effect on financial statements.

Q3. "Materiality is determined and fixed at planning stage" Comment.

Ans. False. Materiality once fixed during planning stage might be changed by audit during evaluation.

Q4. "There is positive direct relationship between materiality and audit risk" Comment.

Ans. False. There is inverse relationship between Materiality and audit risk. An auditor never forgets to check transactions which are material. Hence chances of audit risk are low here.

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

Corresponding Old AAS - 4 (w.e.f 1st April, 2009)

QUESTIONS ON SA 240

Q1. What procedures are carried out by the auditor under SA 240 to Identify fraud ?

(Hints - Risk Assessment procedure, Fraud Risk factors, Overall Response, Response at assertional level, Test journal entries, Review accounting estimates).

Q2. Short notes on Fraud Risk factors

Example - 1 : An organization is keeping huge amount **of cash in hand instead** of regularly depositing in the bank.

Example - 2 : A **diamond** merchant is not keeping pieces of diamond in a secured way.

Example - 3 : Pressure on the Company to **obtain Bank Loan**.

Three types of Fraud Risk Factors

- i) Pressure
- ii) Opportunites
- iii) Attitude

Q3. "Auditor is responsible for prevention and detection of errors in financial statements" Comment.

Ans. False. The primary responsibility for prevention and detection of errors in financial statements is with the **management**. Mere fact that subsequently misstatements are found in the financial statements audited by auditor, it does not mean that auditor is guilty of violation of code of ethics provided that auditor follows basic principles governing audit.

Q4. While conducting statutory Audit of ABC Ltd. you come across IOUs amounting to rs. 2 crores as against a cash balance shown in books of rs. 2.10 crores. You also observe that despite similar high balances throughout the year, small amounts of rs. 50000 are withdrawn from the bank to meet day-to-day expenses. (5 marks) (june 2009)

Ans. According to SA 240, "The Auditor's Responsibilities relating to fraud in an audit of Financial Statements" when the auditor comes across such circumstances indicating the possible misstatements resulting from the fraud then the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. In this case, the circumstances indicate that the possible misstatement in financial statements is due to fraud and error and the auditor must investigate further to consider effect on financial

statements.

The Guidance Note on Audit of cash and Bank balances also mentions that if the entity is maintaining an unduly large balance of cash, he should carry out surprise verification of cash more frequently to ascertain whether it agrees. If cash in hand is not in agreement with the book balance, he should seek explanations and if the same are not satisfactory should state the said fact appropriately in his Audit Report.

Q5. Indulged In the course of audit of A Ltd. you suspect the management has in fraudulent financial reporting? State the possible source of such fraudulent financial reporting. (6 marks) (May 2012)

Ans. Possible sources of fraudulent financial reporting: As per SA 240, "The Auditor's responsibilities relating to fraud in an audit of financial statements", fraudulent financial reporting involves intentional misstatements or omission of amounts or disclosures in financial statements to deceive financial statements users. It may be accomplished by manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared or misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information or intentional misstatements involve intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure etc.

It often involves management override of controls, misappropriation of assets etc that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

1. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
2. Inappropriately adjusting assumption and changing judgements used to estimate account balances.
3. Omitting , advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
4. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
5. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
6. Embezzling receipts (example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
7. Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
8. Altering records and terms related to significant and unusual transactions.
9. Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
10. Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Q6. The Managing Director of the company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company.

Ans. Fraud committed by Managing Director: the Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "the Auditor's responsibilities to consider fraud and error in an audit of financial statements".

“first of all, as per SA 240, the need to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment. secondly, the auditor need to consider the impact of fraud on financial statements and its disclosure in the audit report. Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management. finally, the auditor shall have to report under CARO, 2003 indicating the nature and amount involved in respect of fraud noticed during the year.

SA 250 - CONSIDERATION OF LAWS AND REGULATION IN AN AUDIT OF FINANCIAL STATEMENTS (REVISED)

Corresponding Old AAS - 21 (w.e.f 1st April, 2009)

QUESTIONS ON SA 250

Q1. While verifying the employee records in a company, it was found that a major portion of the labour employed **was child labour**. **On questioning** the management, the auditor was told that it was outside his scope of the financial audit to into the compliance with other laws. (5 marks) (Nov 2012)

Ans. Compliance with other laws: as per SA 250, “**Consideration of laws and Regulations in a Audit of financial statements**” the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulation generally recognized to have a direct effect on the determination of material and disclosures in the financial statements including tax and labour.

Further, non-compliance **with other laws** and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

In the instant case, **major portion of the labour** employed in the company was child labour. While questioning by auditor, **reply of the management that it was outside his scope of financial audit** to look into the compliance with other **laws is not acceptable as it may have a material effect on financial statements**.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequence for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

SA 260 - COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE (REVISED)

Corresponding Old AAS - 27 (w.e.f 1st April, 2009)

QUESTIONS ON SA 260

- Q1. What audit matters of governance interest need to be communicated to the relevant persons?
- Q2. What are significant difficulties encountered during the Audit?

SA 260
COMMUNICATION WITH TCWG

THOSE CHARGED WITH GOVERNANCE:

The person or organisation having responsibility for-

- Overseeing the strategic direction of the entity.
- Obligations related to accountability of entity.

It includes overseeing the **financial reporting process**.

Q) WHAT MATTERS THE AUDITOR MUST COMMUNICATE WITH TCWG? (4)

ANS) F: SIGNIFICANT FINDINGS

- | | |
|---------------------------------------|---|
| I: INDEPENDENCE. (Declaration to TCWG | i. Audit + Network Firm |
| R:- RESPONSIBILITIES. | ii. Fees charged for audit & other work |
| S:- SCOPE OF AUDIT. | iii. Threats to independence & how resolved |
| T:- TIMINGS | |

1) THE AUDITOR'S RESPONSIBILITIES IN RELATION TO FINANCIAL STATEMENT AUDIT.

AUDITOR RESPONSIBILITIES FOR **FORMING AND EXPRESSING AN OPINION ON FINANCIAL STATEMENT.**

2) PLANNED SCOPE AND TIMING OF AUDIT:

The auditor shall communicate with TCWG an overview extent of planned scope & timing of audit i.e.

a) EXTENT OF USE OF INTERNAL AUDIT.

b) APPLICATION OF CONCEPT OF MATERIALITY.

3) SIGNIFICANT FINDINGS:

- ACCOUNTING POLICIES.
- ACCOUNTING ESTIMATES.
- DISCLOSURE OF FINANCIAL STATEMENT.
- INAPPROPRIATE ACCOUNTING PRACTICE.
- MATERIAL WEAKNESS.
- WRITTEN REPRESENTATIONS (REQUESTED BY AUDITOR)
- SIGNIFICANT DIFFICULTIES.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING AUDIT?

- ❖ DELAY IN PROVIDING INFORMATION.
- ❖ UNNECESSARY BRIEF TIME COMPLETION OF AUDIT.
- ❖ UNAVAILABILITY OF EXPECTED INFORMATION.
- ❖ RESTRICTIONS IMPOSED BY MANAGEMENT.
- ❖ ABSENCE OF ANY REFERENCE OF ACCOUNTING ASSUMPTION i.e. GOING CONCERN WHEN ASKED

COMMUNICATION PROCESS

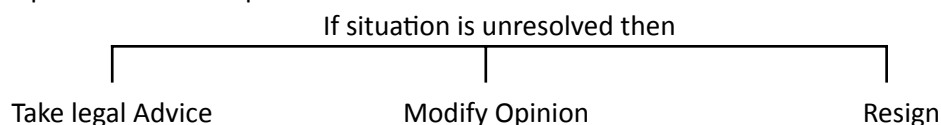
→ 2 WAY COMMUNICATIONS

→ WRITTEN COMMUNICATION IS PREFERRED

If Communication process is inadequate

Inadequate communication means

1. No response/ improper response received from TCWG
2. Auditing issues unresolved
3. Refusal to provide written representations on certain matters.



SA 530 - AUDIT SAMPLING (REVISED)

Corresponding Old AAS - 15 (w.e.f 1st April, 2009)

QUESTIONS ON SA 530

Q1. State your opinion/Comment on :

In cases where audit sample selection has been done on a **random** basis no **statistical process** for selection of samples **need to be followed**?

- Ans.**
- Audit sampling means the application of audit procedures to less than 100% of the items within an account balance class of transactions. The enable the auditor to obtain and evaluate audit evidence about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population.
 - The audit sample collection on a random basis ensures that all items in the population have an equal chance of selection.
 - Selection of an audit sample on a random basis, is a pre-requisite for application of statistical techniques.
 - Hence, in case of selection of an audit sample on the basis of random tables, there is no need to follow any other statistical process for selection of sample.

Q2. On what factors, does sample size depend upon?

Q3. Define/Short Note :

- Audit Sampling
- Sampling and Non-Sampling risk.
- Statistical Sampling
- Stratification

Q4. Discuss with reference to SAs:

While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind.

Ans. PAGE NO 1.23

Q5. "In case where audit sample selection has been done on a random basis, no statistical process for selection of samples needs to be followed ". Comment.

Ans. PAGE NO 3.5

SA 570 - GOING CONCERN (REVISED)

Corresponding Old AAS - 16 (w.e.f 1st April, 2009)

QUESTIONS ON SA 570

Q1. A Company's net worth is eroded and creditors are unpaid due to liquidity constraints. The management represents to the statutory auditor that the promoter's wife is expected to give an unsecured loan to meet the liquidity constraints and that negotiations are underway to secure large export orders. (4 marks)

Ans. In this case, it is subjective, but prima-facie a mere expectation of future cash flows from the promoter's wife without any firm commitment and the possibility of an export order being negotiated, may not that be sufficient appropriate audit evidence of mitigating factors for resolving the going concerns question

under SA 570 "Going Concern".

Q2. R & Co. is the statutory auditor of S Ltd. for the financial year ended on 31st March 2012, S Ltd had disclose in the notes (Notes No. X) "The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit. Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd include financial statements of certain branches which are audited by other auditors. What are the reporting responsibilities of R & Co.?

Ans. Reporting Responsibilities of Statutory Auditor: This question involves two broad aspect with respect to reporting requirements i.e. (i) one which deals with going concern aspect where the company has gone for legal suit and (ii) other is work done by other auditors.

As per facts of the case, the state pollution Control Board has issued the closure order for S Ltd., on account of environmental damaging by its only manufacturing plant. However, S Ltd had challenged the same by way of a law suit. Due to pendency of the outcome of the legal suit, the company has prepared its financial statements on going concern basis.

As per SA 570 "going concern", under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so Management's assessment of the entity's ability to continue as a going concern involves making a judgement, at a particular point in time, about inherently uncertain future outcomes of events or conditions.

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

As per SA 570 going concern, pending legal proceedings is a condition that, individually, may cast significant doubt about the going concern assumption. Existence of above condition signifies that a material uncertainty exists.

Further, when the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

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

If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph as per SA 706 "Emphasis of matter paragraphs and other matters paragraph in the independent Auditor's Report", in the auditor's report to:

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

SA 299 - RESPONSIBILITY OF JOINT AUDITORS

Corresponding Old AAS - 12 (w.e.f 1st April, 1996)

QUESTIONS ON SA 299

Q1. E and S are appointed as Joint, Auditors of X and Y Ltd. What will be their professional responsibility in a case here the company has cleverly **concealed certain transactions that escaped the notice of both the Auditors.**

Ans. Responsibilities of Joint Auditors : In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in SA 200, SA 240 and SA 299 need to be read together for arriving at any conclusion.

The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. However in this case, if it can be assumed that the joint auditors E and S have exercised reasonable care and skill in auditing the accounts of X & Y Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work.

SA 300 - PLANNING AN AUDIT OF FINANCIAL STATEMENTS (REVISED)

Corresponding Old AAS - 8 (w.e.f 1st April, 2008)

QUESTIONS ON SA 300

Q1. Audit plan establishes the scope, timing and direction of the audit.

Ans. False. It is audit strategy that sets the scope timing and direction of the audit and that guides the development of the audit plan. Audit plan includes a description of the nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level.

Q2. Draft Audit programme in relation to a manufacturing concern for the year 2012-2013.

Audit Programme

Year of Audit –

Duration of Audit –

1. Resource

CA A	—	Principal	CA B	—	Audit Mgr
C	—	Article Assistant	D	—	Article Assistant
E	—	Article Assistant	F	—	Article Assistant

Areas :- 1 Revenue

- Check the Sales for the month as per invoice
- Check Non-operating income if any.

2. Expenses

- Check Staff Salary Payments

3. Assets

- a) Examine the movement of assets in the year with reference to invoice.
- b) Verify the investments with reference to receipts attached.

4. Liabilities

Verify the balance due to creditors.

5. Statutory Compliances of PF Act / ESI Act**6. Internal Control for stock properly functioning****7. General verify the minute book****Allocation Table**

Names of Person	Areas assigned	Sample size	No. of days	Remarks

Signature

M. No.

FRN No.

Date :

SA 600 - USING THE WORK OF ANOTHER AUDITOR

Corresponding Old AAS - 10 (w.e.f 1st April, 2002)

QUESTIONS ON SA 600

Q1. P Ltd. of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches. M/s XYZ conducted the audit of the branch **without visiting the branch and instead** getting the books at the H.O. M/s XYZ has submitted their Branch Audit Report to you.

Ans. As per provisions of the Companies Act, 1956, the accounts of a branch office of a company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. It is not necessary for principal auditor M/s XYZ to visit the branch and conduct the audit only at branch's premises. It is a matter of professional judgement for the Principal auditor to decide as to whether he needs to visit the branch.

The principal auditor is entitled to rely upon the 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. As per SA 600, "Using the work of another auditor", the principal auditor is not required to evaluate professional competence because branch auditor happens to be member of ICAI. Hence, in the given case, the statutory auditor is required to deal with M/s XYZ's report in the manner it considers fit under the circumstances.

SA 610 (REVISED) USING THE WORK OF INTERNAL AUDITORS

QUESTIONS ON SA 610

Q1. "A statutory auditor can never rely on work of internal-auditor" Comment.

SA 620 - USING THE WORK OF AUDITOR'S EXPERT

QUESTIONS ON SA 620

Q1. The auditor of SS Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age. (5 Marks)

Ans. Using the work of an Expert: As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans, however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

Hence, the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

If the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be ensured by the auditor.

In the instant case, a qualified actuary has issued a certificate for gratuity liability valuation, for which retirement age adopted is 65 years against the existing retirement age of 60 years; however, the company is considering a proposal to increase the retirement age. In view of SA 500 alongwith SA 620, the assumption made by actuary has no relevance and reasonableness as presently retirement age is of 60 years. Hence the auditor is required to bring out the facts to the notice of management and advise the modification accordingly. In case of failure of compliance of the same the auditor may qualify the report.

SA 505 - EXTERNAL CONFIRMATIONS

Corresponding Old AAS - 30 (w.e.f 1st April, 2003)

QUESTIONS ON SA 505

Q1. "External confirmation is always obtained on balance sheet date" Comment.

Ans. False. External confirmation can be obtained on a date near to balance sheet date. But in such cases auditor must carefully monitor the events between the confirmation date and balance sheet date.

Q2. Moon Limited placed its statutory auditor for the Financial year 2008-09. During the course of audit the new auditor found a credit item of rs. 5lakhs. On enquiry, the company explained him that it is, a very old credit balance. The creditor had neither approached for the payment nor is he traceable. Under the circumstances no confirmation of the credit balance is available. Comment (5 MARKS NOVEMBER 2009)

Ans. This is a case of external confirmation, covered by SA 505 "External Confirmation". The identities of creditors are not **traceable to confirm the credit balance as appearing** in the financial statement of the company. It is also not a case of pending litigation.

It might be a case that an income of rs.5lakhs had been hidden in previous years/s. The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He **should apply alternative audit procedures** to get **documentary proof** for the transaction/s and should not rely entirely on the management representation. Finally, he should **include the matter by way of qualification in his audit report to the members.**

Q3. During the course of audit of star Limited the auditor received some of the confirmation of the balances of creditors outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of sundry Creditors there are number of creditors of small balances except one, old outstanding of rs. 15lacs, whom, no confirmation on the credit balance received. Comment with respect to standard of Auditing. (5 MARKS MAY 2014)

Ans. External confirmation: As per SA 505, "External Confirmation", **Negative Confirmation is a request that** the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative confirmations provide less persuasive audit evidence than positive confirmations.

The failure to receive a response to a negative confirmation **request does not explicitly indicate receipt** by the **intended confirming party of the confirmation request or verification of the accuracy of the** information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request in their favor, and less likely to respond otherwise.

In the instant case, the auditor sent **the negative confirmation requesting the creditors** having outstanding balances in the balance sheet while doing audit of star Limited. One of the old outstanding of rupees 15lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself to respond to the auditor only if the confirming **party disagrees** with the information provided in the request.

But, if the auditor **identifies fact ors that give rise to doubts about the reliability of the response to the** confirmation request, he shall obtain **further audit evidence to resolve those doubts.**

520 - ANALYTICAL PROCEDURES

QUESTIONS ON SA 520

Q1. State your views on the following request made by the management of X Ltd. :

In spite of the internal control weakness commented upon by the audit manager, no further tests need to be carried out, as the purchase and sales figure as a percentage of gross profit was same in the previous year. The audit manager's comments were in regard to control over purchase and sales.

Ans. The audit manager observed that internal control purchase and sales were weak after evaluating the system. The request by the management that no further tests need not to be carried out since purchase and sales as a percentage of gross profit was same as in the previous year cannot be accepted since the same percentage may be a mere coincidence or compensating. For example, sales price may have gone up which was matched partly by a corresponding increase in the purchase price and partly by a fraud, leaving the gross margins comparable to the previous year. **Therefore merely comparing** gross margin of current year with the previous year does not reveal anything and at best provides minimal evidence, As a matter of fact, **while performing analytical procedures when no deviation are reported**, it is necessary to investigate **such situation in a more detailed manner to ascertain the reasons why the percentage has** not changed.

One **cannot rule out attempts by the management to manipulate figures, particularly** in light of evidence of the internal control weakness. Therefore, the audit team would have to rely more on test of details of transaction and balances and a very detailed analytical procedure such as doing a gross margin test at each product category level and investigating the reasons for the fluctuations or no fluctuations than on

drawing their conclusions on the basis of a very broad analytical procedure. Therefore, mere reliance on a very broad analytical procedure will not be prudent, as **internal control weakness had been detected both in regard to purchase and sales.**

Q2. "An auditor can rely totally on analytical procedures" Comment.

Ans. False. The extent of reliance on analytical procedures depends on various factors like materiality of items involved, other audit procedures directed towards same audit objective, accuracy with which expected results can be predicted.

SA 580 - WRITTEN REPRESENTATIONS (REVISED)

Corresponding Old AAS - 11 (w.e.f 1st April, 2009)

QUESTIONS ON SA 580

Q1. An auditor of Sagar Ltd. was not able to get the confirmation about the existence and value of certain machineries. However the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of accounts. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach? Express your views.

SA 265 - COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

Corresponding Old AAS - 27 (w.e.f 1st April, 2010)

Deficiency in Internal Control

This exists when :

- i. A control is designed, implemented or operated in such a way that it is **unable to prevent, or detect** and correct, misstatements in the financial statements **on a timely basis**; or
- ii. A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

QUESTIONS ON SA 402

Q1. Examples of Significant deficiency in Internal Control.

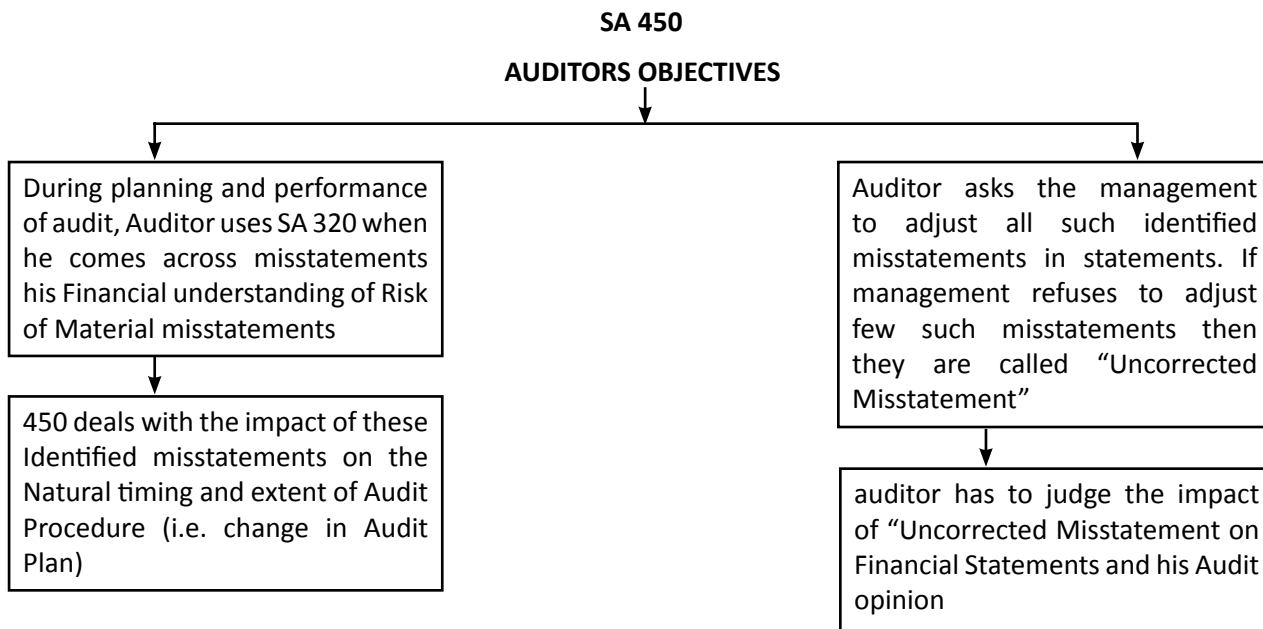
1. **Significant related party transactions not scrutinized by TCWG**
2. **Mgmt fraud not prevented by Internal Control**
3. **Non –compliance of Law and Regulation not prevented by Internal Control**

Q2. What are the matters to be Included in Communication

1. Description of deficiencies & explanation of potential impact.
2. Sufficient information to enable TCWG & Mgt to understand the context of communication.
 - a. Purpose of audit was to express opinion on FS.
 - b. Audit includes consideration of IC but not directed to express an opinion on effectiveness of IC.
 - c. Deficiencies reported restricted to those identified during audit & sufficiently important to merit reporting to TCWG.

SA 450 - EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

(w.e.f 1st April, 2010)



SA 540 - AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES, AND RELATED DISCLOSURES (REVISED)

Corresponding Old AAS - 18 (w.e.f 1st April, 2009)

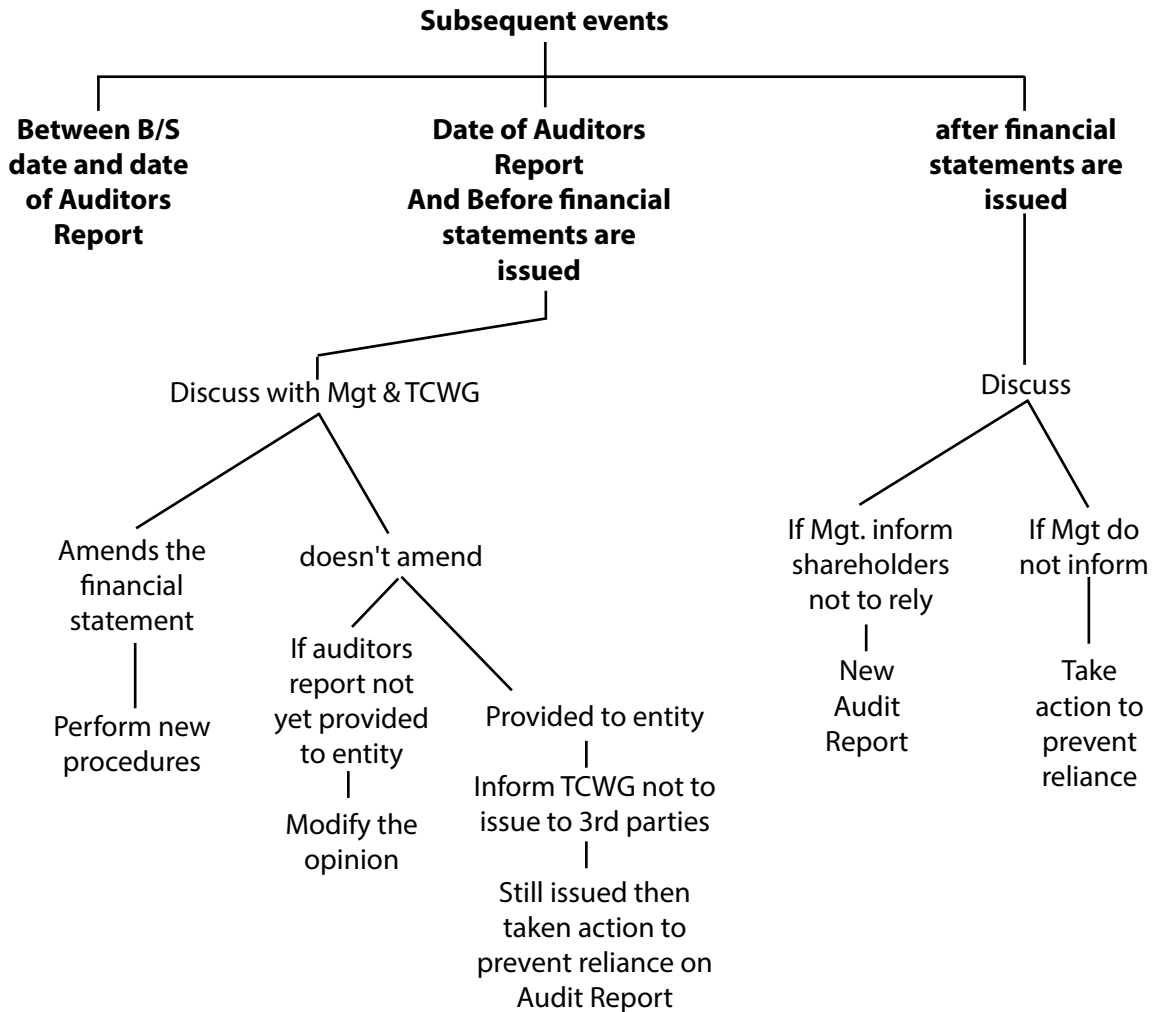
QUESTIONS ON SA 540

- Q1.** What audit response should be taken on the basis of assessed risk of material misstatement - due to accounting estimate.
- Ans.**
- i. Sometimes Management uses experts while making estimates then auditor must analyse the work of expert.
 - ii. Auditor must assess the effect of estimation uncertainty. High estimation uncertainty gives rise to significant risks.
 - iii. Auditor must also consider all events upto the date of auditor report.
 - iv. Test the operating effectiveness of controls over how management made the Accounting estimate [Example – Who approved, who reviewed, From which date estimate is derived]

SA 560 - SUBSEQUENT EVENTS (REVISED)

Corresponding Old AAS - 19 (w.e.f 1st April, 2009)

Subsequent events – Events occurring between the date of the financial statements and the date of the auditor’s report, **and facts** that become known to the auditor **after the** date of the auditor’s report.



QUESTIONS ON SA 560

Q1. A Co. Ltd. has not included in the balance sheet as on 31-03-2010 sum of rs. 1.50 crores being amount in the arrears of salaries and wages are payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded 30-4-2010. The auditor wants to sign the said balance sheet and give the audit report on 31-05-2010. The auditor came to know the result of the negotiations on 15-05-2010. (5 marks) (NOV 2010)

Ans. This case requires attention to SA 560 "Subsequent Events", AS 4 "contingencies and events occurring after the balance sheet date" and AS 29 "Provisions Contingent Liabilities and Contingent Assets.

As per AS 4 "contingencies and events after the balance sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. Similarly as per AS 29 "provisions, Contingent liabilities and Contingent liabilities and Contingent Assets future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that will occur. In the instant case the amount of 1.50 crores is a material amount and it is the result of an event, which has occurred after the balance sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements.

The Auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the Financial Statements i.e. 31-3-2010 to the date of Auditors Reports i.e. 31-05-2010. It will be observed that as a result of long pending negotiations a sum of rs. 1.50 crores representing arrears of salaries of the year 2008-09 and 2009-10 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.

As per SA560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustments or disclosure have been adjusted or disclosed.

So the auditor should request the management to adjust the sum of rs.1.50 crores by making provisions for expenses. If the management does not accept the request the auditor should qualify the audit report.

Q2. As a statutory auditor of a company on the following:

A fire broke out on 15th May 2012, in which material worth rs.50 lakhs which was lying in stock since 1st March, 2012 was totally destroyed. The management of the company argues that since the loss occurred in the year, 2012-13, no provision for the loss needs to be made in the financial statements for 2011-12.(5 marks) (Nov 2012)

Ans. Event occurring after the balance sheet date: this case requires attention to SA 560 "subsequent Events" and AS 4 "Contingencies and Events Occurring the Balance Sheet".

As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence substratum of the enterprise) is not appropriate.

AS-4 also requires disclosure of the non-adjusting event, in the report of the approving authority.

Further, as per SA 560 "subsequent events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment to disclosure have been adjusted or disclosed.

The event took place after the close of the accounting year does not relate to conditions existing at the balance sheet date. Thus, it will have no effect on items appearing at the balance sheet date as per AS 4 "Contingencies Events occurring after Balance Sheet Date" have to be adjusted that provide

evidence of condition existing as at the balance sheet date. However, the auditor has to ensure that this loss will not materially affect the substratum of the enterprises as per its size, nature and complexity of operations.

Thus, subject to satisfaction in respect to non-violation of going concern concept, the company has correctly accounted by not providing provision. However, the auditor is required to ensure the proper disclosure of above mentioned event.

Q3. Discuss the following:

- a) **Inquiry from Management is helpful for Auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements.**
- b) **The discipline of behavioral science is closely linked with the subject of auditing.**

Ans. PAGE NO 1.28

SA 230 - AUDIT DOCUMENTATION (REVISED)

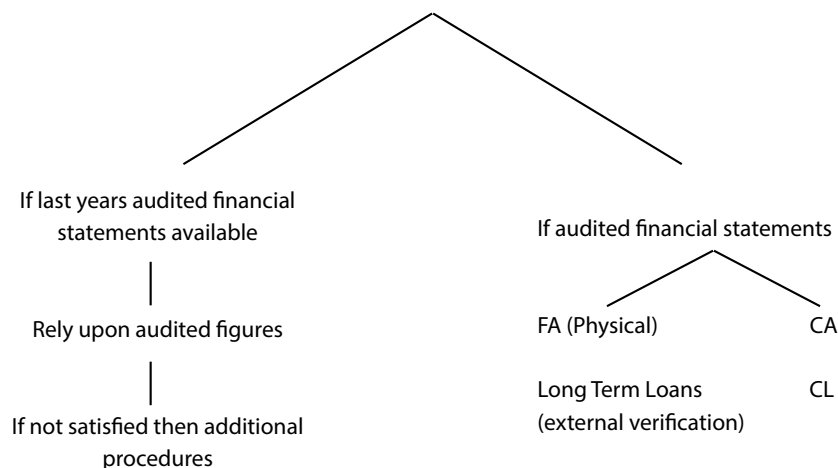
Corresponding Old AAS - 3 (w.e.f 1st April, 2009)

QUESTIONS ON SA 230

Q1. 'The auditors are being insisted by the management to handover the letters of confirmation of balances received by the auditor from debtors are creditors'.

Ans. SA 230 on Audit Documentation states that "Audit working papers are confidential documents. However an auditor **may** at his discretion, if considered appropriate, make copies of or extracts from his working papers and give to his client". Hence it is left to the discretion of auditor to make copies of the same to the management.

SA 510 - INITIAL ENGAGEMENTS - OPENING BALANCES (REVISED)



Note — If the previous auditor has modified his audit report, then the new auditor will have see the impact of those modifications if any in the current year's opening balances.

QUESTIONS ON SA 510

Q1. Give your comments on the following :

Auditors of MIs Fortune India (P) Ltd. were changed for the accounting year 2004-05. The closing stock of the company as on 31.3.2004 amounting to Ps. 100 lacs continued as it is and became closing stock as on 31.3.2005. The auditors of the company propose to exclude from their audit programme the audit of closing stock of Rs. 100 lacs on the understanding that it pertains to the preceeding year which was audited by another auditor.

Ans. Opening balances convey brought forward net effect of the transactions and other events of the preceeding period as well as the accounting policies of the preceeding period

If the opening balances are not correctly stated, it will result in material misstatement in the current year's financial statement. Hence the auditor should obtain sufficient appropriate audit evidence that

- i. The closing balances of the previous period have been correctly brought forward to the current period;
- ii. The opening balances do not contain misstatements that materially affect the financial statements of current period; and
- iii. Appropriate accounting policies are consistently applied

Where the audit of the preceeding financial period was conducted by another auditor, the current auditor can place reliance on the closing balances except when the performance of the current audit procedure indicate the possibility of misstatement of opening balances.

The contention of the management that the stock has not undergone any change cannot be accepted. Moreover, it is also quite likely that the stocks lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude from iis audit programme the audit of closing stock.

SA 710 - COMPARATIVES

QUESTIONS ON SA 710

Q1. The audit report of P Ltd. for the year 2007-08 contained a qualification regarding non- provision of doubtful debts. As the statutory auditor of the company for the year 2008-09, how would you report, if:

- I. The company does not make provision for doubtful debts in 2008-09?
- II. The company makes adequate provision for doubtful debts in 2008-0-9? (8 marks) (june 2009)

Ans. Auditor's responsibility in case where audit report for an earlier year is qualified is given in SA 710 "comparative information- corresponding figures and comparative financial statements". As per SA 710, when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to modification is unresolved, the auditor shall modification paragraph in the auditor's report, the auditor shall either:

I. Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

II. In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

Q2. SA 710

State with reasons (in short) whether the following statements are true or false:

SA 710 on 'comparatives' is applicable to corresponding previous year figures and not to comparative Financial Statement (2 Marks, June 2009)

Ans. False. As per SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements", there are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited the requirements and guidance in SA 510 "Initial Audit Engagements – Opening Balances" regarding opening balances also apply.

SA 210 - AGREEING THE TERMS OF AUDIT ENGAGEMENTS (REVISED)

Corresponding Old AAS - 26 (w.e.f 1st April, 2010)

QUESTIONS ON SA 210

- Q1.** What should an auditor do where he is requested to change the terms of engagement before the completion of engagement?
- Q2.** Write short note on Pre-conditions for audit?
- Q3.** X, a Chartered Accountant was engaged by PQR & CO. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, Which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.

A SHORT NOTE ON: "CONTROL ENVIRONMENT"

CONTROL ENVIRONMENT is concerned with the GOVERNANCE AND MANAGERIAL FUNCTIONS performed by THOSE CHARGED WITH GOVERNANCE and management along with their attitudes and awareness towards the internal control of the organisation. It is concerning the entity's internal control, thereby any deficiency in the control environment may undermine the effectiveness of internal control. However the converse may not be true as a sound control environment though promotes an appropriate foundation, may not necessarily mean a sound internal control within the organisation.

Relevant elements of control environment are as follows:

- Communication and enforcement of integrity and ethical values.
- Commitment to competence by the management for particular jobs to obtain requisite skills and knowledge.
- Participation by those charged with governance.
- Management philosophy and operating style.
- Human resource policies and practices.

SA 705 & 706

EMPHASIS OF MATTER PARAGRAPH (4)

- Q. Write a short note on Emphasis of Matter Paragraph 4 MARKS
AS per SA 706, Emphasis of matter paragraph is a paragraph which highlights fundamental Matters relating to the company and the matter should be brought to the notice of its user's i.e. Shareholders
- It should be inserted after the opinion paragraph.
 - The auditor must include in the emphasis of matter paragraph a declaration that the AUDITOR'S opinion is not modified in respect of the matter emphasised in that paragraph.
- EXAMPLE: THERE IS A LEGAL SUIT PENDING AGAINST THE COMPANY WHICH MAY PUT TO THE RISK ITS GOING CONCERN AND ITS RESULTS IS UNCERTAIN NOW. THE AUDITOR'S REPORT IS NOT QUALIFIED DUE TO THE ABOVE FACT.

SA 700,705

- Q. WHAT POINTS MUST BE CONSIDERED WHILE QUALIFYING THE AUDIT REPORTS ? 4 MARKS
QUALIFIED REPORT is a type of audit report where financial statements are showing true and fair view subject to certain reservations.
An audit report can be qualified when there is:
- Any LIMITATION on scope of audit is not material
 - Any immaterial DISAGREEMENT WITH ACCOUNTING POLICIES FOLLOWED by the company.
- While qualifying the audit reports an auditor must
- AS PER SA-705 mention the basis for qualified opinion in his report before the opinion paragraph, stating and explaining as to why the report is being qualified.
 - Quantify the effect of that misstatement and show its effect on profit and loss of the company.
- If the company's inventories are not carried at lower of cost or net realisable value then auditor in his report must state that the financial statements are not in accordance with accounting standards and also quantify that as to by what amount the management would have required to write the inventories down/up and accordingly by what amount the cost of sales, net profit and shareholder's funds would have been reduced or increased

SA 210

Q. What is an engagement letter? (3)

Ans. According to SA 210 Engagement letter is sent by auditor to the client before accepting the audit work.

It contains:-

- SCOPE AND OBJECTIVES OF AUDIT.
- MUTUAL TERMS AND CONDITIONS TO AVOID MUTUAL MISUNDERSTANDING.

AUDITOR → CLIENT [before accepting the audit work]

Q. Whether new Engagement letter will be required or not in the subsequent terms of 5 years? (3)

Ans. The requirement of new engagement letter in the subsequent terms of 5 years depends upon the following factors-

- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature and size of entity's business.
- A change in legal or regulatory requirements.
- A change in financial reporting framework adopted in the preparation of the financial statement.
- Misunderstanding last year

Q. How will an auditor react if the engagement are denied?(2)

CHANGES IN THE TERMS OF THE AUDIT ENGAGEMENTMENT



Example:

- Change in Law
- Size and nature of business changes
- He may withdraw and inform Management
- TCWG
- Shareholders and regulatory bodies if legal responsibility

→ The auditor and management shall agree on and record the new terms of the engagement letter Or other suitable form of written agreement

<p>→</p> <p>→</p> <p>→</p> <p>→</p> <p>→</p>	<p><u>CAUSES:</u> where there is no <u>reasonable justification</u> for doing so Prior to completing the audit engagement the changes comes a lower level of assurance.</p> <p><u>RESULTS</u> WITHDRAW FROM THE AUDIT ENGAGEMENT. REPORT THE CIRCUMSTANCES TO <u>OWNERS,REGULATORS OR TCWG.</u></p>
--	---

DRAW AN AUDIT ENGAGEMENT LETTER (8)
TO THE BOARD OF DIRECTORS, AAB LTD.

You have requested that we audit the financial statements of AAB LTD for the year ended 31st march 20xx. We are pleased to confirm our acceptance by means of this letter. Our audit will be conducted with the objective of expressing an opinion on the financial statements.(elaboration on the scope of audit)

AUDITOR'S RESPONSIBILITY:

A significant responsibility of auditor is to conduct the audit in accordance to standards on auditing {SA}

The responsibilities of the auditor includes-

- Obtaining reasonable assurance about the financial statements is free from material misstatements.
- Performing **SUBSTANTIVE AND COMPLIANCE PROCEDURES** to obtain audit evidence.
- **EVALUATE THE appropriateness AND reasonableness of ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES.**
- **PROFESSIONAL SKEPTICISM, COMPLIANCE WITH ETHICAL REQUIREMENTS.**
- **MOSTLY GIVING A "QUALIFIED REPORT"** that due to inherent limitations and internal control, some material misstatements (inherent and control risks) may not be detected despite the audit is properly planned and performed in compliance with SA'S.

MANAGEMENT'S RESPONSIBILITY:

- Preparation of financial statements showing **TRUE AND FAIR VIEW.**
- Making Reasonable and prudent judgements and estimates.
- Selection and implementation of appropriate accounting policies and making relevant disclosures therein.
- Internal control framed by the management must operate effectively without any loopholes.
- The financial statements are free from any material misstatements.
- The management must voluntarily provide with:
 - a)Access ,to all information including books ,accounts,vouchers,other records,documentation,minutes books,internal audit reports,any additional information as may be required by the auditor.(AVOID DISCLAIMER OF OPINION)

FULFILLMENT OF ADDITIONAL FORMALITIES AND ACKNOWLEDGEMENT

DATE:	CHARTERED ACCOUNTANTS (SIGNATURE)
PLACE:	(NAME OF THE MEMBER)
ACKNOWLEDGEMENT FROM AAB LTD.	(DESIGNATION) (SIGNATURE)

Q. What are preconditions before accepting audit work?

- Hints:
- i. Auditor accepts financial reporting framework
 - ii. Audit premises present and management agrees to audit premises

Q. ON WHAT FACTORS SAMPLE SIZE DEPENDS? (3)

- ❖ **POPULATION SIZE:** An increase in the population will **increase** the sample size and vice-versa.
- ❖ If the expected error **increases** sample size **increases**.
- ❖ If the tolerable error **increases** sample size **decreases**.
- ❖ If the risk of material misstatement **increases** sample **size increases**.
- ❖ If the sample size increases then sampling risk is **low**.

EXTERNAL CONFIRMATION :

It is direct written response obtained by auditor from a **third party** in –

- A) PAPER FORM
- B) ELECTRONIC / OTHER MEDIA.

EXAMPLE

It is used in case of stock lying with

- A) THIRD PARTY.
- B) DEBTORS BALANCE.
- C) CREDITORS BALANCE.

ANALYTICAL PROCEDURES:

Evaluating financial information of CREDIBLE RELATION BETWEEN FINANCIAL & NON FINANCIAL DATA
It also includes the investigation of identified fluctuation and relationship that are inconsistent / not matching with other relevant information or predictions. We must also compare with other firms in the same industry.

ANALYTICAL PROCEDURES ARE CARRIED OUT AT:-

- A. PLANNING STAGE.
- B. EVALUATION STAGE.
- C. FINAL STAGE.

SA 230

AUDIT DOCUMENTATION

MEANING:-

The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached terms as audit documentation.

An auditor should maintain confidentiality with regard to his papers .if working paper is shared with someone then it is a breach of confidentiality principles.

Example of Audit Documentation

- 1. Audit programmes
- 2. Summaries of significant matters
- 3. Letters of confirmation

Q. PRELIMINARY ENGAGEMENT ACTIVITIY?(3)

Ans. Auditor should undertake the following activities at the beginning of the current audit engagement

- 1. PROCEDURES REQUIRED BY SA 220 He will ensure that the firm follows quality control practices.)
- 2. INDEPENDENCE (auditor should be unbiased)
- 3. TERMS OF ENGAGEMENT LETTER (auditor should understand its terms)

SA 580

WRITTEN REPRESENTATIONS

- ❖ Written representations (statement) is given by management provided to auditor to confirm certain matters or to support other audit evidence.
- ❖ Management representation can never be a substitute for audit evidence. An auditor has to cross check management representation with other evidence obtained.
- ❖ If management refuse to give representations to the auditor then the auditor will consider it as a LIMITATION ON THE SCOPE OF AUDIT and auditor would give a qualified report or disclaimer of opinion as the case may be.[2 marks in big case studies.]

Give case studies where WR is given:-

- 1) WR about compliance with all laws & regulations.
- 2) WR about related party transactions.
- 3) WR about adequacy of internal control system.

Types of Statutory Audit Report

AUDIT REPORT

CLEAR REPORT / UNQUALIFIED

- When financial Statements show **True and fair View** *
- Positive Report

MODIFIED REPORT

QUALIFIED REPORT

- Showing True and Fair View **Subject to Certain reservations.**
(Ex. :- Depreciation overcharged)

ADVERSE REPORT

- Financial Statements **does not** show True and Fair View
- Negative Report (Ex. :- No disclosure is made regarding the fact, that entity is no longer a going concern)

DISCLAIMER OF OPINION

- Auditor could not arrive at any opinion due to **material misstatements** on the scope of Audit.
- Neither positive nor negative in nature. (Ex.:- Auditor was not allowed to check any records by the management.) *

* True and fair view means —

- 1) Proper books of accounts are Kept.
- 2) Compliance with Accounting Standards.
- 3) Compliance with schedule III, etc.

* Personal Verification not allowed.

If limitation is not material, then qualified report is given.

How Audit Evidence is Obtained

AUDIT EVIDENCE IS OBTAINED THROUGH

SUBSTANTIVE PROCEDURES

Vouching

(Related to expenses and income)

Verification

(Related to assets and liabilities)

Analytical review

(Analysis of significant ratios, trend)

(Comparison with other firms) **EXAMPLE** given in class on "SARDAAR"

COMPLIANCE PROCEDURES

(Test of Controls)

(Checks whether internal control is effective or not)

Internal Control (Satyam Fraud)

Policies designed by management which provides reasonable assurance about.

Financial Reporting Reliability.

Asset Safeguarding.

Rules, regulations and laws.

(Example : Given in class on purchase, sales, finance, etc.)

SA 700 pg-174, SA 700, 705, 706 done together.

Sandards ON Auditing

ELEMENTS OF AUDIT REPORT

- **Title** (Auditor's Report)
- **Addressee**
- **Introductory Paragraph** (Audited the A/c.'s for the year ended.....)
- **Management's Responsibility Paragraph** (Schedule III)
- **Auditors Responsibility** (Auditor must not be biased, should give reasonable assurance in compliance with SA. He must evaluate policy, estimates and must apply professional judgements including RAP)
- **Auditor's Opinion** * (Auditor's Report)
- **Report on other legal regulatory requirement** (Report on sec. 143 of companies act)
- **Date of Report** (Date till which auditor has audited the A/c.s)
- **Place of Signature**
- **Auditor's Signature**

As per SA 705, first state the basis for modified report before the opinion paragraph. The auditor must Quantify. the effect to the extent possible and it can be understood better by following example.

Emphasis of matter paragraph

- Comes after opinion paragraph in the auditor's report.
- This paragraph highlights a particular fundamental problem. **But audit report not qualified due to this paragraph.**

OUR OPINION IS NOT QUALIFIED IN RESPECT OF THIS MATTER

- Comes after opinion paragraph
(Example : Suppose a case is pending which may effect the working of business. This fact must come into the eyes of shareholder. This is **EOM**.
It **dose not** make the **report negative**.)

pg. : 179 - 181, Do questions with the answer (given)

pg. : 168 SA 210

Short note on engagement letter. (5 Marks)

Engagement letter is sent by **Auditor** to **Client** before accepting the audit work. It contains the scope, objective of audit, terms and conditions to avoid misunderstanding.

A new letter may or may not be sent by auditor to the client if he is **Reappointed**, on some factors like

- Change of **Management**
- Change of **Ownership**
- Change of **Nature / Size of Business.**
- Change of **Reporting requirements.**
- Change of **Legal / Regulatory requirement**

AUDIT RISK,

Risk that auditor gives inappropriate audit opinion on the financial statements that are materially misstated. It can never be zero.

COMPONENTS

Control Risk

is a risk that Internal control system **cannot prevent and defect material misstatements**

Inherent Risk (3 Marks)

wrong audit opinion arises from inherent limitations of audit :-
Test nature of Audit
 i.e. it is based on **Sampling**
 Audit evidence is **Persuasive** and not conclusive.
Human Judgement.

Detection Risk,

risk that **material misstatement** cannot be prevented & detected by auditor's **Substantive procedures (VVA)** (procedure carried out by auditor is defective)

- ◆ There is an **INVERSE RELATIONSHIP** between detection risk and inherent and control risk.
- ◆ **PROFESSIONAL SKEPTICISM :-**
 Attitude of questioning being alert. Auditor must always maintain this attitude throughout the audit.

Case Study :-

Sardar showed Sales = 10 core, and PBDD of 9 crores in his book of account.

So, auditors must have cross-checking & questioning about the matters.

AUDIT METHODS

Observation (others perform, we observe) Ex. :- inventory counting process by the entity observed by Auditor.

Inspection (checking of bills and voucher)

Confirmation (external confirmation)

Inquiry — **employees**
 — **management**
 — **TCWG**

Top level planning, responsible for strategic planning, direction & control

Those charged with governance

- ◆ **Reliability** — External evidence is more reliable than internal evidence.
- ◆ **Relevance** — Audit procedure

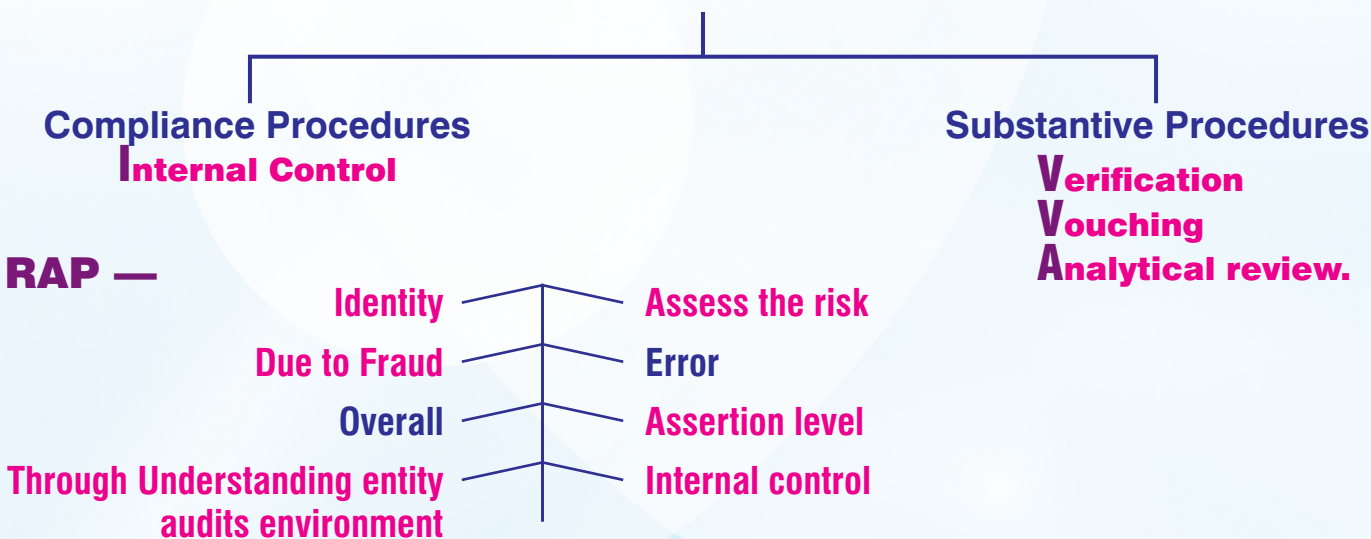
Compliance Procedure — **V**
Substantive Procedure — **V**
A

◆ **Assertions** :— **Representations by Management** in the financial statements and auditor checks these, to find out there is no fraud and errors.

Example :- DCB Ltd. is holding L & B 50 Lacs, as per B/S.

◆ **RAP** :— **Procedures** carried out by auditors to **ASSESS RISK** of **Material Misstatements** due to fraud/errors at individual basis in the financial statement and assertion level. This is carried out at **Initial Stage** and further audit procedure are carried later on.

Further Audit Procedures



4th Class (SA 302, 240, 250, 260) (pg-10)

◆ Assertions use by auditor to consider different types of Potential misstatements fall in the following categories **(4 Marks) Refer Material for details.**

cat

a) Transactions and events for the period :-

P/L A/c. item, like

⇒ **Occurrence** — Transactions recorded have occurred.

⇒ **Completeness** — All transactions are recorded.

b) Balance at the period end :-

Balance Sheet items, —

⇒ **Occurrence**

⇒ **Completeness**

c) Presentation and disclosure :-

As per Schedule III to the Company's Act. —

⇒ **Accuracy** — Information are disclosed at proper amounts.

⇒ **Completeness** — Disclosures are clearly expressed.

COMPONENTS OF INTERNAL CONTROL

Information System — System recording transaction.

Control Environment — Attitude, ethics of management and TCWG about internal control if environment is weak then the internal control is automatically weak. But the opposite may not happen.

Risk Assessment Activities of Management

Control Activities — Segregation of Duties.

Monitoring of Control —

(Technique I'C Ram coming towards me
or
'MICRA' Car

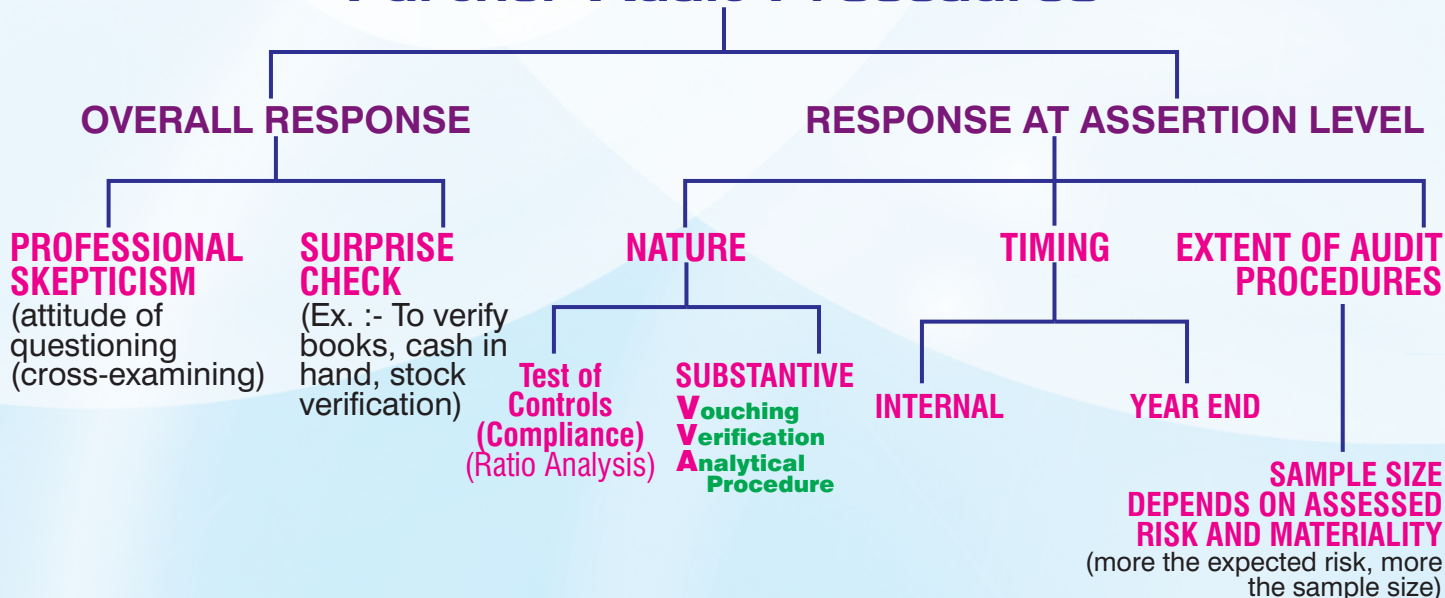
PLANNING STAGE FOR AUDITOR

OR
WHAT PROCEDURES ARE CARRIED BY AUDITOR TO
IDENTIFY COMPLIANCE WITH LAW

- ➡ **Study Company's INTERNAL CONTROL, Environment** (Legal environment)
- ➡ Determine **MATERIALITY** level of the business.

Design RAP — **Inquiry**
Analytical
Procedure

Further Audit Procedures



LIMITATION OF INTERNAL CONTROL

- ◆ Controls are **not Cost Effective**.
- ◆ Controls cannot handle **transaction of unusual nature**.
- ◆ **Manipulation** by persons (Management)
- ◆ Controls are **Static**.

SA - 320

- ◆ Materiality depends on the size & nature of the business.
- ◆ **Materiality** is any information which influence decision of investors of financial statement.
- ◆ Small misstatements can-not be ignored but, **First the Cumulative effect** of small misstatements should be checked.
- ◆ Materiality once fixed during planning stage might be changed during auditing.

- ◆ There is an **INVERSE RELATIONSHIP** between materiality and Audit risk. Auditor never forgets to check transactions which are material.

↑ **Materiality** ↓ **Audit Risk**

SA - 240

- ◆ Auditor is **not** responsible for prevention and detection of errors in financial statement, **it is the management who is responsible.**
- ◆ Test nature of audit is a major limitation of audit **as auditing is based on sampling, and on its basis auditor gives his opinion, and later on it is found that audit opinion on the basis of sampling is subsequently found to materially misstated.**
- ◆ Fraud risk factors does not indicate that fraud has taken place. Rather, **Fraud risk factors are those which increase the risk of fraud.** (Ex. :- 1) Keeping huge amount of cash in hand. 2. Diamond merchant not keeping pieces of diamond in a secured way.
- ◆ Auditor has the duty of communicating the frauds to **TCWG, regulatory authorities and share holders.**

After the new companies Act. 2013, auditor must even report to Central Government in case of fraud.

SA - 250 (4 Marks)

Responsibilities of Auditor

- ◆ Auditor is **not** responsible **for preventing non-compliance** and cannot be expected **to detect non-compliance** with all laws and regulations.
- ◆ Auditors responsibility in relation to compliance of laws and regulations :-
 1. Provisions must have **direct effect** on the determination of material amount and disclosures.
 2. Laws which have **indirect effect** on the disclosures in the financial statements, whose compliance may be fundamental to financial statements.

SA - 260 (5 Marks)

Matters to be communicated between Auditor and TCWG :-

- ★ **FINDING - (5 Marks)** Example : Difficulties encountered during auditing, material weakness, significant matters, frauds, errors.
- ★ **INDEPENDENCE**
- ★ **RESPONSIBILITIES OF AUDITOR -** 1) For forming & expressing an opinion.
- ★ **SCOPE OF AUDIT**
- ★ **TIMING -** of the audit.
Communication should be in writing.

Audit Sampling / Test Nature of Audit

- ◆ **Auditors Use** { **STATISTICAL**
(Techniques) } **NON-STATISTICAL**
(Techniques not scientific)
- ◆ **STRATIFICATION** — **Process of dividing** population into sub-population, each of which is a group of sampling units of **similar characteristic.** **Helps in directing efforts towards items having greatest potential errors.**

↑ Sample Size → ↓ Sample Risk

- ◆ **SAMPLING RISK**— Risk that auditor's conclusion based on a sample may be different from conclusion if entire population were subject to same auditing.
- ◆ **NON-SAMPLING RISK**— See Material
- ◆ **STATISTICAL SAMPLING** — Characteristics -
RANDOM SELECTION
PROBABILITY THEORY

FACTORS ON WHICH SAMPLE SIZE DEPENDS.

- ◆ Sample size is \propto Expected errors.

↑	S.S.	→	↑	E.E.
↓	S.S.	→	↓	E.E.
- ◆ Tolerable errors is \propto sample size.

↑	T.E.	→	↑	S.S.
↓	T.E.	→	↓	S.S.
- ◆ **ANAMOLY** — error not expected to occur again

METHODS OF SAMPLE SELECTION

- ◆ **Random** — each item has equal chance of getting selected.
- ◆ **Systematic** — Sampling Units Divided by same size to give a sampling interval.
(Ex. :- each 50th sampling unit thereafter is selection.)
- ◆ **Haphazard (Un-organised)** — Selection without following **Structured Technique**.
(Ex. :- avoiding difficult to locate item / always choosing or avoiding the first or last entries on a page. (Statistical technique not used))
- ◆ **How Auditor Will Evaluate Sample Result ??**
 - Step - 1** Investigate the nature & cause of any deviation.
 - Step - 2** Projecting misstatements.

CASE STUDIES (Going Concern) Fundamental Accounting Assumptions.

◆ AUDITOR'S RESPONSIBILITY

To obtain appropriate evidence about appropriateness of management's use of going concern assumptions in financial statements & to conclude whether there is a material uncertainty about the entity's ability to continue.

1) CONDITIONS CASTING DOUBT ABOUT GOING CONCERN - FINANCIAL INDICATIONS.

- ◆ Negative operating cash flow.
- ◆ Advance Key financial ratios.
- ◆ Withdrawal of financial support from creditor.
- ◆ Inability to pay creditors.

2) OPERATING INDICATIONS.

- ◆ Loss of a major market.
- ◆ Loss of key management without replacement.

3) OTHER

- ◆ Non-compliance with statutory requirements.

(In spite of these indications, the situation may improve further due to management's future plans. Auditor must ensure whether these plans are technically and economically viable)

AUDIT PROCEDURES WHEN CONDITIONS ARE IDENTIFIED

(Technique - Use the concept of RAP)

- ◆ Analysis of **cash flow, profit** and other relevant forecast with management.
- ◆ Analysis of **interim financial statements**.
- ◆ Analysis the **terms of loan agreements** and debentures.
- ◆ Reading **minutes** of the share holders meeting.
- ◆ **Inquiring** about entity's legal counsel.
- ◆ **Reviewing reports** of regulatory actions.

USE OF GOING CONCERN ASSUMPTIONS



6th Class - (SA - 299, 300, 600(Amendment), 610)

SA-299 (RESPONSIBILITY OF JOINT AUDITORS)

(In big insurance companies, two - three (firms carry the audit jointly))

CASE STUDY CAN COME FROM THIS SA.

Explain the areas where auditors are jointly responsible. **(5 marks)**

When audit work is not divided

In respect of decisions taken by all joint auditors concerning Nature, Extent, Timing of audit procedures to be performed.

In respect of matters brought to the Notice of joint auditors.

For examining whether financial statements comply with Disclosure requirements.

For ensuring Audit Report Complies with the relevant statute.

A

★ **Audit report format**

N

★ **Work not divided NET Notice**

D

★ **Disclosure Requirements**

- ◆ Relationship between Principle Auditor and Branch Auditor is not governed by SA 299.
- ◆ Relationship Among Joint Auditors.
- ◆ Each joint auditor is responsible only for the work allotted to him.
- ◆ Each joint auditor is entitled to assume that other joint auditors have carried out their part in accordance with generally accepted audit procedure. (SA)
- ◆ It is not necessary for a joint auditor to review the work of other auditors, **(This line can be added in case study answers) (Separate question in a big case study)**

REPORTING RESPONSIBILITIES (2 Marks)

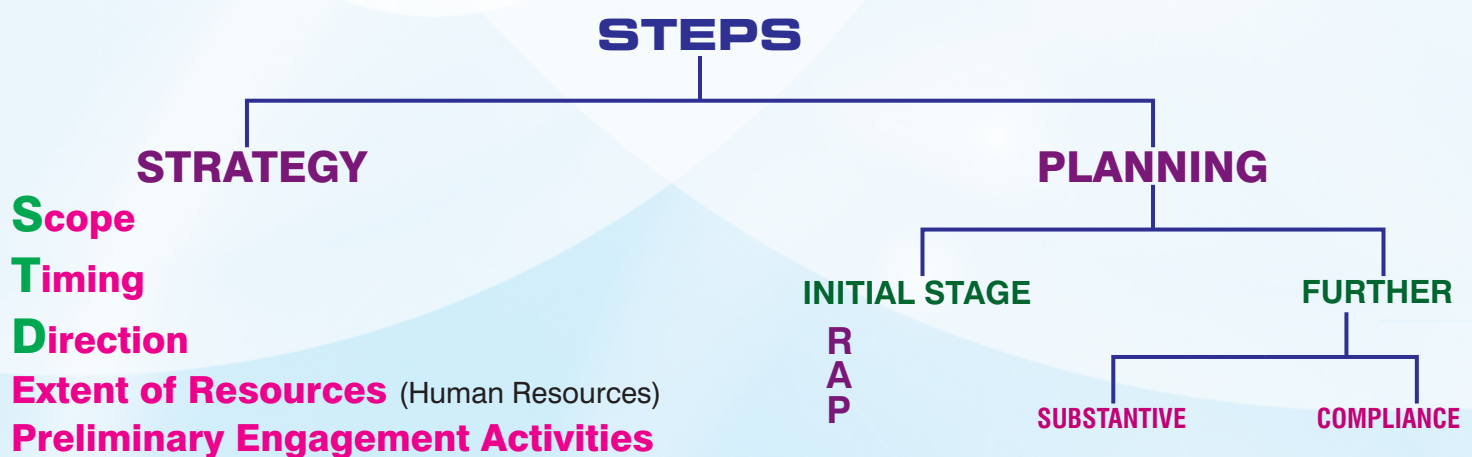
SA-300 (PLANNING AN AUDIT OF FINANCIAL STATEMENTS)

[Direct Short note form this zone]

Short note on Audit Panning

The Auditor should plan his work in order to conduct an **effective audit** in an **efficient and timely manner**.

Audit Planning should be based on **Knowledge** of **Client's business**.



◆ What do you mean by **PRELIMINARY ENGAGEMENT ACTIVITY** ??

(Direct Question)

- ◆ Auditor should undertake the following activities at the beginning of the current audit engagement

1. PROCEDURES REQUIRED BY SA 220

He'll ensure that the firm follows quality control practices.)

2. INDEPENDENCE (auditor should be unbiased)

3. TERMS OF ENGAGEMENT LETTER (auditor should understand its terms)

USE OF AUDIT PLANNING :-

- Work is completed in time.
- Work is Co-ordinated.
- Problems are promptly identified.
- Important areas are covered.

AUDIT PLAN IS MORE DETAILED THAN THE OVERALL AUDIT STRATEGY.

SA - 610 (USING THE WORK OF INTERNAL AUDITORS)

- ◆ **INTERNAL AUDIT** - sec 138 of companies Act makes internal audit compulsory for certain companies mentioned in the Law Book (Copy the figures from Black Company Law Book).

- ◆ **INTERNAL AUDIT** - Internal audit check whether other parts of internal Control are working properly or not Internal audit can be carried by CA, CS or CMA

CAN SA Rely on the work of IA ??

- ◆ **EXPLAIN THE FACTORS**

SA can rely on the work of IA after general & specific evaluations of the audit work in The following manner :-

Professional Care

Objectivity of internal audit

Effective Communication

Technical Competence

- ◆ **OBJECTIVITY DEPENDS ON**

Status of internal audit function.

Recommendations of internal auditor expected by the management.

Constraints / Restrictions placed on IA.

- ◆ **Internal Auditor reports to management and** Statutory Auditor reports to shareholders.
- ◆ **The scope of Statutory Auditor is determined by Companies Act and pronouncements of CA Institute while** the scope of internal auditing is determined by Management.
- ◆ Internal Audit is **Post mortem review** of transactions and systems of **Internal Control**, as it check that all other parts of Internal Control are operating effectively.

7th Class [SA - 580, 560, 540, 550, 710]

SA - 580 [WRITTEN REPRESENTATIONS]

- ◆ **Write a short note on WR**

- 1) **Written Representative (Statement)** is given **by management to the auditor** to confirm certain matters.
- 2) Management representations actions **can never be a substitute for audit evidence. An auditor has to cross check management representations with other evidence obtained.**
- 3) If management refuse to give representations to the auditor then the auditor will consider it as a **limitation on the scope of audit** and auditor would give a qualified report or disclaimer of opinion **as the case may be.] 2 marks in big case studies.**

- ◆ **Give case studies where WR is given :-**

- 1) **WR about compliance with all laws & regulations.**
- 2) **WR about related party transactions.**
- 3) **WR about adequacy of internal control system.**

- ◆ **Indirect Question (case study on SA 580)**

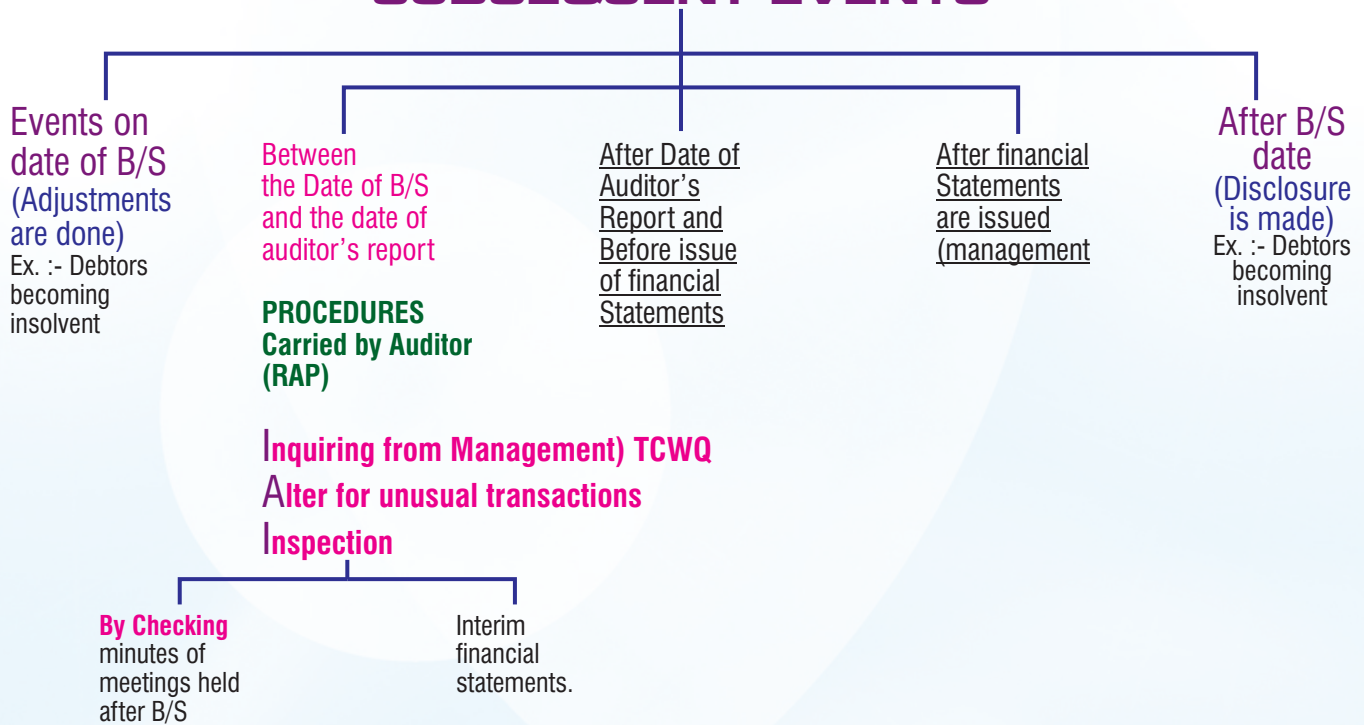
An auditor of Sagar Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of machinery as appearing in books of accounts. The auditor accepted the same without any further procedure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

Ans :- WR is not a substitute for other audit evidence.

SA - 560 [SUBSEQUENT EVENTS]

[Numericals done in a/cs would be asked in audit paper) + Direct theory.

SUBSEQUENT EVENTS



OBJECTIVES OF AUDITOR ON KNOWING SUCH EVENTS

- 1) Obtain appropriate audit evidence about the events that require adjustment / disclosure in financial statements, before date of auditor's report.
 - 2) Respond appropriately after the date of auditor's report.
- Ref. Q 5, 6, 7, 8 Case Studies in Pg - 150.

SA - 540 [Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related disclosures (Revised)]

◆ PROCEDURES PERFORMED TO IDENTIFY A/C. ESTIMATES ARE REASONABLE??

- 1) RAP procedures
- 2) Response

◆ If managements estimate and auditor's estimate are different then auditor request management to

1) make adjustment

2) if management refuse to make adjustments auditor would give a adverse qualified report

SA - 550 [RELATED PARTIES]

(In CA-Final, AS-18 Questions can be merged in audit)

RELATED PARTY TRANSACTIONS

Reliance Industries Ltd.



Auditor's Duty is to check whether **RP** Transaction are properly disclosed in the **Notes to Accounts or Not.**

PROCEDURES CARRIED OUT BY AUDITOR TO IDENTIFY RP TRANSACTIONS

- 1) **Inquiry** [Management, TCWG] [WR]
- 2) **Alert** [Unusual Transactions]
- 3) **Inspect** [Register, minutes IT return, working paper of previous years]

ARM S LENGTH. (Director Q. or Case Study)

Transaction is done on same terms and conditions as if is done with unrelated parties.

Ex. :- Same market price, same periods terms and condition.

AMENDMENT Auditor will inspect Register of Contracts in which directors are interested. Sec 189 of Companies Act 2013 - earlier it was known as 301 register.

SA - 710 [COMPARATIVES] [Direct Short Note only - 5 marks]

P/L					
Parties	C.Y.	P.Y.	Parties	C.Y.	P.Y.

B/S					
Liabilities	C.Y.	P.Y.	Assets	C.Y.	P.Y.

Note : Revise Concept of SRE, SRS, SAE from our material

AMIT BACHHAWAT TRAINING FORUM

SOME PAST UNCOMMON QUESTIONS IN STANDARD OF AUDITING

Q1. When should an Auditor consider Withdrawal from Engagement in case of fraud being identified by an Auditor?

Ans. Auditor Unable to Continue the Engagement

A. Exceptional circumstances:

- i. Entry does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances;
- ii. Auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; or
- iii. Auditor has significant concern about the competence or integrity of management or those charged with governance.

B. Determine professional & legal responsibilities & reporting to:

- i. Appointing authority.
- ii. Regulator.

C. May need legal advice.

D. Further, as per section 143(12) of the companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

Q2. As auditor comment on one following situation:

As an auditor of ABC Ltd you have asked your audit assistant to draw the audit programme. The assistant draw up the audit programme without going through the monthly report of the Internal Auditor on the plea that he is a Chartered Accountant and have found no serious irregularities and internal control system is running perfectly. (8 marks, May 2007)

Ans. The contention of the audit assistant is not valid and contrary to the view and guidelines given in SA 200.

According to SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing," the auditor shall plan and perform an audit **with professional skepticism** recognizing that circumstances may exist that cause the financial statements to be materially misstated. He shall **exercise professional judgment** in planning and performing an audit of financial statements. Professional skepticism **includes being alert** to, for example, audit evidence that contradicts other audit evidence obtained, conditions that may indicate possible fraud, circumstances that suggest the need for audit procedures in addition to those required by the SAs.

Professional skepticism is necessary to **the critical assessment of audit evidence** which includes questioning **contradictory** audit evidence, and the reliability of documents; and responses to inquiries, and other information obtained from management and those charged with governance.

The SAs require that the auditor **exercise professional judgment and maintain professional skepticism throughout the planning and performance** of the audit and, also identify and assess risks of material misstatement, whether due to fraud or error, based on an **understanding of the entity** and its environment, including the **entity's internal control**. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, **due to inherent limitations of internal control**.

In the given case, the Auditor has not exercised the professional judgment in planning and performing the audit of financial statements.

Merely accepting the soundness of the internal control violates the basic principles. The auditor will know whether the internal and related internal control is effective or not only after proper evaluation of Internal Control as per SA 315.

Q3. Mr. X a partner in X & Co. a firm of Chartered Accountants, died on 31-3-2010 after completing routine audit work of XYZ Company Ltd. Mr. Y another partner of the firm of chartered Accountants signed the financial statements of XYZ Company Ltd. Without reviewing the finalization work done by the assistants comment. (5 Marks) (Nov 2010)

Ans. 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, when the auditor's delegates work to assistants or uses work performed by other auditors/experts he will continue to be responsible for forming and expressing his opinion on the financial statements. However, he will be entitled to rely on the 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. The auditor should carefully directed by them. Supervise work performed by other auditors/experts and assistants are adequate for his purpose.

Conclusion: In the instant case, Mr. X a partner of the firm had completed routine audit work and died on 31 March, 2010. Mr. Y another partner of the firm has signed the financial statement of XYZ Company Ltd. without reviewing the finalization work done by the assistants. Mr. Y will be fully responsible for negligence, **he cannot take the shelter that Mr. X had done the work. Hence, Y has negligently performed his duties.**

Q4. As an auditor of a Limited Company, you observe that during the month of March.2009, sales invoices were not recorded in books of accounts, you also observe that payment of wages was much higher compared to last year. Keeping in mind the above, analyze possible ways of manipulation of accounts. (6 Marks, June 2009)

Ans. Such frauds are difficult to be detected as they are committed by persons holding position of trust. Such frauds are usually of the following nature:

- a. Recording fictitious sales or omission of sales.
- b. Recording fictitious purchases or suppression of purchases.
- c. Over valuation or under valuation of stock.
- d. Recording fictitious expenses or omission of expenses.
- e. Taking credit for accrued income not likely to be received or omission of income.
- f. Revenue expenses changed to capital and vice-versa.

Q5. What is Auditor's responsibility?

Ans.

1. An auditors conducting an audit in accordance with 5As is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error? As described in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with standards on Auditing", owing to the inherent limitations of an audit, there is an unavoidable k that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
2. The risk of not **detecting a material misstatement resulting from** fraud is higher than the risk of not detecting one resulting from error.
3. Furthermore, the risk of the auditor not **detecting a material misstatement resulting** from management fraud is greater than for employee fraud.
4. When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering an attitude of professional **skepticism** throughout the audit, considering the **potential for management override of controls** and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

It may be concluded from the above that detection of fraud and **error is not the duty of the auditor provided that he** complies with the requirements given in standards on auditing. Maintains professional skepticism throughout the audit and is not grossly negligent in the performance of his duties as an auditor.

Q6. State two financial statement level risks

Ans. The auditor's understanding of internal control may raise doubts about the auditability of an entity's financial statements. For example:

1. Concerns about the integrity of the entity's management may be so serious bas to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted.
2. Concerns about the condition and reliability of an entity's records may cause the auditor to conclude that it is unlikely that sufficient appropriate audit evidence will be available to support an unqualified opinion on the financial statements.

Q7. With reference of SA 250 give some examples or matters indicating to the auditor about non-compliance of laws & regulation by management. (8 Marks, November,2013)

- Ans.**
- a. Investigation by regulatory organization Government departments or payment of fines, additional taxes or penalties.
 - b. Payments for unspecified services or loans to consultants related parties, employees or Government employees.
 - c. Unusual payments in cash, purchases in the form of cashiers, cheques payable to bearer or transfers to numbered bank accounts.
 - d. Unusual payments towards legal and retainer ship fees.
 - e. Unusual transactions with companies registered in tax havens.
 - f. Adverse Media Comment.

Q8. How can management ensure compliance with relevant laws?

Ans. The following are procedures an entity may implement to **assist in the prevention and detection of non compliance** with laws and regulations-

- a) Monitoring legal **requirements** and ensuring that operating procedures are designed to meet these requirements.
- b) Instituting and operating **appropriate systems of internal control**.
- c) Developing publishing and **following a code of conduct**.
- d) Monitoring **compliance with the code of conduct** and acting appropriately to discipline employees who fall to comply with it.
- e) Engaging legal **advisors** to assist in monitoring legal requirements.
- f) Maintaining a **register of significant laws and regulations** with which the entity has to comply within its particulars industry and a record of complaints.
- g) Ensuring **employees are properly trained and understand** the code of conduct.

Q9. The auditor may exercise his judgment to identify which risks are significant risks. Explain the above context of SA-315. (6 Marks)

Detailed Explanation

Ans. In exercising judgment as to which risks are significant risks, the auditors shall consider the following:

- (a) Whether the risk is a **risk** of fraud;
- (b) Whether the risk is related to **recent Significant economic**, accounting, or other developments;
- (c) The **complexity** of transaction;
- (d) Whether the risk involves **significant transactions with related parties**;
- (e) The **degree of subjectivity** in the measurement of financial information; and
- (f) Whether the risk involves significant **unusual transactions**.

Q10. Explain the Inherent Risk with reference to the relevant Standards on Auditing.

Ans. Inherent Risk: Inherent risk is the **susceptibility of an account** balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

As per SA 330 "**The Auditor's Responses to Assessed Risks**", while designing the further **audit procedures to be performed**, the auditor shall consider the reasons for the assessment given to the risk of material misstatement at the assertion level for the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (**i.e., the inherent risks**) and obtain **more persuasive audit evidence the higher the auditor's** assessment of risk.

As per SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", **for this purpose, the auditor shall:**

- (i) **Identify** risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (ii) **Assess the identified risks**, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (iii) Relate the identified risks to what can go wrong **at the assertion level**, taking account of relevant controls that the auditor intends to test; and
- (iv) Consider the likelihood of misstatement, including the possibility of **multiple misstatements, and whether the** potential misstatement is of a magnitude that could result in a material misstatement.

Q11. Explain the factors to be considered for determining materiality

Ans. Factors to be considered for determining materiality

1. Item of materiality may be determined **individually** or in aggregate.
2. The materiality depends on the regulatory or **legal consideration**.
3. Materiality is not often reckoned with respect to quantitative details above. It has **qualitative dimensions** as well.
4. Even **insignificant items in terms of quality** may be material in special circumstances.
5. Sometimes the materiality of an item in terms of quantity is described in law itself, For example, Schedule III requires disclosure of items of expenditures which are in excess of **one percent of the revenue** from operations or **100000** whichever is higher.
6. An item whose impact is **insignificant** at present but in **future it may be significant**, may be material item.

Q12. Explain in concept of materiality and factors which act as guiding factors to this concept.(6 Marks, November, 2009)

Ans. Materiality

1. Involves use of professional judgment.
2. Starting point – a percentage often applied to a chosen benchmark.

Q13. Factors that may affect the identification of an appropriate benchmark

Ans. Factors for identification of benchmark

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