



COMPLEXITY

SIMPLIFIED

CA INTER AUDIT
May'24

QUESTION BANK

Chapter-1

Nature, Scope and Objective of Audit



PROF. VISHAL



Preface

Greetings students,

As the author of this question bank, I've taken a thoughtful approach to its construction, prioritizing a competitive spirit in your learning journey.

Correct / Incorrect Questions

The Correct and Incorrect questions/answers are intentionally not kept in sequential order. Why? To encourage analytical thinking without the comfort of knowing the topic heading in advance.

Dedication to Holistic Learning

My dedication to creating content knows no bounds. I've meticulously curated questions from over 20 years of ICAI materials, including Study Material Practice Questions, MTPs, RTPs, and Suggested Answers. The sequencing of chapter topics aligns seamlessly with the ICAI study material. For downloading Complete Question Bank click [here](#)

ADDITIONAL INFORMATION ABOUT COMPLETE QUESTION BANK

Insights from Examiner Comments

Moreover, the inclusion of examiner comments adds a unique dimension. Learning from the mistakes highlighted by ICAI examiners can significantly improve your understanding. This book is not just about questions and answers; it's a tool to help you comprehend common mistakes and guide you on how to avoid and rectify them.

Comprehensive Question Selection Strategy

I've gone a step further. Not only have I kept questions directly related to the current study material, but I've also included additional ones related to previous years with some relevance to the current context. These carry relevance, but I advise focusing on them only after thoroughly covering the main syllabus according to the current study material.

VIDEO LEARNING INITIATIVE



And here's an exciting initiative—I've started creating YouTube videos to help you understand any challenging question or topic. All you need to do is message us on WhatsApp or Telegram using the provided link at the bottom of the page, and I'll promptly create a video to address your request.

Closing Note: Embark on Your Learning Journey

So, dive into this question bank with enthusiasm, and remember, I'm here to support your learning journey every step of the way.

Best regards,
Prof. Vishal

If you require further assistance with your study techniques or any other aspect, don't hesitate to contact us.

You can instantly reach out via WhatsApp by clicking this icon,  or join our Telegram group  to pose questions that could also benefit your peers.



<h1>Chapter 1</h1>	<h1>Nature, Scope and Objective</h1>
------------------------	--

Part A – Correct Incorrect

Q1. State with reasons (in short) whether the following statements are True or False :	
1.	<p>The basic objective of audit does not change with reference to nature, size or form of an entity. (TYK (2 Marks, May, 2015; Nov 2017) (RTP IPCC May 17) (MTP Oct 2018, 2 Marks)</p> <p>Correct</p> <p>An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.</p>
2.	<p>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. (TYK)</p> <p>Correct</p> <p>As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.</p>
3.	<p>The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. (TYK (MTP May 2023) (RTP IPCC Nov 17)</p> <p>Correct:</p> <p>As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.</p>
4.	<p>The primary objective of an audit is to detect fraud and errors in Financial Statements. (RTP IPCC Nov 15) (2 Marks each, November, 2014)</p> <p>Incorrect</p> <p>Detection of fraud and errors in the financial statements is not the primary objective of audit. The primary objective of an audit is to obtain reasonable assurance about whether the financial statements are free from material misstatements thereby enabling the auditor to express an opinion on the financial statements.</p>
5.	<p>The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. (MTP-IPC April 2019, 2 Marks) (RTP May 2018, RTP May 2019-Inter New) (RTP IPCC Nov 18)</p> <p>Incorrect</p>



	<p>The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.</p>
6.	<p>Audit procedures used to gather audit evidence may be effective for detecting an intentional misstatement.</p> <p style="text-align: right;">(RTP IPCC Nov 18)</p> <p>Incorrect</p> <p>Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.</p>
7.	<p>The matter of difficulty, time, or cost involved is in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.</p> <p style="text-align: right;">(RTP IPCC Nov 2018)</p> <p>Incorrect</p> <p>The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.</p> <p>Examiner Comment: Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.</p>
8.	<p>The preparation of financial statements involves judgment by management.</p> <p style="text-align: right;">(Inter Audit MTP/ New/ Old. May 2022)</p> <p>Correct</p> <p>The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.</p>
9.	<p>Standards on Review Engagements (SREs) - to be applied in the audit of historical financial information.</p> <p style="text-align: right;">(RTP IPCC May 15) (RTP IPCC Nov 16)</p> <p>Incorrect</p> <p>Standards on Review Engagements (SREs) - to be applied in the review of historical financial information.</p>
10.	<p>There is no difference between "audit" and "review."</p> <p style="text-align: right;">(Inter RTP Nov. 2022)</p> <p>Incorrect:</p> <p>"Audit" and "Review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement</p>
11.	<p>Historical financial information relates to financial information based on assumptions about occurrence of future events and possible actions by an entity.</p> <p style="text-align: right;">(MTP Nov 2023) (Inter Sugg. Nov 2022)</p> <p>Incorrect</p> <p>Historical financial information relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods.</p>
12.	<p>According to Mr. H, one of the team members of the auditor of Very Essential Limited was of the view that no relation exists between accounting and auditing from the point of view of a company.</p> <p style="text-align: right;">(TYK)</p>

	<p>Incorrect</p> <p>The viewpoint of Mr. H is incorrect because there exists a proper relation between accounting and auditing from the point of view of a company. Audit is conducted for financial statements of a company and those financial statements are prepared with the help of books of accounts of that company. In order to properly conduct an audit of a company, an auditor is required to be aware of accounting principles and accounting policies of that company.</p>
13.	<p>For auditor's opinion, reasonable assurance is an absolute level of assurance. (RTP Nov.2023) (Inter RTP Nov. 2022) (2 Marks, May 2018)</p> <p>Incorrect</p> <p>Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.</p> <p>Examiner Comment : Many Examinees did not know about the difference between reasonable assurance and absolute assurance. They did not mention that reasonable assurance is a high level of assurance but not an absolute assurance because there are inherent limitations of audit.</p>
14.	<p>The objective of audit is to obtain absolute assurance and to report on the financial statements. (RTP May 2018)</p> <p>Incorrect</p> <p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <ol style="list-style-type: none"> To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.
15.	<p>The auditor is expected to and can reduce audit risk to zero. (MTP May 2020, 2 Marks)</p> <p style="text-align: center;">OR</p> <p>The objective of audit is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement. (MTP April 2019, 2 Marks)</p> <p style="text-align: center;">OR</p> <p>The Auditor is expected to reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. (2 Marks, MTP Oct.2022)</p> <p>Incorrect</p> <p>The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. In auditing, reasonable assurance can be given which is high level assurance but not absolute assurance. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.</p>
16.	<p>The principle of confidentiality precludes auditor to disclose the information about the client to a third party at all circumstances without any exception. (Old Course SM) (RTP IPCC Nov 14)</p> <p>False</p> <p>The principle of confidentiality is one of the basic principles of auditing. Auditor is generally not expected to divulge the information of his client to others. But it is not the case always. He can disclose the information to others if</p> <ol style="list-style-type: none"> permitted by his client and if he has to disclose it as per any statutory obligation dictated by any law.



Part B – Descriptive Questions

Meaning and nature of auditing

Q. 1 The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.

(RTP, May 2020) (RTP IPCC May 2020)

OR

“An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.” Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody.

(MTP Oct 2019, 4 Marks)

OR

An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. What the auditor is supposed to do to satisfy himself that nothing contained in the statements will mislead anybody?

(RTP IPCC Nov 15)

OR

Explain clearly meaning of Auditing. How would you as an auditor perform the audit.

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

Analysis of the Definition

- Audit is an independent examination of financial information.
- Independence, here, implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
- The auditor should be independent of entity whose financial statements are subject to audit so that he can form an opinion without being affected by any influence. Independence increases auditor’s ability to act objectively without creeping in of any biases.
- The entity whose financial information is examined need not necessarily be profit oriented like in case of a business. It can be a non-profit organization like an NGO or a charitable trust. Audit can be undertaken in respect of any organization be it a small, medium or large. Further, it can be conducted for any entity irrespective of its legal structure i.e. such an entity may be a proprietary concern, a partnership firm, a LLP, a private company, a public company, a society or a trust.
- The purpose of audit is to express an opinion on the financial statements.

In doing so, he has to see that financial statements would not mislead anybody by ensuring that: -

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





Interdisciplinary nature of auditing

<p>Q. 2</p>	<p>The field of auditing as a discipline in simple words involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. In this context, you are required to explain the relationship between auditing and accounting.</p> <p style="text-align: right;">(RTP IPCC Nov 15)</p>
<p>Relationship of Auditing with Diverse Subjects: Auditing is interdisciplinary in nature. It draws from diverse subjects including accountancy, law, behavioral science, statistics, economics and financial management and makes use of these subjects.</p> <p>Auditing and Accounting: Since audit financial statements is concerned with financial information, a sound knowledge of accounting principles is a fundamental requirement for an auditor of financial statements to conduct audit and express an opinion.</p>	
<p>Q. 3</p>	<p>Auditor is expected to be familiar with the overall economic environment in which his client is operating.” Discuss.</p> <p style="text-align: right;">(RTP IPCC May 15) (RTP IPCC Nov 16)</p>
<p>Relationship of Auditing with Diverse Subjects: (Intro copy from Q.2)</p> <p>Auditing and Economics: Knowledge of subject like economics helps auditor to be familiar with overall economic environment in which specific business is operating.</p>	
<p>Q. 4</p>	<p>Briefly explain the relationship between Auditing and Behavioral Science.</p> <p style="text-align: right;">(RTP IPCC May 12)</p> <p style="text-align: center;">OR</p> <p>The discipline of behavioral science is closely linked with the subject of auditing. Discuss.</p> <p style="text-align: right;">(RTP IPCC Nov 18) (5 Marks, Nov 2018)</p> <p style="text-align: center;">OR</p> <p>Discuss briefly relationship of Auditing with Behavioral Science.</p> <p style="text-align: right;">(RTP IPCC Nov 13)</p>
<p>Relationship of Auditing with Diverse Subjects: (Intro copy from Q.2)</p> <p>Auditing and Behavioral Science: During course of audit, auditor has to interact with lot of persons for seeking information and making inquiries. This can be done only if one has knowledge of human behavior.</p>	
<p>Q. 5</p>	<p>“The relationship between auditing and law is very close one.” Discuss.</p> <p style="text-align: right;">(MTP Oct 2019, 4 Marks) (RTP IPCC May 14)</p>
<p>Relationship of Auditing with Diverse Subjects: (Intro copy from Q.2)</p> <p>Auditing and law: Good knowledge of business laws and various taxation laws helps auditor to understand financial statements in a better way in accordance with applicable laws.</p>	
<p>Q. 6</p>	<p>Discipline of statistics and mathematics has come quite close to auditing” Explain.</p> <p style="text-align: right;">(RTP IPCC May 16)</p> <p>Auditing and Statistics & Mathematics: Auditors use statistical methods to draw samples in a scientific manner. It is not possible for an auditor to check each and every transaction. So, use of statistical methods to draw samples for conducting audit is made and mathematics for verification of inventories.</p>

Objectives of audit

<p>Q. 7</p>	<p>Explain the objectives of an Audit as per SA 200.</p> <p style="text-align: right;">(RTP, May 2020) (RTP IPCC May 2020)</p> <p style="text-align: center;">OR</p> <p>CA Jatin is the auditor of JP Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements. Explain w.r.t SA 200.</p> <p style="text-align: right;">(MTP MAY 2023)</p>
--------------------	---

	<p style="text-align: center;">OR</p> <p>Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2022-23, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives.</p> <p style="text-align: right;">(Inter RTP Nov 2023)</p>
	<p>A. As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <ol style="list-style-type: none"> a. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and b. To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. <p>B. An analysis of above brings out following points clearly:</p> <ul style="list-style-type: none"> ▪ Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance. ▪ Misstatements in financial statements can occur due to fraud or error or both. The Auditor has to see effect of misstatements on financial statements as a whole, in totality. ▪ Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. ▪ The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing <p>(FOR OR PART) - In the given case of JP Ltd, CA Jatin expressed his opinion on the financial statements of JP Ltd without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that CA Jatin did not comply with the objective of audit as stated in SA 200</p>
<p>Q. 8</p>	<p>The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements". Explain stating the objectives of audit as per SA 200.</p> <p style="text-align: right;">(RTP IPCC May 17) (RTP May) (RTP Nov 17)</p> <p style="text-align: center;">OR</p> <p>"The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.". Explain stating the objectives of audit as per SA 200.</p> <p style="text-align: right;">(RTP IPCC Nov 19)</p>
	<p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <p>Refer Q7 for objective (Refer Part A)</p> <p>The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers etc. Enhancing of degree of confidence is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.</p> <p>Applicable financial reporting framework means a framework adopted in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.</p>



Scope of audit

Q. 9 Explain the Scope Of an Audit? What points are included in scope of audit of financial statements?

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements,

Scope refers to range or reach of something. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.

Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers etc. Enhancing of degree of confidence is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Applicable financial reporting framework means a framework adopted in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The following points are included in scope of audit of financial statements : -

1. Coverage of all aspects of entity

Audit of F.St's should be organized adequately to cover all aspects of the entity relevant to the F.St's being audited.

2. Reliability and sufficiency of financial information

The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements. The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.

3. Proper disclosure of financial information

a. the auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard. It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

b. The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories. The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

Q. 10 Write a short note on Audit versus Investigation.

(Old Course SM)

OR

An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss.

(RTP May 2023)(Old Course SM)

- **Auditing versus Investigation:** As Per SA 200 "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- Investigation is critical examination of the accounts with a special purpose. For example, if fraud is suspected and an accountant is called upon to check the accounts to whether fraud really exists, it takes character of investigation.
- Investigation may be undertaken in numerous areas of accounts, e.g., the extent of waste and loss, profitability, cost of production etc. It extends scope beyond books of accounts.
- The objective of audit, on the other hand as we have already discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

	<ul style="list-style-type: none"> Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in the normal course of examination of the accounts adopting generally followed techniques unless circumstances call for a special probe. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation. Fraud, error, irregularity, whatever comes to the auditor's notice in the usual course of checking, are all looked into in depth and sometimes investigation results from the prima facie findings of the auditor. <p>As per sub section 12 of section 143 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.</p>
<p>Q. 11</p>	<p>"Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.</p> <p style="text-align: right;">(TYK)</p> <p>Choosing of appropriate accounting policies is responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management- Refer Q9 (Point 3(b)).</p>
<p>Q. 12</p>	<p>Distinguish between absolute and reasonable assurance. Identify the type of assurance that is expected in an audit of the financial statements, clearly outlining the reasons to justify your point of view.</p> <p style="text-align: right;">(Old Course SM) (6 Marks, May 2017) (RTP IPCC May 2019)</p> <ul style="list-style-type: none"> As per SA-200 overall objectives of the independent auditor, in conducting an audit of financial statements, one of the objectives of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance <p>Authors Note :</p> <ul style="list-style-type: none"> Absolute assurance is the highest level of assurance an auditor can give, if he check each and every transaction. Therefore, absolute assurance is the level of assurance that can only be given if the auditor does not perform sampling testing. However, it is not possible to give absolute assurance because of time and cost involved. Therefore, auditors give reasonable assurance. Reasonable assurance is less than absolute assurance As the basis for the auditor's opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive <p>Examiner Comment - Only few examinees attempted this question. Most of the examinees were not aware about the concept of reasonable assurance and absolute assurance.</p>



Inherent Limitations of audit

Q. 13	Discuss Limitations of audit. <p style="text-align: right;">(8 Marks, May, 2011) (6 Marks, May, 2015)</p> <p style="text-align: center;">OR</p> What are the inherent limitations of audit? <p style="text-align: right;">(8 Marks, Nov. 2005) (RTP IPCC Nov 14)</p> The process of auditing is such that it suffers from certain limitations, i.e., the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. Explain. <p style="text-align: center;">(RTP IPCC May 15) (RTP IPCC Nov 16) (RTP IPCC Nov13, Nov14, Nov16, Nov 17) (RTP IPCC Nov 19)</p> <p style="text-align: center;">OR</p> The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain <p style="text-align: center;">(RTP IPCC May 15, May16, nov17, RTP Nov 17, RTP Nov 18 – Inter New)</p> <p style="text-align: center;">OR</p> “The process of auditing is such that it suffers from certain limitations” Discuss. <p style="text-align: right;">(RTP IPCC May 16)</p> <p style="text-align: center;">OR</p> An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (Refer Point B) <p style="text-align: right;">(MTP Nov 2023) (TYK)</p>
-------	--

Inherent Limitations of Audit: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error.

These fundamental limitations arise due to the following factors:

a. The Nature of Financial Reporting:

Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty.

Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

b. The Nature of Audit Procedures:

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

1. An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.
2. Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence
3. The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.
4. An auditor may be led to accept invalid audit evidence on the basis of unauthentic documents.
5. It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions

	<p>c. Not in nature of investigation</p> <p>Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors</p> <p>d. Timeliness of financial reporting and decrease in relevance of information over time:</p> <p>The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it. Consider, for example, an auditor who is conducting audit of a company since last two years.</p> <p>During these two years, he has sought detailed information from management of company regarding various matters. During his third year stint, he chooses to rely upon some information obtained as part of audit procedures of second year. However, it could be possible that something new has happened and that information is not relevant. So, the information being relied upon by auditor is not timely and may have lost its reliability</p> <p>e. Future events</p> <p>Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.</p> <p>Therefore, it is in view of above factors, that an auditor cannot provide a guarantee that financial statements are free from material misstatements due to frauds or errors</p>
Q. 14	<p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples. (RTP Nov.2023)</p> <p style="text-align: center;">OR</p> <p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation. (RTP Nov 2022) (Inter Audit RTP/ New/ Old Nov. 2021) (MTP Oct 2020, 3 Marks) (RTP, May 2020) (RTP IPCC May 2020) (RTP Nov 2023)</p> <p>The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example - Refer Q 13 (Point. b)</p>
Q. 15	<p>Future events or conditions may affect an entity adversely. Explain. (RTP, May 2020) (RTP IPCC May 2020)</p> <p>Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events</p> <p>Therefore, it is in view of above factors, that an auditor cannot provide a guarantee that financial statements are free from material misstatements due to frauds or errors.</p>
Q. 16	<p>The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain. (RTP IPCC May 18)</p> <p style="text-align: center;">OR</p> <p>The auditor has to form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Explain the above statement with reference to "Timeliness of Financial Reporting and decrease in relevance of information over time. (Inter Audit MTP/ New/ Old. April 2022) (4 Marks)</p> <p style="text-align: center;">OR</p> <p>The relevance of information decreases over time and auditor cannot verify each and every matter. Explain. Timeliness of Financial Reporting and decrease in relevance of information over time: Refer Q 13 (Pt. D)</p>



Q. 17	A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement <p style="text-align: right;">(TYU)</p>
	<p>It is not a reasonable assurance engagement. It is in nature of investigation. Assurance Engagement is an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria.</p> <p>Reasonably, insurance requires a high, but absolutely Assurance.</p> <p>In this case, a chartered accountant is specifically asked to check accounts whether fraud exists</p>
Q. 18	Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct? <p style="text-align: right;">(TYU)</p>
	<p>An audit does not provide assurance to investor in shares regarding safety of his money. Share prices of securities are affected by range of factors. An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. Hence, thinking of Lalji Bhai is not correct.</p>
Q. 19	Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit? <p style="text-align: right;">(TYU)</p>
	<p>Proper disclosure of financial information is well within scope of audit. Refer Q9(Point 1, 2, 3)</p>
Q. 20	A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report? <p style="text-align: right;">(TYU)</p>
	<p>Appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. It is an investigation and not in nature of audit report</p>

Benefits of audit

Q. 21	What is the importance of having the accounts audited by an independent auditor? <p style="text-align: right;">(RTP IPCC Nov 13) (5 Marks, May, 2008)</p> <p style="text-align: center;">OR</p> What are the advantages of an independent audit? <p style="text-align: right;">(8 Marks, May, 2012), (5 Marks, May 15)</p> <p style="text-align: center;">OR</p> “Having accounts audited by independent auditor, among other advantages, acts as a moral check on the employees from committing fraud.” Explain stating the advantages of independent audit.
--------------	--

(RTP IPCC Nov 13, May 15, Nov 15) (RTP IPCC Nov 16)

OR

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit.

Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain.

(RTP, Nov 17) (RTP Nov, 18 – Inter New)

OR

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Explain stating the advantages of independent audit.

(RTP IPCC May 19)

OR

PACE is proprietorship firm of Mr Abhinav engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 50 crores. It has also availed cash credit limit of Rs. 5 crores from Axis Bank.

OR

In the year 2017-18, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches CA Mahesh about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited.

(MTP Oct-New 2018, 5 Marks)

OR

RAG is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 5 crores from Canara Bank. In the year 2017-18, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited.

(MTP March 2018, 5 Marks)

Benefits Of Audit

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





To whom report is submitted by an auditor

Q. 22	<p>Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise.</p> <p>An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm. However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with accountant through banking channel.</p> <p>The partners of firm blame auditors for futile audit exercise. Are partners of firm correct in their view point? Imagine any probable reason for such a situation.</p>
	(TYU)

Inherent Limitations of Audit: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error.

It is example of failure of internal controls of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls. This is an inherent limitation of audit.

Elements of an Assurance Engagement

Q. 23	<p>An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement.</p>
	(TYK)

Elements of an assurance engagement

- Three Party relationship
- An appropriate subject matter
- Suitable Criteria
- Sufficient appropriate evidence.
- Written assurance report in appropriate form

Q. 24	<p>Assurance engagements are not restricted to audit of financial statements alone. Discuss.</p>
	(TYK)

Example of assurance engagement	Type of assurance engagement
Audit of financial statements	Reasonable assurance engagement
Review of financial statements.	Limited assurance engagement
Examination of Prospective financial information	Provides assurance regarding reasonability of assumptions forming basis of projections and related matters
Report on controls operating at an organization	Provides assurance regarding design and operation of controls

Q. 25	<p>The management of Exotic Tours and Travels Limited requests its auditor Raja & Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures. Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?</p>
	(TYU)

	<p>Raja & co. can provide a review report in this case. Review is a limited assurance engagement and involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusion can be drawn up.</p> <p>Hence Raja & co. can provide a report as required by management of Exotic Tours and Travels Limited. Such report would be in nature of "Review".</p> <p>However, auditors would have to obtain sufficient appropriate evidence based on the limited procedures performed.</p>
--	---

Qualities of auditor

Q. 26	<p>State briefly the qualities of Auditors. (4 Marks, November, 2004) (RTP IPCC May 13)</p> <p style="text-align: center;">OR</p> <p>All those personal qualities required to make a good person contribute to the making of a good auditor. Explain stating the qualities of an Auditor. (RTP IPCC NOV 17)</p> <p style="text-align: center;">OR</p> <p>"The auditor should possess specific knowledge of accountancy, auditing, taxation, etc. which are acquired by him during the course of his theoretical education". Explain stating briefly the qualities of Auditors. (MTP Oct 2018, 6 Marks)</p> <p style="text-align: center;">OR</p> <p>"All those personal qualities that go to make a good businessman contribute to the making of a good auditor." Explain. (RTP IPCC Nov 15)</p> <p style="text-align: center;">OR</p> <p>Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating also the qualities of Auditor. (RTP May 2019)</p>
	<p>Qualities of an Auditor:</p> <p>An auditor is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent.</p> <ul style="list-style-type: none"> ▪ Personal Qualities: Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability are some of qualities which an auditor should have. <p>In short, all those personal qualities required to make a good businessman contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height.</p> <ul style="list-style-type: none"> ▪ Integrity: He must have the highest degree of integrity backed by adequate independence. ▪ Professional Knowledge: The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education. <p>He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert.</p> <p>An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.</p>
Q. 27	<p>In terms of the Revised Preface, the Auditing and Assurance Standards are now renamed based on the type of assurance provided by the engagement undertaken by a member." Discuss.</p> <p style="text-align: center;">OR</p> <p>State the Standards issued by AASB which are collectively known as engagement standards. Explain with Examples. (4 Marks, May 2013) (RTP IPCC May 14) (RTP IPCC May 19)</p> <p style="text-align: center;">OR</p> <p>Discuss "Standards collectively known as the Engagements Standards issued by AASB under the authority of the council of ICAI". (5 Marks, May, 2012), (4 Marks, Nov 2015)</p>



The following Standards issued under authority of ICAI Council are collectively known as Engagement Standards: -

1. Standards on auditing (SAs) which apply in audit of historical financial information.
2. Standards on review engagements (SREs) which apply in review of historical financial information.
3. Standards on Assurance engagements (SAEs) which apply in assurance engagements other than audits and review of historical financial information.
4. Standards on Related Services (SRSs) which apply in agreed upon procedures to information, compilation engagements and other related service engagements.

The purpose of issue of these standards is to establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services.

▪ **Some examples of Standards on Auditing are:**

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

▪ **Examples of Standards on Review engagements are**

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

▪ **Examples of Standards on Assurance Engagements are:**

- i. SAE 3400 The Examination of Prospective Financial Information
- ii. SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

▪ **Examples of Standards on related services are:**

- i. SRS 4400 Engagements to perform agreed-upon procedures regarding financial information.
- ii. SRS 4410 (Revised) Compilation engagements

Q. 28 CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing. Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

(TYU)

It is the duty of professional accountants to see the standards are followed in engagement undertaken by them.

However, a situation may arise when a specific procedure, as required in standard, would be ineffectuated in a particular engagement. In such a case, professional accountant is required to ensure the following:

- a. Document how alternative procedure performed to achieve the purpose of required procedure. Next slide.
- b. Reason for departure has also to be documented.
- c. Reports should draw attention to such departures

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

Questions (related to Standards not in Module)

Q. 29	<p>Explain the term "Applicable Financial Reporting framework" in context of the relevant Standard on Auditing. (RTP IPCC Nov 11)</p> <p>Applicable financial reporting framework</p> <p>As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.</p> <p>The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:</p> <ol style="list-style-type: none"> 1. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or 2. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances. <p>The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.</p>
Q. 30	<p>Professional judgment is essential to the proper conduct of an audit." Discuss the statement in terms of Standard on Auditing 200. (RTP IPCC NOV 15)</p> <p style="text-align: center;">OR</p> <p>"Professional judgment is essential to the proper conduct of an audit." Discuss. (MTP Oct 2020, 3 Marks)</p> <p>Professional Judgment: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional judgment is essential to the proper conduct of an audit.</p> <p>This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about-</p> <p>The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.</p> <p>The Auditor shall Exercise Professional Judgment in planning and performing an audit of Financial Statements. Professional Judgment is necessary regarding decisions about -</p> <ol style="list-style-type: none"> 1. Materiality and audit risk. 2. The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence. 3. Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor. 4. The evaluation of management's judgments in applying the entity's applicable financial reporting framework. 5. The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.



Miscellaneous

Q. 31	<p>As an auditor how would you react to the following situations/comments?</p> <p>Director (Finance) of KK Ltd. informed their newly appointed statutory auditor that they have sound Internal control system implemented by a renowned professional firm and he is satisfied with its effectiveness and functioning and therefore, the statutory auditor should concentrate on verifying only the routine books and financial statements.</p> <p style="text-align: right;">(8 Marks, May, 2008)</p>
	<p>As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing",</p> <p>The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general-purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. The scope of an audit of financial statements will be determined by the auditor for having regard to the terms of the engagement, the requirement 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. The report of the auditor is based on his examination of financial statements and the underlying documents and evidences. It is for the auditor to decide based on his evaluation of the internal control as to its existence and effectiveness. The nature, timing and extent of audit procedure are based on such evaluation. In the instant case, management has no right to guide and place any restriction on the work of the auditor as it would amount to restriction on the scope of the audit. The auditor should ask the management not to impose such restriction on his scope of the audit that impairs his ability to examine and express an opinion and if the management does not agree, he should issue a qualified opinion or disclaimer, as appropriate.</p>
Q. 32	<p>"Generally, an audit is not concerned with the propriety of business conduct".</p> <p>The objective of an audit of financial statements of an enterprise is to enable an auditor to express an opinion as to the truthfulness and fairness of financial statements. The auditor's opinion helps to establish reliability of the financial statements. The auditors, however, does not give opinion on the propriety of business conduct or its future prospects. SA 200 (revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" has specifically pointed out that the user of the financial statements should not assume that the auditor's opinion is an assurance as to future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise. In pursuance of the role of the auditor in lending credibility to the financial statements the Companies Act, 2013, has provided that he should be concerned about propriety of some specific transactions. Section 227(1A) of the Act requires the auditor to enquire into six specified matters and report by exception. This section has been inserted into the Act to ensure that the funds of the company have not been siphoned off by the directors. Also under CARO, 2003 issued by the Central Government in pursuance of powers given to it by Section 227 (4A) of the Companies Act, 1956, the company auditor is required to examine the financial propriety of some transactions. Further, SA 570, "Going Concern" requires the auditors to evaluate whether the going concern concept is applicable to the circumstances of the entity and whether it will continue for a foreseeable future i.e., a period not exceeding one year after balance sheet. In other words, future viability for one year is to be assessed. To conclude, we can say that though, generally, an audit is neither concerned with propriety of business conduct nor its future viability yet the auditor would be required to examine the former for the purposes of Section 227(1A) and Section 227(4A) of the Act and the latter for assessing applicability of going concern assumption as per the requirements of SA 570, "Going Concern".</p>

Q. 33

“Doing a statutory audit is full of risk’. Narrate the factors which cause the risk.

(RTP IPCC May 16)

Factors Causing Risk Under Statutory Audit: As Per SA 200 “Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing”, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

In the case of most general-purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

An independent audit whether performed in terms of applicable financial reporting framework or in terms of the engagement, the auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements. Since the entire process of auditing is based on the assessment of judgements made by the management of the entity as well as evaluation of internal controls, the audit suffers certain inherent risks.

Factors which may cause such risk in conducting an audit are discussed below-

1. **Exercising judgement on the part of the auditor:** The auditor’s work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements.
2. **Nature of audit evidence:** Much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The auditor normally relies upon persuasive evidence rather than conclusive evidence. Even in circumstances where conclusive evidence is available, the cost of obtaining such an evidence may far exceed the benefits.
3. **Inherent limitations of internal control:** Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.

On account of above, it is quite clear that an audit suffers from control risk on account of inherent limitations of internal control and detection risk on account of test nature of audit and judgement and estimates involved in formulating accounting policies.

Alternate answer

The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement (RMM) and detection risk. RMM comprises of Inherent Risk and Control risk. Various factors which causes different types of risks are given below:

1. **Inherent Risk:** Inherent risk arises on account of nature of financial reporting & auditing. Entire process of auditing is based on the assessment of judgments made by the management of the entity as well as evaluation of internal controls.
2. **Control Risk:** Control Risk arises on account of Inherent limitations of internal control. Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.
3. **Detection Risk:** Detection risk arises on account of judgment on part of auditor, test nature of audit and nature of audit evidences collected. The auditor’s work involves exercise of judgment in many areas like deciding the extent of audit procedures and assessing the reasonableness of the judgments and estimates made by management in preparing the financial statements. The auditor normally relies upon persuasive evidence rather than conclusive evidence. Even in circumstances where conclusive evidence is available, the cost of obtaining such an evidence may far exceed the benefits.

Q. 34

“The independent audit of an entity’s financial statements is a vital service to investors, trade payables, and other participants in economic exchange”. Explain.



Auditing along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession.

▪ **Owners**

No business or institution can effectively carry on its activities without the help of proper records and accounts, since transactions take place at different of time with numerous persons and entities.

The effect of all transactions has to be recorded and suitably analysed to see the results as regards the business as a whole.

Periodical statements of account are drawn up to measure the success of whole. Periodical statements of account are drawn up to measure the success or failure of the activities in achieving the objective of the organization.

This would be impossible without a systematic record of transactions.

▪ **Management**

Financial statements are often the basis for decision making by the management and for corrective action so as to even closing down the organization or a part of it.

All this would be possible only if the statements are reliable; decisions based on wrong accounting statements may prove very harmful or even fatal to the business.

For example, if the business has really earned a profit but because of wrong accounting, the annual accounts show a loss, the proprietor may take the decision to sell the business at a loss.

Thus from the point of view of the management itself, authenticity of financial statements is essential.

▪ **Investors**

It is more essential for those who have invested their money in the business but cannot take part in its management, for example, shareholders in a company, such persons certainly need an assurance that the annual statements of accounts sent to them are fully reliable. It is auditing which ensures that the accounting statements are authentic

In today's economic environment, information and accountability have assumed a larger role than ever before. As a result, the independent audit of an entity's financial statements is a vital service to investors, trade payable, and other participants in economic exchange

Q. 35 **In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.**
(RTP, Nov.2023) (RTP, May 2020) (RTP IPCC May 2020)

Other Matters that Affect the Limitations of an Audit: In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

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

International Auditing and Assurance Standards Board (IAASB)

Q. 36 **The IAASB functions as an independent standard-setting body under the auspices of IFAC. Explain stating the objective of IAASB and also how it achieves those objectives.**
(RTP, May 2019)

OR

The objective of the IAASB is to serve the public interest by setting high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. Advise how this objective would be accomplished.

(MTP March 2018, 5 Marks) (MTP March 2019, 4 Marks)

Objectives of International Auditing and Assurance Standards Board: The International Federation of Accountants (IFAC) was set up in 1977 with a view to bringing harmony in the profession of accountancy on an international scale.

In pursuing this mission, the IFAC Board has established the IAASB to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world.

The IFAC Board has determined that designation of the IAASB as the responsible body, under its own authority and within its stated terms of reference, best serves the public interest in achieving this aspect of its mission.

The IAASB functions as an independent standard-setting body under the auspices of IFAC. The objective of the IAASB is to serve the public interest by setting high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB achieves this objective by:

- Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators and other key stakeholders across the world;
- Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters;
- Establishing high quality standards and guidance for other related services;
- Establishing high quality standards for quality control covering the scope of services addressed by the IAASB; and
- Publishing other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of professional auditors and assurance service providers.

Compliance with Documents Issued by the Institute

Q. 37 Discuss the following: "Statements" and "Guidance Notes" of ICAI- whether mandatory or recommendatory?

(RTP IPCC NOV 18)

1. **Statements:** The 'Statements' have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions.
'Statements' therefore are **mandatory**.
Accordingly, while discharging their attest function, it will be the duty of the members of the Institute to ensure that statements are followed and complied with.
 - to examine whether 'Statements' relating to accounting matters are complied with in the presentation of financial statements covered by their audit.
In the event of any deviation from the 'Statements', it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and
 - to ensure that the 'Statements' relating to auditing matters are followed in the audit of financial information covered by their audit reports. If, for any reason, a member has not been able to perform an audit in accordance with such 'Statements', his report should draw attention to the material departures, therefrom.
2. **Guidance Notes:** 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are **recommendatory** in nature.
A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.
Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.
There are, however a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.





LIVE

FOR CA STUDENTS

Get in-depth guides on preparation strategies, innovation, and tips for success in CA exams.

STRATEGY WEBINAR



PROF. VISHAL
CA INTER/ FINAL AUDIT TEACHER



To stay updated about the upcoming webinar

Subscribe to our email newsletter Join our Telegram group

NEW
SCHEME MAY'24

Nishchay A **REGULAR** AUDIT BATCH

CA INTER
VIDEO COURSE



[CLICK HERE TO EXPLORE](#)

Language - English / Hinglish Unlimited Views 2/3 Device Access
Validity- 15 Months (share with your friend / Buy with your Friend)



AUDIT MADE EASY

1 KEYWORD = 1 TOPIC LEARNT

WANNA KNOW HOW?

WATCH THE DEMO LECTURE

FASTRACK COURSE
EKALAVYA

Free

*MINIMAL ADMINISTRATIVE CHARGES APPLY

JUST 1 KEYWORD?



NEW
SCHEME MAY'24




Ekalavya

CA INTER AUDIT

REGULAR
VIDEO COURSE

AVAIL AT
FREE OF COST
Click HERE
for details



Language - English / Hinglish Unlimited Views 2/3 Device Access
Validity- 15 Months (share with your friend / Buy with your Friend) PROF. VISHAL

NEW
SCHEME MAY'24




CHAKRAVYUH

FAST TRACK / EXAM ORIENTED

CA INTER AUDIT

VIDEO COURSE

CLICK HERE TO
EXPLORE



Language - English / Hinglish Unlimited Views 2/3 Device Access
Validity- 15 Months (share with your friend / Buy with your Friend) **AUDIT ALCHEMY** PROF. VISHAL

NEW
SCHEME MAY'24




Ekalavya

CA INTER AUDIT

FAST TRACK / EXAM ORIENTED
VIDEO COURSE

AVAIL AT
FREE OF COST
Click HERE
for details



Language - English / Hinglish Unlimited Views 2/3 Device Access
Validity- 15 Months (share with your friend / Buy with your Friend) PROF. VISHAL

MAY'24




KAVACH

AN EXAM ORIENTED
AUDIT BATCH

CA INTER VIDEO COURSE

25 HOURS | 4-5 DAYS

CLICK HERE TO
EXPLORE



Language - English / Hinglish Unlimited Views 2/3 Device Access
 (share with your friend / Buy with your Friend) PROF. VISHAL



WhatsApp Chat

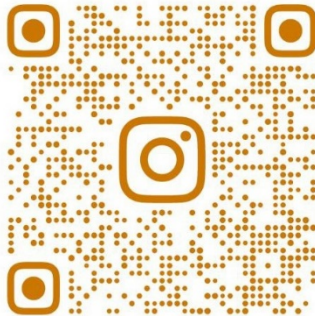


Telegram Chat



Instagram Pages

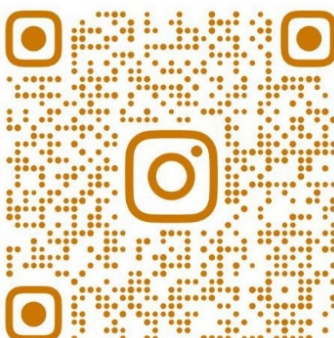
Ca Motivation



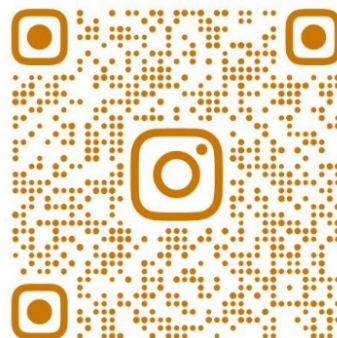
Audit Alchemy



CA in ME



Study Tips



Telegram

Telegram Discussion Group



Telegram Channel



Scan to get Connected with us.