CASE TUDIES

Q1. While auditing Z Ltd., you observe certain material FS assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?
Hint Ans: Refer SA 540

Q2. The management of S Ltd. requests you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an appropriate response?
Hint Ans: Refer SA 505

Q3. The audit report of P Ltd. for the year 2008-09 contained a qualification regarding non- provision of doubtful debts. As the statutory auditor of the company for the year 2009-10, how would you report, if?
(a) The company does not make provision for doubtful debts in 2008-09?
(b) The company makes adequate provision for doubtful debts in 2008-09? Hint Ans: Refer SA 710
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.

Q4. The directors of C Ltd. are concerned about the reliability and usefulness of the monthly financial management information that they receive. As a result, the company's auditors have been engaged to review the system and the information it generates, and to report their conclusions.
(a) What an ordinary procedure includes for the review of FS?
(b) Contrast this assignment with the statutory audit of the company's financial statements with regard to the scope of the assignment and to the report issued.
Hint Ans: (a) Refer SRE 2400
(b) Contrast of a review assignment with the statutory audit of the company's FS with regard to the scope of the assignment and to the report issued is hereunder:

SCOPE	
Review assignment	Statutory audit
Scope of Review assignments are generally falls in agreement between parties	Scope of Statutory audit should be in accordance with the Companies Act, 1956 or in accordance with other statute.
Scope of Review assignments is restricted to instructions	Scope of Statutory audit should be in accordance with Audit Regulations and Norms
Review assignment should be done in accordance with SREs	Statutory audit should be conducted in accordance with SAs, 14 Statements and Guidance Notes etc

REPORT	
Review assignment	Statutory audit
Report of Review Assignment is addressed to the board	Statutory Audit Report is addressed to the members
Format of Report of Review assignment is wholly discretionary	Statutory Audit Report is on true and fair view and as per prescribed format.
Report of Review Assignment is private report	Statutory Audit Reports are in public domain

Q5. You are appointed statutory auditor of X Ltd. X Ltd. has an internal audit system and reports for the same are given to you. Mention the factors you will consider to ensure that the said system of internal audit of X Ltd. is commensurate with the size of the company and nature of its business.
Hint Ans: Refer "SA 610"

Q6. You are an audit senior working for the firm Kala & Company. You are currently carrying out the audit of W Ltd., a manufacturer of waste paper bins. You are unhappy with W Ltd.'s inventory valuation policy and have raised the issue several times with the audit manager. He has dealt with the client for a number of years and does not see what you are making a fuss about. He has refused to meet you on site to discuss these issues. The former engagement partner to W Ltd. retired two months ago. As the audit manager had dealt with W Ltd. for so many years, the other partners have decided to leave the audit of W Ltd. in his capable hands. Comment on the situation outlines above.
Hint Ans: Refer SA 220

Q7. While commencing the statutory audit of B Company Limited, the auditor undertook the risk assessment and found that the detection risk relating to certain class of transactions cannot be reduced to acceptance level.
Hint Ans: SA 315 and SA 330 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and "The Auditor's Responses to Assessed Risks" establishes standards on the procedures to be followed to obtain an understanding of the accounting and IC systems and on audit risk and its components: inherent risk, control risk and detection risk. SA 315 and SA 330 require that the auditor should use professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. "Detection risk" is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material. The higher the assessment of inherent and control risks, the more audit evidence the auditor should obtain from the performance of substantive procedures. When both inherent and control risks are assessed as high, the auditor needs to consider whether substantive procedures can provide sufficient appropriate audit evidence to reduce detection risk, and therefore audit risk, to an acceptably low level. The auditor should use his professional judgement to assess audit risk and to design audit procedures to ensure that it is reduced to an acceptably low level. If it cannot be reduced to an acceptable level, the auditor should express a qualified opinion or a disclaimer of opinion as may be appropriate.

Q8. While auditing accounts of a public limited company for the year ended 31st March 2011, an auditor found out an error in the valuation of inventory, which affects the FS materially – Comment as per standards on auditing.
Hint Ans. Refer SA 240

Q9. At the statutory audit of TOR Limited, the physical verification of fixed assets was conducted. However the auditor was not able to confirm the existence of valuables and important machinery. In this connection, the auditor obtained a certificate from the management to prove its existence and value and accepted the same blindly without any further procedures.
Hint Ans: The physical verification of fixed assets is the primary responsibility of the management. The auditor, however, is required to examine the verification programme. Further, he must satisfy himself about the existence, ownership, procession and valuation of fixed assets. It appears from the facts of the case that the auditor has not been able to verify either existence or valuation of significant fixed assets despite conducting physical verification audit procedure himself. Ultimately, he accepted the certificate from the management without performing further procedures. As per SA 580 (Revised), "Written Representations", representation by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. Thus, a representation by management as to the existence of valuables and machinery is no substitute for adopting normal audit procedures regarding verification of valuable and important machinery. If the auditor is unable to obtain sufficient appropriate audit evidence that he believes will be available, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter and the auditor may express a disclaimer of opinion.

Q10. In the course of the audit of R Ltd., the audit manager of ABC & Co. observed that R Ltd. has outsourced certain activities to an outsourcing agency. As the engagement partner guide the audit manager in the assessment of services provided by the outsourcing agency in relation to the audit.
Hint Ans: Refer SA 402

Q11. In the course of audit of T Ltd., the audit team is not sure of the possible source of misstatements in the FS. As the audit manager identify the sources of misstatements.
Hint Ans: Refer SA 450
Q12. The teeming & lading fraud was detected and the amount involved was subsequently deposited by the Executive Director of the company & therefore, need not be reported upon. Hint Ans: It will be necessary for the auditor to bring to the notice of the shareholders about the teeming and lading fraud since the same had been committed by the Executive Director. Such an event shows that the internal control systems are quite weak in the organization and the top management is in a position to abuse its authority. The mere fact that no loss to the company has occurred would not preclude the auditor from bringing it to the notice of the shareholders. A suitable disclosure is called for, particularly, in view of the fact that the fraud has been committed by the Executive Director. Even SA-240 (Revised) on Auditors responsibilities relating to the fraud in an audit of FS require specifically, if the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or may be the result of fraud and that management is involved, the auditor shall re-evaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the NTE of audit procedures to respond to the assessed risks. The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.
Conclusion: Thus, the auditor should also consider the implications of the circumstances on the true and fair view which the FS ought to convey and frame his report accordingly.
[Note: The question does not specify the amount of money involve. Therefore, it is difficult to apply the criterion of materiality.]

Q13. "Auditor's assessment of materiality may be different at the time of planning the engagement than at the time of evaluating the results of his audit procedures". Discuss.
HintAns: SA 320 on "Materiality in Planning and Performing an Audit" recommends that the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the FS and in forming the opinion in the auditor's report. SA 450 "Evaluation of Misstatements Identified during the Audit", explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the FS. While formulating an overall audit plan, SA 300 (Revised) on "Planning an Audit of FS" also requires the auditor to consider the setting of materiality levels for audit purpose right from the initial stages and throughout the process of conducting the audit till the audit opinions is formulated. However, the auditor's assessment of materiality may be different at the time of initially planning the engagement than at the time of evaluating the results of his audit procedures. Since audit materiality related to specific amount balances and classes of transactions, helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk. Such selection of audit procedures would undergo a change as audit work progress. The assessment of materiality and audit risk the stage of evaluating the results of audit procedures would also change because of a change in circumstances or a change in the auditor's knowledge as results of audit. For example, if the audit is planned prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally the auditor may, in planning the audit work, intentionally set the acceptable cut-off level for verifying individual transactions at a lower level than is intended to be used to evaluate the results of the audit. This may be done to cover a larger number of items and thereby reduce the likelihood of undiscovered misstatements and to provide the auditor with the major of safety when evaluating the effect of misstatements discovered during the audit.

QUESTIONS

Q1. Comment on the following:
(a) You are the auditor of Easy Communications Ltd. for the year 2007–08. The inventory as at the yearend i.e. 31.3.08 was Rs. 2.25 crores. Due to unavoidable circumstances, you could not be present at time of annual physical verification. Under the above circumstances

how would you ensure that the physical verification conducted by the management was in order? (5 Marks) (Nov 2008)
(b) You have been appointed as auditor of Good Health Ltd. for 2007-08 which was audited by CA Trustworthy in 2006-07. As the Auditor of company state the steps you would take to ensure that the Closing Balances of 2006-07 have been brought to account in 2007-08 as Opening Balances & Opening Balances do not contain misstatements.(5 Marks) (Nov 2008)

Q2. Short notes on Frauds through supplier ledger (4 Marks) (Nov 2008 & May 2011)

Q3. (a) In the course of the audit of R Ltd., the audit manager of ABC & Co. observed that R Ltd. has outsourced certain activities to an outsourcing agency. As the engagement partner guide the audit manager in the assessment of services provided by the outsourcing agency in relation to the audit. (4 Marks) (May 2011)
(b) In the course of audit of T Ltd., the audit team is not sure of the possible source of misstatements in FS. Identify the sources of misstatements. (4 Marks) (May 2011)
(c) While auditing Z Ltd., you observe certain material FS assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements? (6 Marks) (May 2011)
(d) The management of S Ltd. requests you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an appropriate response?(6 Marks) (May 2011)

Q4. Y Ltd. engaged an actuary to ascertain its employee cost, gratuity & leave encashment liabilities. As the auditor of Y Ltd., you would like to use the report of the actuary as audit evidence. How do you evaluate the work of the actuary? (8 Marks) (May 2011)

Q5. Short notes on Guidance note on Audit of Misc. Expenditure. (4 Marks) (Nov 2010)

Q6. While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. What types of reports/opinions he can obtain and to what extent he can rely upon the same? (4 Marks) (Nov 2010)

Q7. (a) In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty? (4 marks) (May 2010)
(b) While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind? (4 marks) (May 2010)
(c) Auditor’s responsibilities in respect of corresponding figures? (4 marks) (May 2010)
(d) IT systems also pose specific risks to an entity's internal control? What are those risks? (4 Marks) (May 2010)

Q8. Answer the following:
(a) You are appointed statutory auditor of X Ltd. X Ltd. has an internal audit system and reports for the same are given to you. Mention the factors you will consider to ensure that the said system of internal audit of X Ltd. is commensurate with the size of the company and nature of its business. (8 Marks) (June 2009)
(b) Audit report of P Ltd. for year 2007-08 contained a qualification regarding non-provision of doubtful debts. As auditor of 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) Company makes adequate provision for doubtful debts? (8 Marks) (June 2009)

Q9. Moon Limited replaced its statutory auditor for the financial year 2008-09. During the course of audit, the new auditor found a credit item of Rs. 5 lakhs. 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) (Nov 2009)

Q10. Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud. (6 Marks) (Nov 2009)

Q11. Briefly explain the audit procedures on subsequent events (4 Marks) (Nov 2009)

Q12. Comment on the following:
(a) You are appointed to compile FS of Y & Co. for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing the same, the partners of Y & Co. tell you that since you are not conducting an audit, the said figures duly certified by the firm should be accepted. (5 Marks) (June 2009)

(b) 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. 50,000 are withdrawn from the bank to meet day-to-day expenses. (5 Marks) (June 2009)

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