JAAHNVI COMMERCE ACADEMY

PUREAD AUDIT SERIES

FIRST EDITION

P A S

ADVANCED AUDITING AND PROFESSIONAL ETHICS

Self Study Notes for CA Final

AKHIL MITTAL

ABOUT THE BOOK

As a Chartered Accountant with over 13 years of corporate experience, I understand the unique challenges CA students face in navigating the demanding course. The path to becoming a CA is rigorous, filled with intense study hours, conceptual depth, and the need for practical insights. Having walked this journey myself, I am committed to giving back to the CA community by contributing to students' success through carefully curated audit notes.

Why Audit Notes?

Audit is not just a subject—it's a critical skill that lays the foundation for any CA's career. However, it often becomes daunting for students due to its vast syllabus and the need for a precise understanding of standards, processes, and real-world application. My audit notes are crafted to:

- Simplify Concepts: Breaking down complex auditing standards and topics into easy-to-understand language.
- Enhance Retention: Using structured formats, mnemonics, and examples to aid memory.
- Bridge Theory and Practice: Connecting theoretical knowledge with practical scenarios encountered in professional life.
- Save Time: Presenting concise & exam-focused content to help students make most of their study hours.

My Vision

I believe that learning should not just be about passing exams but also about building confidence in the subject matter. These audit notes are more than just study material—they are a guide to understanding the essence of auditing and its role in shaping a CA's career. My vision is to make the learning process more accessible, efficient, and impactful for aspiring CAs.

What You'll Find in These Notes

- Exam-oriented insights with a focus on frequently tested areas.
- Examples to connect academic knowledge with practical application.
- Tips and strategies to approach auditing questions effectively.
- Updated content in line with the latest ICAI syllabus and standards.

A Note to Students

Remember, every concept you master today is a step closer to your dream of becoming a Chartered Accountant. It's not just about passing exams; it's about preparing for a profession that demands excellence, ethics, and expertise. Through these notes, I aim to be a part of your excellence story.

Standardizing Internal Audit Methodology

Planning

- SIA 110 – Nature of Assurance
- SIA 120 – Internal Controls
- SIA 210 – Managing IA function
- SIA 220 – Overall IA Planning
- SIA 230 – Objectives of IA
- SIA 310 – Planning IA Assignment

Execution

- SIA 5 – Sampling
- SIA 6 – Analytical Procedures
- SIA 7 – Quality Assurance in IA
- SIA 11 – Consideration of Fraud in IA
- SIA 18 – Related parties
- SIA 130 – Risk Management
- SIA 140 – Governance
- SIA 150 – Compliance with Laws & Regulations
- SIA 240 – Using work of Expert
- SIA 320 – IA Evidence
- SIA 330 – IA Documentation
- SIA 350 – Review & Supervision of IA
- SIA 520 – IA in IT Environment
- SIA 530 – Third Party Service Provider

Reporting

- SIA 250 – Communication with those charged with Governance
- SIA 360 – Communication with Management
- SIA 370 – Reporting Results
- SIA 390 – Managing & Reporting Prior Audit Issues

CHAPTER 3
AUDIT PLANNING, STRATEGY AND EXECUTION

"AUDIT" Process

Below is the diagrammatic presentation of audit process-

Audit Engagement →	Audit Planning →	Audit Execution →	Audit conclusion & Reporting
SA 210	SA 300	Perform audit procedure	Issue report

Elements of Planning

Below flowchart will help in understanding the elements of planning-

Preliminary Engagement Activities

Perform procedure w.r.t. Client acceptance as per SA 220*.
Whether there is mgmt. integrity issue.

Ensure compliance of Ethical requirement as per SA 220.
Whether auditor is maintaining Independence/confidentiality.

Establish understanding of terms with client as per SA 210.**
Whether there is misunderstanding regarding TOE.

Planning Activities

(Explained after case Study 1)

Establish Audit Strategy

Audit Strategy
- Defining audit approach to obtain Necessary assurance at lower cost with optimum resource utilization.
- It sets out scope, timing & direction of audit and development of plans.

Develop Overall Audit Plan
- Detailed description of **N,T,E** of Risk Assessment Procedure**(RAP)**
- Description of **N,T,E** of further audit procedure **(FAP)**
- Other planned audit procedures **(PAP)**necessary to be performed

- Standard 210: Managing the Internal Audit function
- Standard 220: Conducting Overall Internal Audit Planning

COMMENCING THE AUDIT

SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" state that in order to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning & performing audit.

Audit कब करनी है	Audit की requirement	Audit & report issuance	Follow ups
Audit Request	Requirement Request	Audit Execution	Report Communication
Date Agreement	Agenda Sent to Auditee	Audit Preparation	Bi-annual Remedy plans
Auditor Assignment	Audit Preparation	Draft Audit Report Issuance	Remediation period update
		Final Report Issuance	Action plan sent to auditee

Advantages of Planning and Audit of Financial Statements

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways:

Code to Remember : D.C. – P.A.S.T.

1. Direction and Supervision of Engagement Team.
2. Easy Coordination in work done by auditors of components and experts.
3. Proper Organization and Management of Audit Engagement.
4. Attention to Important.
5. Proper Selection of Engagement Team.
6. Timely resolution of Potential Problems.

Nature and extent of Planning

Size and Complexity of the Auditee	If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small
Past Experience & Expertise	The key engagement team members' previous experience & expertise also contributes towards variation in planning activities.
Change in Circumstances	Another factor contributing towards variation in planning activities is change in circumstances.

General points to be remembered

(a) Planning is not a discrete phase of an audit but rather a continual and iterative process. It begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement.

(b) Auditors need to modify/update and change the **overall audit strategy and audit plan** as necessary during the audit engagement.

(c) Overall audit strategy and the audit plan remain the auditor's responsibility. The engagement partner and other key members of the engagement team should be involved in planning the audit.

(d) "Audit Plan" contain more details than "audit strategy". The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience, thereby, enhancing the effectiveness and efficiency of the planning process.

Content of an Audit Plan

The auditor should develop an audit plan that shall include a description of-

SA 315	SA 330	Other SAs
"Identifying and assessing the risks of Material Misstatement through Understanding Entity and Its Environment".	Auditor's Responses to Assessed Risks	Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

CASE STUDY 1

XWL Limited was engaged in dealing in commodity futures trading based in Surat. CA P, based at Delhi, was auditor of the company. The auditor did not even once visit the office of the company and failed to understand the nature of business of the company. All the papers and account books were received on emails and audit was concluded. There were also included in his working papers checklists which had a requirement of test checking of cost of raw material consumed & cost of stores and spares. There was nothing in his working papers showing understanding of the nature of business of company. What does it reflect upon planning of audit by CA P?

SOLUTION

Provision

SA 300 requires the auditor to plan the audit in such a manner that it is performed effectively. It also requires auditor to establish overall audit strategy including identifying the characteristics of the engagement, facilitating him to define its scope and planning of nature, timing and extent of audit procedures required to be performed to achieve the objective of audit. SA 300 further requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

Facts of the case

In the given situation, auditor didn't even once visit the company and failed to understand about business of the company. The auditor has to plan the audit commensurate to the nature and complexity of the business of the entity and identify and assess the risk of material misstatement. Further, working papers of auditor also do not show his understanding of nature of business since it contains checklist which had a requirement of test checking of cost of raw material consumed & cost of stores and spares.

Conclusion

No understandability of business and no visit to business shows flouting of requirement of SA 300 to plan the audit in such a manner that it is performed effectively. Inclusion of a checklist in the working papers having requirement of test checking of cost of raw material consumed & cost of stores and spares shows that it was a general checklist, and specifics of business were never understood, which is again a blatant violation of requirement of SA 300. Hence, audit was not planned to be conducted in an effective manner in accordance with requirements of SA 300.

Considerations in Establishing the Overall "Audit Strategy"

Below are some of the examples that should be considered by auditor while forming audit strategy-

Engagement Characteristics

- Financial Framework
- Industry-specific reporting requirement.
- Expected audit coverage
- Effect of IT on the audit procedures
- Availability of client personnel and data

Reporting objective, audit timing

- Entity's timetable for reporting.
- Discussion with the management w.r.t
  - (a) NTE of the audit work.
  - (b) Type & timing of audit report.
- Nature & timing of communication among engagement members.

Significant factors, Preliminary Engagement Activities

- Determination of materiality in accordance with SA 320.
- Identification of high-risk areas.
- Results of previous audits.
- Volume of transactions which may determine reliance on internal control

Nature, timing and extent of resources

- The selection of the engagement team and the assignment of audit work to the team members.
- Engagement budgeting

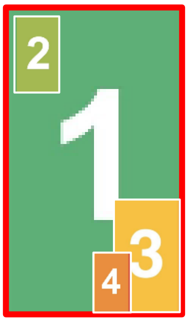
Relationship among "Audit Planning", "Audit Strategy ", "Audit Plan" and "Audit Programme"

1 AUDIT PLANNING = 2 AUDIT STRATEGY + 3 AUDIT PLAN

1 Audit Planning: Includes consideration of nature, Timing and extent of RAP.

2 Audit Strategy: Sets out in general terms how the audit is to be conducted and set the scope, timing & direction (STD) of audit.

3 Audit Plan: Contains detailed response to auditor's risk assessment and determines how the audit will be performed – **RAP,FAP.**



4 AUDIT PROGRAMME
It is commonly prepared to allocate work to team members which may include the list of audit procedures and instructions to be followed by the member.

Que. :- " The audit plan is more detailed than the overall audit strategy". Do you agree ? Explain.
Ans. :- Yes , an audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For Example :- Planning of the auditor's risk assessment procedures occur early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

AUDIT PROGRAMME

An audit programme is commonly prepared to allocate work to team members that include the list of audit procedures and instructions to be followed by the member. Following are the matters which need to be considered in this regard are:

CODE TO REMEMBER : O – S.O.N.I.A.

1. **Overall Plan:**
   - Overall plan for audit programme should be drawn up to ensure a systematic approach to the work. In case of any divergence from overall audit plan, then first the overall plan should be modified after due consideration and thereafter only the matter may be taken in the audit programme.

2. **System of internal control and accounting procedures:**
   - The existence of a system of internal control ensures that both financial and statistical records are checked continuously. The auditor needs reasonable assurance that transactions are properly authorized & recorded in the accounting records.
   - The study of such internal control helps the auditor to establish the reliance.

3. **Organisation size and structure of its management:**
   - An increase in the size of business enhances the complexity of the examination of its accounting records. It means bigger the size of an organisation, more planning required for conducting audit.

4. **Nature of business in which the organisation is engaged:**
   - On his first appointment, the auditor should examine in detail the financial and accounting organisation of the business.
   - This can be done by visiting the client's office; by observing different stages through which papers pass before each transaction is authorized and recorded.

- In the case of an industrial concern, he must also visit the factory to acquaint himself with the different processes of manufacture.
- Auditor, therefore, should draw up the programme of audit on a consideration of the technical, financial and accounting set-up of the company.

5. Information as regards organisation of the business:
   - To plan audit programme, it is necessary that the auditor should obtain from his client information i.e. history of client, business.
   - Purpose and nature of engagement and time schedule for the completion of audit.

6. Accounting and management policies:
   - The auditor should review the financial statements of the past several years, audited by his predecessors.
   - This would reveal a great deal of information regarding accounting and management policies which have been followed in the past and whether these have been employed consistently or not.

Drawing up the "Audit Programme"

Once auditor has gained and collected the knowledge about the business, he/she will be in position to formulate the audit programme. When an auditor is appointed to audit the accounts of an entity for the first time, the audit programme should be developed in three stages stated below

STAGE 1	STAGE 2	STAGE 3
A broad outline of the audit programme should be drawn up.	After the detailed checking, the extent to which procedures to be applied should be determined.	After review, details should be documented taking into consideration deficiencies in system.

ALTERATION OF AUDIT PROGRAMME - Given below are a few circumstances wherein the audit programme would have to be suitably altered.

CODE TO REMEMBER : **M.I.** phone par **V.A.T.**

(a) When a suspicion has aroused w.r.t to **assets** of the company have been **misappropriated**.
(b) If during the audit, it has been discovered that **internal control procedures** were not as effective as assumed at the time the audit programme was framed.
(c) Where there has been an extraordinary increase in book debts or in **value of stocks** as compared to that in the previous year.
(d) Significant changes in **accounting** organisation, procedures & personnel subsequent to audit procedures.
(e) If the audit procedures were designed for a certain volume of **turnover** and subsequently the volume have substantially increased.

CASE STUDY 2

CA Pradyuman is planning for audit of a listed company headquartered in Noida. While doing this exercise, he has made a list of various procedures intended to be performed by him during the course of audit. He has further made up his mind to decide about sample size at time of performing various planned procedures. Is the above approach of CA Pradyuman proper?

SOLUTION

Provision
SA 300 states that audit plan shall include descriptions about nature, timing & extent (NTE) of audit procedures. The extent of audit procedures also includes deciding about sample sizes to be tested for performing audit procedures.

Facts of the case
In the given situation, auditor made a list of various procedures intended to be performed by him during the course of audit including sample size of time of performing.

Conclusion
Therefore, the said approach is not proper. Various procedures planned to be undertaken should also include considerations relating to sample sizes to be tested.

CASE STUDY 3

CA Nikita is conducting audit of a leading society engaged in promoting awareness regarding usefulness of internet among the disadvantaged sections of society through easily understandable means and methods. The society is also registered under FCRA, 2010 for receipt of foreign contributions. During the course of audit, she embarked upon extensive procedures relating to verification of receipt of foreign contributions to rule out "round-tripping" in comparison to procedures originally thought of. She is documenting various procedures performed by her including relevant audit findings. However, she doesn't feel need for putting into writing about how she planned the whole exercise. Does she require refreshening of her knowledge?

SOLUTION

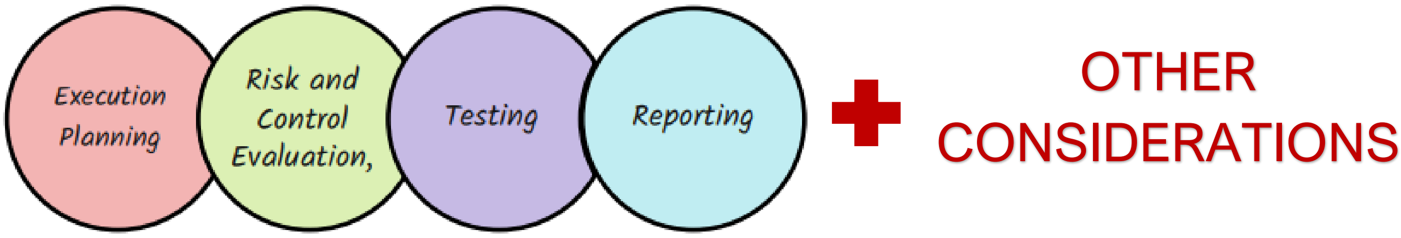
Provision
SA 300 requires auditor to document audit plan and significant changes made during the audit engagement to the audit plan. It also requires auditor to document reasons for such changes. The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. Any change in the audit plan with reason, need to be documented.

Facts of the case
In the given situation, auditor is documenting various procedures performed by her including relevant audit findings but didn't feel to document the whole exercise of planning of audit, by way of putting it in writing.

Conclusion
Failure to document audit plan could entail risk of not conducting audit according to professional standards in a qualitative manner

AUDIT EXECUTION

Prior to commencement of an audit engagement, it is important to lay down the roadmap for audit execution to ensure timely and quality audit results. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner.



Each step is explained below-

Execution Planning

Prior to commencement of an audit engagement, it is important to lay down the roadmap for audit execution to ensure timely and quality audit results by way of-

(1) Detailed audit program is prepared explaining audit objectives, Scope and approach.
(2) The manpower requirement, audit team qualifications, and the time element, etc.
(3) A preliminary survey would help in gathering the required information.

Risk and Control Evaluation

Auditors should conduct detailed risk & control assessment for each audit segment-

(1) List the risks that must be reviewed and controls that exist/needed to protect against the risk.
(2) While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.

Testing of Internal controls placed

Once a comprehensive understanding is gained of the key risks and the controls to be evaluated-

(1) Auditors should test the operating effectiveness of the controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls.

Reporting

SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued-

(1) The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the forming an opinion on financial statements.
(2) This assessment involves considering whether the financial statements-
  (a) Have been prepared in accordance with acceptable financial reporting framework applicable to the entity.
  (b) Comply with the relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.
(3) Content of the auditor 's report helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur.

OTHER CONSIDERATIONS

There are certain other considerations which auditor is required to take care while executing the audit, that are given below

[SA 600] USING THE WORK OF ANOTHER AUDITOR 600

When auditor delegates work to assistants or uses work performed by other auditors or experts, he will continue to be responsible for forming & expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

PRINCIPAL AUDITOR - Auditor who uses the work performed by other auditors is Principal auditor.

OTHER AUDITOR - Auditor, other than principal auditor with responsibility for reporting on the financial information of a component which is included in financial information audited by the principal auditor.

Way to remember is – मर्द (M.A.R.D.) है principal auditor who is using work of other person.

ACCEPTANCE AS PRINCIPAL AUDITOR

Accepting acceptance of work as principal auditor

Auditor should ensure that his own participation is sufficient, for this consider following

Code to Remember : M.A.R.D.

M.

Area covered by Principal Auditor

☑ Materiality of the portion of Financial statement.

A.R.D.

Area covered by Other Auditor

☑ Can principal auditor perform **Additional** procedures as per SA 600 on components*.

☑ **Risk** of MMST** involved in the components audited by other auditor.

☑ Principal auditor's **Degree** of knowledge regarding components.

* **Components -** means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

** **MMST –** Material Misstatement.

☑ SA 600 does not deal with those instances where 2 or more auditors are appointed as joint auditors, nor it deal with principal auditor's relationship with a predecessor auditor.

For the areas to be covered by PRINCIPAL AUDITOR, following audit procedures can be followed by him to ensure that audit is carried out effectively. *NTE – Nature, timing and extent of audit procedure

PRINCIPAL AUDITOR PROCEDURE

- Auditor to visit and examine books of accounts of component.
- Principal auditor to consider the professional competence of other auditor.
- Procedures to be performed by Principal Auditor while using the work of other auditor
  - Inform another auditor what work or report principal auditor is planning to rely / use & make sufficient arrangement among themself for co-ordination at planning stage
  - (b) advise the other auditor of significant accounting, auditing & reporting requirements & obtain representation as to compliance with them.
- Principal auditor to review the written summary of other auditor's procedures by
  - ☑ Visiting him.
  - ☑ Obtain NTE*.
- Principal auditor should consider the significant findings of the other auditor
  - Discuss with other auditor and component mgmt.
  - Decide supplementary test of records.
  - Such test can be performed by principal or other auditor
- When other auditor is not a professionally qualified auditor

The principal auditor would inform the other auditor of matters such as

Shortcut - SIT

- **Special** consideration to be applied by another auditor E.g. treatment of interest during moratorium period given in COVID
- Procedures which another auditor should **identify Intercomponent** (RPT) transactions.
- **Timetable** for completion of audit.

DOCUMENTATION by Principal Auditor

- *List of components audited by another auditor's*
- *Significance of each of these components like there total T/O, Profits, Assets.*
- *Who performed their audit*
- *Conclusions and nature of reports received from another auditor*
- *Audit procedures applied by principal auditor before relying / using the work or reports*
- *If report from another auditor is modified then how principal auditor dealt with such things while framing his own report.*

COORDINATION BETWEEN AUDITORS

There should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

Principal Auditor With Other Auditor

- Advise OA on any matter which are important for his work.
- PA may sent detailed questionnaire on matter to OA.
- PA may sent / issue written communication to OA.

Other Auditor With Principal Auditor

- Should ensure statutory compliance of communication.
- If OA comes to know about significant findings which can be resolved at entity level and important for PA, he should send such information immediately.
- OA should respond to questionnaire on timely basis.

PA = Principal Auditor || OA = Other Auditor.

REPORTING CONSIDERATIONS

There should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

Report of OA not reliable

☑ If PA thinks that work of OA can not be used, and

☑ PA has not been able to perform sufficient additional procedure w.r.t financial information of component audited by OA,

☑ PA should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.

Report of OA reliable but modified

☑ If OA issues or intend to issue modified audit report,

☑ PA should consider subject matter of qualification especially nature and significance w.r.t financial information of whole entity.

☑ Then PA should make conclusion whether such modification is required in PA's report.

DIVISION OF RESPONSIBILITY

There should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

Responsibility of PA

PA is not responsible for work and report made by OA on the component

But if he had information which aroused suspicion about reliability of work of OA, then he should perform additional procedures to confirm reliability else PA will also be responsible for inappropriate work or report

Disclosure in Audit Report

PA should clearly specify in his Audit report number of branches, subsidiaries which are not audited by him and also indicate quantum of financial activity and balances at components in monetary terms or in percentage terms.

CASE STUDY 4

CA Sourabh, an engagement partner, is conducting statutory audit of BBI Bank for SBT & Associates. The bank has 1034 branches spread all over the country which are audited by branch auditors. In respect of one large branch audited by a branch auditor, there were errors in NPA classification of many advances which were not pointed out by branch auditor in his report through memorandum of changes and NIL memorandum of changes was reported electronically. During overall review of financial statements of bank by statutory auditor, the above-mentioned errors did not come into light. The statutory auditor had also called soft copies of internal inspection report and concurrent audit reports of above branch as part of overall review procedures. However, these reports did not point towards any irregularities in such accounts.
Would the statutory auditor of bank be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?

SOLUTION

Provision
SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

Facts of the case
In the given situation, nothing has come to light of statutory a uditor which would arouse his suspicion about reliability of work performed by branch auditor.

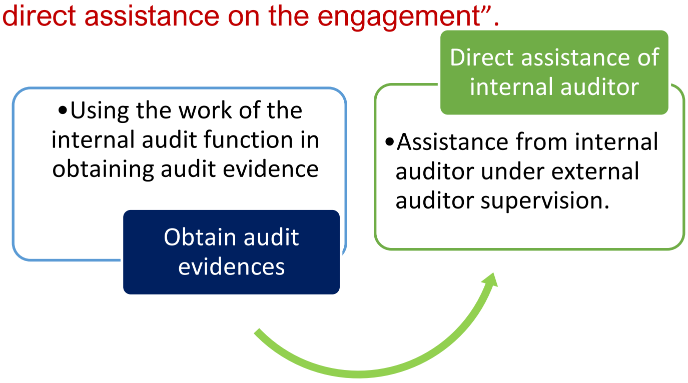
Conclusion
Therefore, he would not be responsible for work performed by branch auditor. Further, it should be clearly stated in the report that 1034 branches of bank have been audited by branch auditors.

[SA 610] USING THE WORK OF INTERNAL AUDITOR 610

SA 610, "Using the Work of Internal Auditors" defines conditions that are necessary for the external auditor to be able to use the work of internal auditors. In simple words, below are the broad objectives under this SA:

(a) If work of internal auditor function or direct assistance from internal auditor can be used.
(b) If using work of internal audit function is adequate for the purpose of the audit.
(c) If internal auditors provide direct assistance, than external auditor should supervise, direct and review their work.

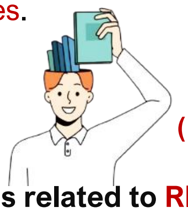
"The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement".



Non-applicability of SA-610
(a) If entity does not have an internal audit function.
(b) If there is any restriction under any other law/rules on use of internal audit functions.
(c) E.g. – Section 144 of Companies Act 2013 prohibits statutory auditor from performing certain non-audit services.

OBJECTIVES AND SCOPE OF INTERNAL AUDIT FUNCTIONS

When an entity has internal audit function, the objective and scope include assurance and consulting activities to evaluate and improve the effectiveness of the entity's risk management, internal control and governance processes.



CODE TO REMEMBER : R.I.G.

(Risk management | Internal control | Governance processes)

Activities related to RISK MANAGAMENT (F.R.- Fraud and Risk)

☑ IAF* may assist the entity by identifying and evaluating significant exposures to risk.
☑ IAF may perform procedures to assist the entity in the detection of fraud.

*** IAF = Internal Audit Function**

Activities related to INERNAL CONTROL

☑ Evaluation of internal control
☑ Examination of financial and operating information.
☑ Review of operating activities.
☑ Review of compliance with Laws and regulations

Activities related to GOVERNANCE PROCESSES

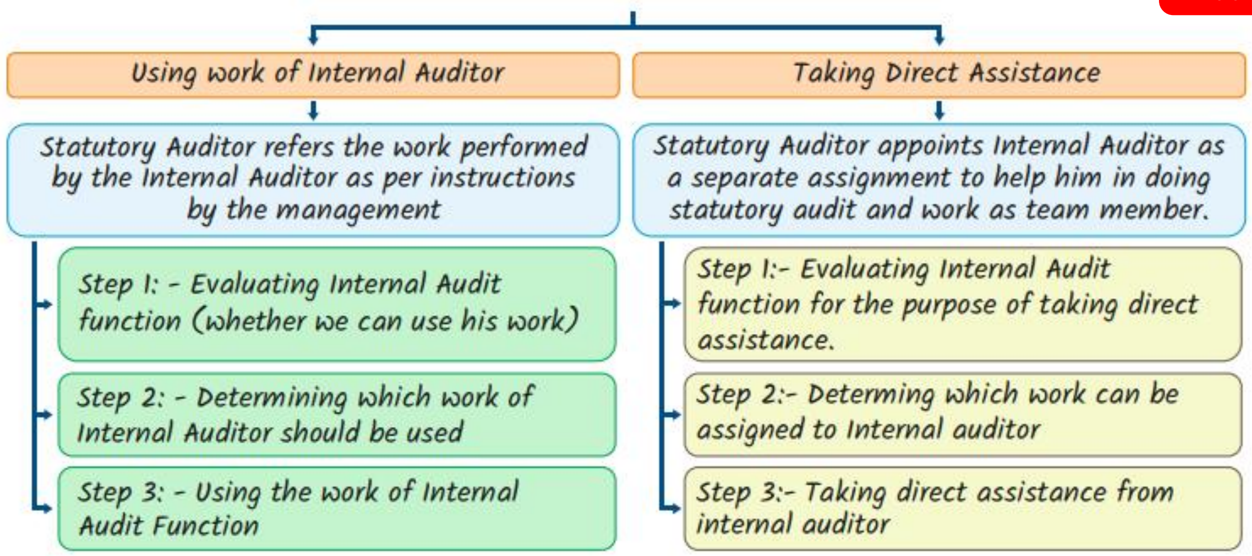
☑ IAF may assess the governance process in its accomplishment of objectives on :
(a) Performance management, accountability, values and Ethics (P.A.V.E.)
(b) Communicating risk and control information.

OBJECTIVES OF EXTERNAL AUDITOR(Where entity has an internal audit function)

In case the entity has an internal audit function, external auditor can take help of internal audit function in following two ways:

*** IAF = Internal Audit Function**

"STATUTORY AUDITOR CAN TAKE HELP OF IAF"



Meaning of Internal Audit Function & Direct Assistance

Internal Audit Function: A function of an entity that performs assurance and consulting activities designed to evaluate & improve effectiveness of the entity's governance, risk management and internal control processes.

Direct Assistance: The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

USING WORK OF INTERNAL AUDITOR

Statutory Auditor refers the work performed by the Internal Auditor as per instructions by the management

*** IAF = Internal Audit Function**

Step 1
Evaluating Internal Audit Function (whether we can use his work)

FACTORS TO BE CONSIDERED

- ☑ Competency level of IAF.
- ☑ Objectivity of internal auditor.
- ☑ Systematic & Disciplined approach applied by the IAF.

IAF WORK NOT TO BE USED

- ☑ Lack sufficient competence.
- ☑ Entity's policies & procedures don't support objectivity of the internal auditor.
- ☑ Systematic & disciplined approach not applied by IAF.

Step 2
Determining which work of Internal Auditor can be used

AREAS WHICH STATUTORY AUDITOR MAY USE

- ☑ Testing of the effectiveness of controls.
- ☑ Observations of inventory counts.
- ☑ Tracing transaction through IT system.
- ☑ Substantive procedures (judgment)

Step 3
Using the work of Internal Audit Function (IAF)

- ☑ Read IA reports.
- ☑ External auditor perform Sufficient audit procedure
- ☑ External auditor to determine adequacy of IA work.

CASE STUDY 5

CA Keshav raj is conducting statutory audit of a listed company "Live with Nature Limited". The company is engaged in producing environment-friendly niche products for new-born babies. There is also a well-functioning internal audit department in the company. On perusal of internal audit reports, he finds that not only verification of inventories was attended by internal auditors at regular intervals during the year, workings were also made in respect of inventory valuation as at year end.

He has also attended inventory count at end of financial year, and no prima facie adverse inferences were drawn by him. However, ongoing through inventory reports, he gathers that inventories are being held for considerably long period before being sold. The internal audit reports have not taken this aspect into consideration. Should he choose to rely upon inventory valuation work performed by internal auditor ?

SOLUTION

Provision

For a particular account balance, class of transaction or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. As explained in SA 200, the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.

Facts of the case

In the given situation, inventories are being held for considerably long period before being sold. As company is dealing in niche products for new-born babies, there is a risk of inventory obsolescence due to changes in customer preferences. It carries a significant risk of material misstatement and requires more judgment on part of statutory auditor in planning and performing procedures. In such circumstances, statutory auditor needs to perform procedures directly like comparing net realizable value of products with costs to verify completeness of provisions, recomputing of provisions for obsolete stocks etc.

Conclusion

Therefore, in the given situation, he should perform procedures directly in accordance with SA 610.

`

[SA 620] USING THE WORK OF AUDITOR'S EXPERT

620

Applicability of SA 620

SA 620 deals with auditor's responsibilities regarding use of work in a field of expertise other than accounting or auditing when that work is used to assist auditor in obtaining sufficient appropriate audit evidence:

Specialised knowledge, skills and experience in particular field other than accounts & audit

- **Auditor Expert(to help in auditing)**
  - Internal Expert (Who is partner or staff, including temporary staff of auditor's firm or network firm) (SA 220)
  - External Expert (External to the firm) (SA 620)
- **Managerial Expert (to assist the entity in preparing the FST) (SA 500)**

EXAMPLES OF EXPERT IN SOME AREAS

Liability
- Insurance 4
- Tax
- Emp. Benefit plan 4
- Env liability 5
- Law, contract

4 Actuarial calculation of liabilities.

5 Valuation of (L3)environmental liabilities, and site clean-up costs.

Asset
- L & B 1
- P & M
- O & G
- Intangible assets 2
- Business Combination
- Impairment 3
- Financial Instrument
- Jewellry
- Art & Antiques

1 Valuation of complex financial instruments, land & buildings, plant and machinery.

Fixed assets

2 Valuation of Intangible assets

Other

3 Asset & Liabilities of acquired business.

Investment

SA 620 DOES NOT DEAL WITH

Situations where the engagement team includes a member with expertise in specialised area of accounting or auditing.

The auditor's use of the work of an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing financial statements (a management's expert), which is dealt with in SA 500.

FACTOR AFFECTING NATURE, TIMING & EXTENT OF AUDITOR'S PROCEDURE

Assuming that entity is in the business of drilling oil and natural gas. Keeping the same in mind, now will study the factors affecting NTE of audit procedure-

CODE TO REMEMBER : Q.U.R.A.N.

1. **Whether that expert is subject to the auditor's firm's quality control policies and procedures.**

   If expert is within QCPP ambit, lesser magnitude of NTE.

   If it is an internal auditor's expert, then he is considered as member and QCPP (Quality control Policies & Procedures) is applicable but if he is external then he is not member therefore QCPP is not applicable, then auditor need to be alert & do more evaluation.

2. **The usage/significance of that expert's work in the context of the audit.**

   For instance, the oil/gas wells valuation done by expert comes to **Rs. 960 crores** out of the total assets appearing in balance sheet of **Rs. 1,200 crores.** Auditor is dependent on experts work in this significant matter.

   Oil/gas well amount is 80% of total asset & significant.

3. **The risks of material misstatement in the matter to which that expert's work relates.**

   400% change as compared to last year, there is no policy / system on how to value oil well.

   System Absence

4. **The auditor's knowledge of and experience with previous work performed by that expert.**

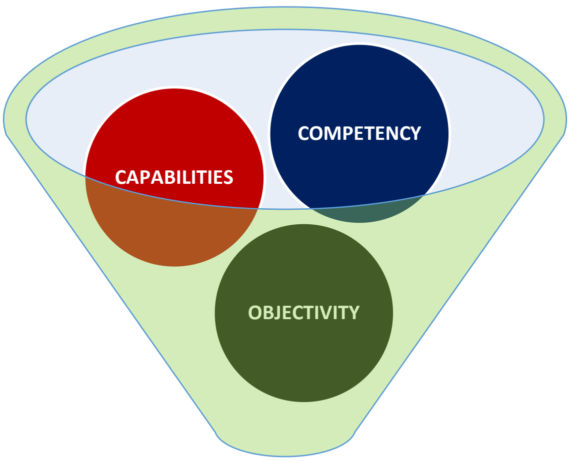
   Prior experience with expert.

   Auditor has work with the expert before, expert sometime works in haste and misses some important point so Auditor should be careful.

5. **The nature of the matter to which that expert's work relates.**

   Valuation depends on depth, width, density, soil level of surface, drilling cost etc.

COMPETENCY, CAPABILITIES AND OBJECTIVITY OF THE AUDITOR'S EXPERT



Competence (knowledge, qualifications, training, experience, reputation)

Capabilities (time availability, team, equipment)

Objectivity (ability to remain unbiased)

Expert can be trusted

Evaluate of objectivity shall include inquiry regarding interest and relationships of expert with entity

Important consideration while evaluating CCO

- Whether expert is following any legal or regulatory requirement w.r.t. work
- Whether expert have accreditation from any licensing body
- Whether expert following professional standards and technical performance standards

EVALUATION OF THE SIGNIFICANCE OF THREATS TO OBJECTIVITY

The evaluation of the significance of threats to objectivity & of whether there is a need for safeguards may depend upon **role of the auditor's expert** and **significance of the expert's work** in the context of audit:

EVALUATION OF THE SIGNIFICANCE OF THREATS TO OBJECTIVITY

Step 1
Inquiry of the entity
☑ If any interest or relationship between entity and auditor's external expert.

Step 2
Discuss with that expert
☑ Discuss with expert and evaluate whether adequate measures adopted to reduce threats to acceptable level.

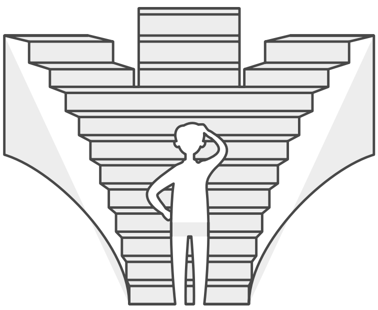
AGREEMENT WITH THE AUDITOR' S EXPERT

The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert upon role of the auditor's expert:

Define Work
Clearly outline the nature, scope, and objectives of the expert's work to ensure alignment.

Communication Plan
Determine the frequency, timing, and form of communication to maintain effective collaboration.

Roles and Responsibilities
Establish the roles and responsibilities of both the auditor and the expert to avoid confusion.

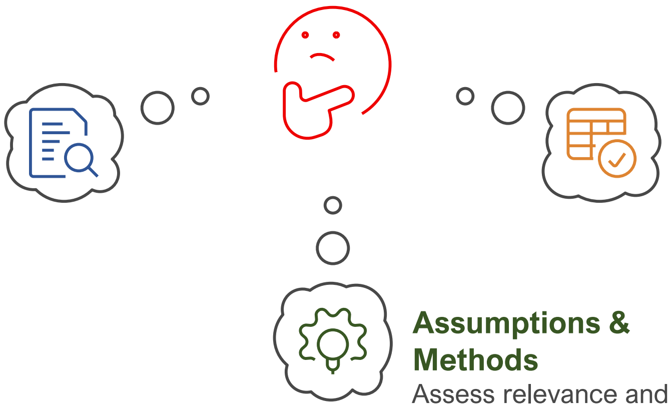


+

The need for the auditor's expert to observe confidentiality requirements.

EVALUATING THE ADEQUACY OF AUDITOR'S EXPERT'S WORK

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes,

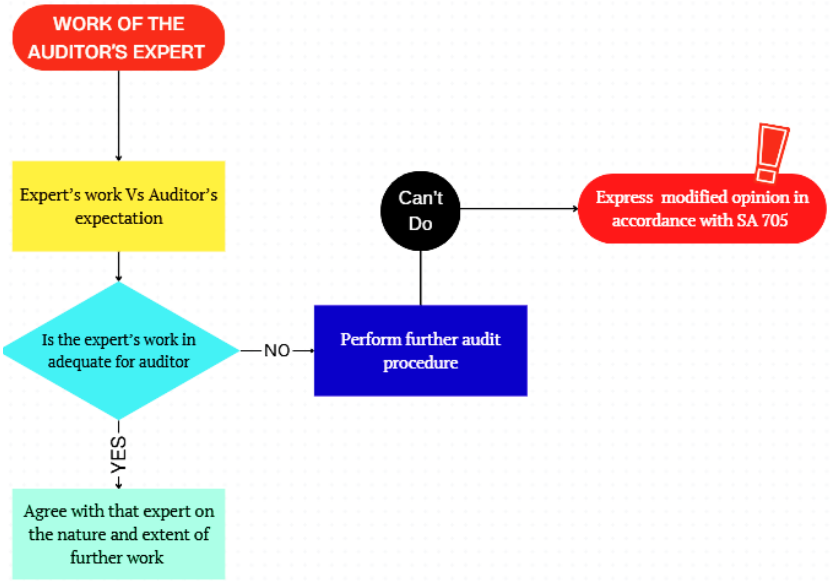


Findings & Conclusions
Evaluate relevance and consistency with audit evidence.

Source Data
Verify relevance, completeness, and accuracy of source data.

Assumptions & Methods
Assess relevance and reasonableness of assumptions and methods.

WHEN WORK OF THE AUDITOR'S EXPERT IS NOT ADEQUATE FOR THE AUDITOR'S PURPOSES



REFERENCE TO THE AUDITOR'S EXPERT IN THE AUDITOR'S REPORT

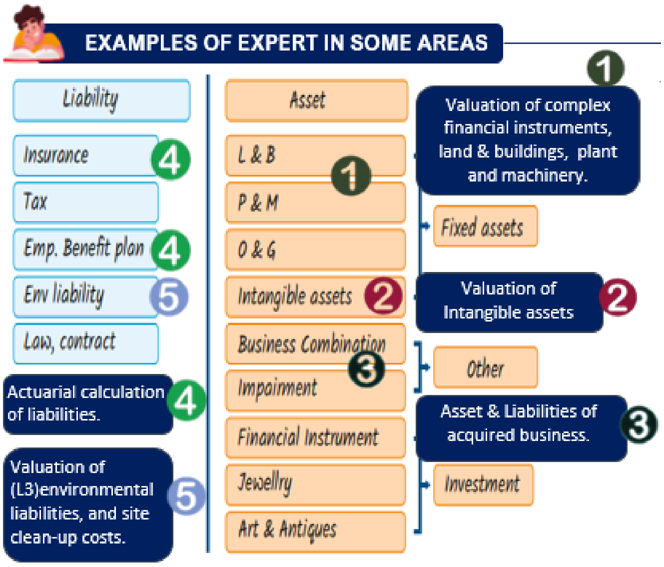
The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion **unless required by law or regulation to do so.**

If auditor refers to work of an auditor's expert and is **relevant to an understanding of a modification to the auditor's opinion,** the auditor shall indicate in auditor's report that such reference does not reduce auditor's responsibility for that opinion.

CASE STUDY 6

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?

SOLUTION



As per SA 620, "Using the Work of an Auditor's Expert", during the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert.

While doing audit, Ram, the auditor can obtain various types of reports or statements of an expert for purpose of audit evidence.

(a) While using the work of auditor's expert, he shall evaluate the adequacy of auditor's expert's work, including the relevance and reasonableness of that expert's findings or conclusions, assumptions and in case of expert's work involves the use of source data that is significant to his work, the relevance, completeness, and accuracy of that source data.

(b) If auditor determines that the work of the auditor's expert is not adequate for auditor's purposes, he shall agree with that expert on the nature and extent of further work to be performed by that expert; or perform further audit procedures appropriate to the circumstances

[SA 540] Auditing Accounting Estimates, Including Fair Value Accounting Estimates & Related Disclosures

540

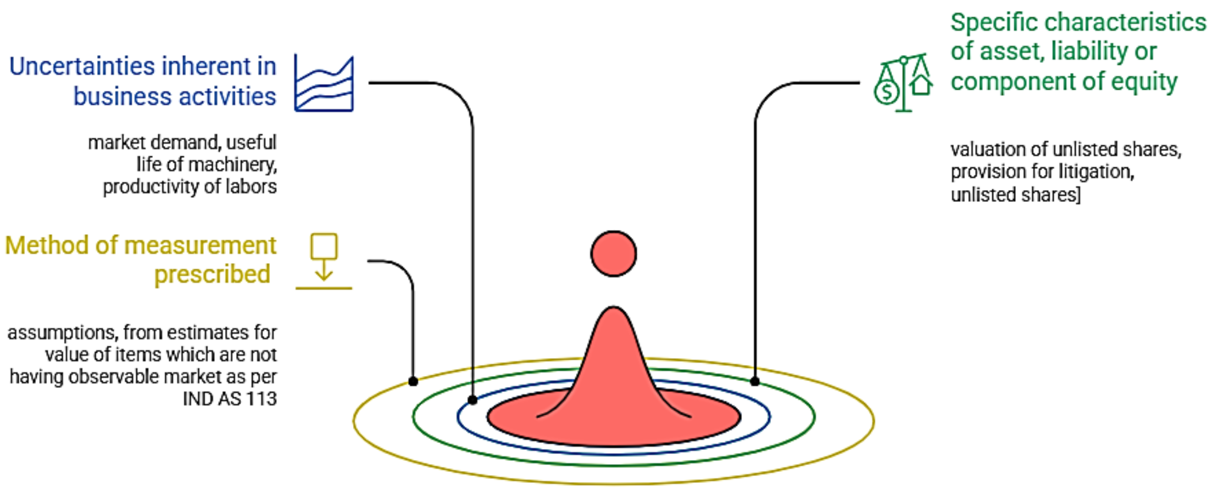
Applicability of SA 540

This Standard on Auditing (SA) deals with the auditor's responsibilities regarding accounting estimates, including fair value accounting estimates, and related disclosures. It expands on how SA 315 [Identifying and Assessing the Risks of Material Misstatement] & SA 330 [Auditor's Responses to Assessed Risks] and other relevant SAs are to be applied in relation to accounting estimates.

Nature of Accounting Estimates

Accounting estimate – An approximation of a monetary amount in the absence of precise means of the measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where this SA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

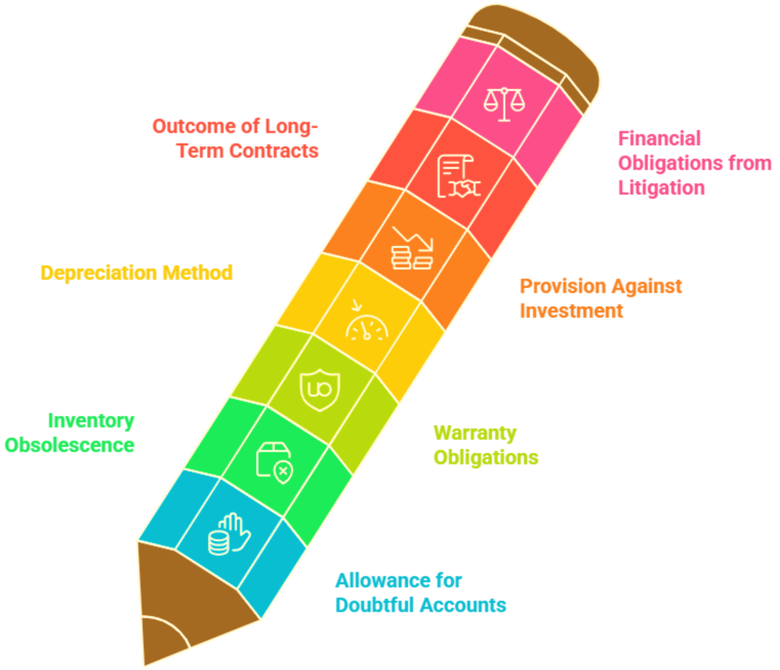
Why estimates are required



For some accounting estimates, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions

DIFFERENT TYPES OF ACCOUNTING ESTIMATES

1 Examples of situations where accounting estimates, other than fair value accounting estimates, may be required include-



2 Examples of situations where fair value estimates may be required include -

- Complex Instruments
- Share-Based Payments
- Property for Disposal
- Business Combination Assets
- Non-Monetary Exchanges

...CODE TO REMEMBER – W.I².L.².D

W	Warranty obligations
I	Inventory obsolescence
I	Provision against the carrying amount of an investment If there is uncertainty
L	Outcome of long-term contracts
L	Financial Obligations / Costs arising from litigation settlements and judgments
D	Depreciation method or asset useful life

3 **Estimation involves judgment**

Estimates in financial statements are educated guesses made using current data and reasonable judgment. For many accounting estimates, these include making assumptions about matters that are uncertain at the time of estimation.

Objectives of SA 540

The objective of the auditor is to obtain sufficient appropriate audit evidence whether they are in the context of applicable financial reporting framework.

ESTIMATE लगाना **&** **DISCLOSURE करना**

Accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable

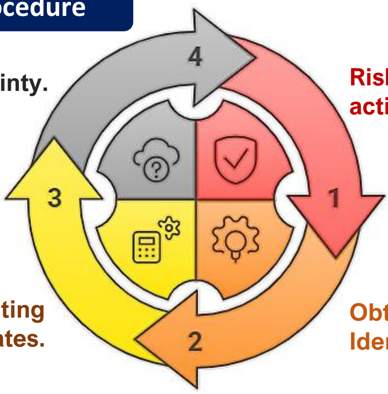
Related disclosures in the financial statements are adequate

ऑडिटर को करना क्या है in case of accounting estimates

Auditor's responsibility/Audit Procedure

Estimation Uncertainty.

Risk assessment procedures and related activities for accounting estimates.



How management makes the accounting estimates.

Obtaining understanding of how Management Identifies the Need for Accounting Estimates.

RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES FOR ACCOUNTING ESTIMATES.

(a) In addition to performing risk assessment procedures and activities to obtain understanding of entity,

(b) Auditor shall obtain the understanding of **following matter** to form the basis of consideration of risks of material misstatement for accounting estimates-
   (1) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates.
   (2) Requirements of the applicable financial reporting framework, including disclosures.

OBTAINING UNDERSTANDING OF HOW MANAGEMENT IDENTIFIES THE NEED FOR ACCOUNTING ESTIMATES.

(a) Auditor shall enquire of mgmt. about the changes in circumstances that may give rise to new or revise existing accounting estimate,

(b) The entity has engaged in new types of transactions that may give rise to accounting estimates

(c) **SA 315** deals with the circumstances where the auditor identifies risks of material misstatement that management failed to identify.

HOW MANAGEMENT MAKES THE ACCOUNTING ESTIMATES

(a) Method or model used in calculation of estimates.

(b) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates.

(c) Assumptions underlying the accounting estimates.

(d) Whether management has used an expert.

ESTIMATES UNCERTAINITY

(a) Whether and how management assessed estimation uncertainty.

(b) In addition to SA 330 (**auditor's responsibility** to design and implement responses to the assessed risk of material misstatement) requirement, the auditor shall evaluate-
   (1) How management considered alternate assumptions and why they are rejected.
   (2) Whether the significant assumptions used by management are reasonable.

For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence (SA 540).

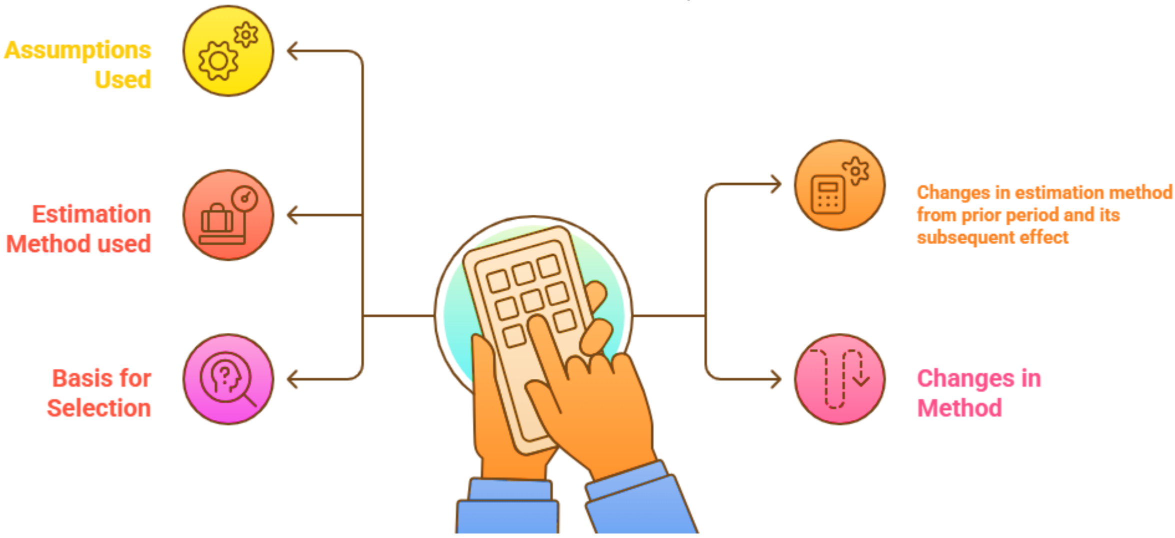
Auditor Reporting and Disclosures

DISCLOSURE IN FINANCIAL STATEMENTS

The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of applicable financial reporting framework.

APPLICABLE FINANCIAL REPORTING FRAMEWORK

Presentation of financial statement in accordance with the applicable financial reporting framework includes adequate disclosure of material matters. These disclosures may include-



Written Representations: The auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

SA 540 SUMMARY

Management's Responsibility

☑ Follow unbiased approach in preparing the estimates.

☑ To make appropriate disclosure about assertion & estimates

Auditor's Responsibility/Audit Procedure

☑ Perform risk assessment procedure.

☑ Identify ROMM*.

☑ Response to assessed risks.

☑ Evaluate reasonableness of accounting estimates.

Audit Reporting

- Adequate disclosure of material matter, such as
  - Assumption used
  - Method of estimates used
  - Basis for selection
  - Change in method of estimates
- If significant risk exist even after adequate disclosure the auditor may conclude that the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved.

* ROMM = risk of material misstatements

[SA 450] Evaluation of Misstatement identified during the Audit 450

Applicability of SA 450

SA 450 deals with the auditor's responsibility to evaluate the
(a) Effect of identified misstatements on audit and
(b) Effect of uncorrected misstatements, if any, on the financial statements

Before moving ahead, lets study some definitions-

Misstatement
A difference between the amounts, classification, presentation, or disclosure of a **reported financial statement** item and the amount, classification, presentation, or disclosure **that is required** for the item to be in accordance with the applicable financial reporting framework. So, in nutshell, it is difference between reported item and ought to be reported items.

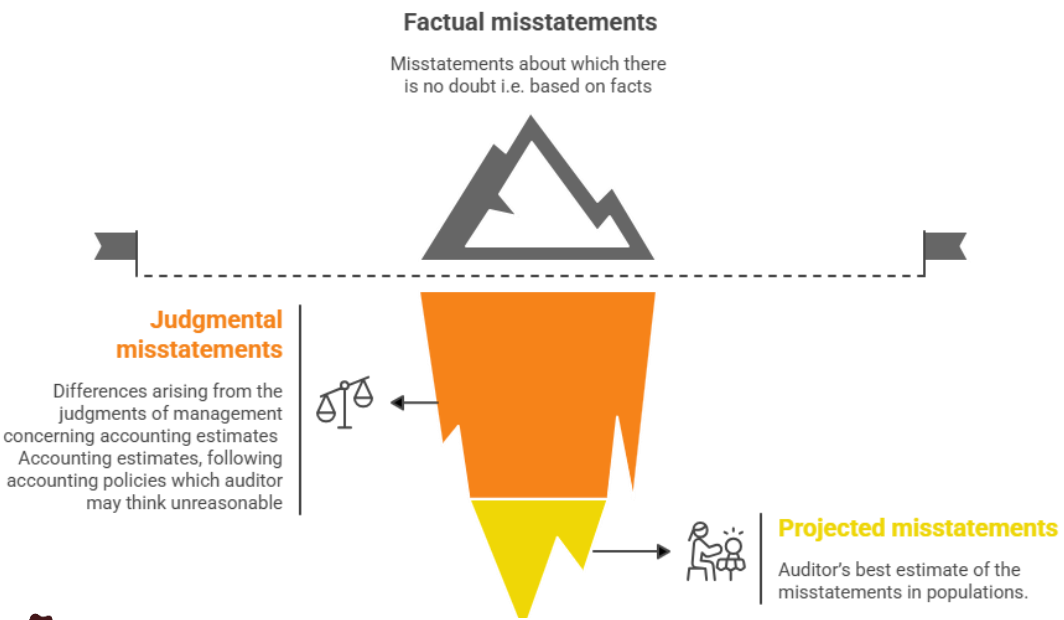
As such, we can also say that such misstatement can be **due to error or fraud.**

Uncorrected misstatements
Misstatements that the auditor has accumulated during the audit and that have not been corrected.

Accumulation of Identified Misstatements

The auditor shall accumulate misstatements identified during the audit, but not the clearly trivial (which means wholly different (smaller) order of magnitude than materiality determined in accordance with SA 320.

Clearly trivial - कोई चीज़ बहुत ही कम महत्वपूर्ण, साधारण या महत्वहीन है । However, we need to understand the different types of misstatement, which an auditor may come across:



Communication & correction of misstatement

The auditor shall communicate all misstatements identified during the audit during the audit with appropriate level of management.

Post identification and communication of the misstatements with the management, it is possible that the management response in following two manners

Management Correction

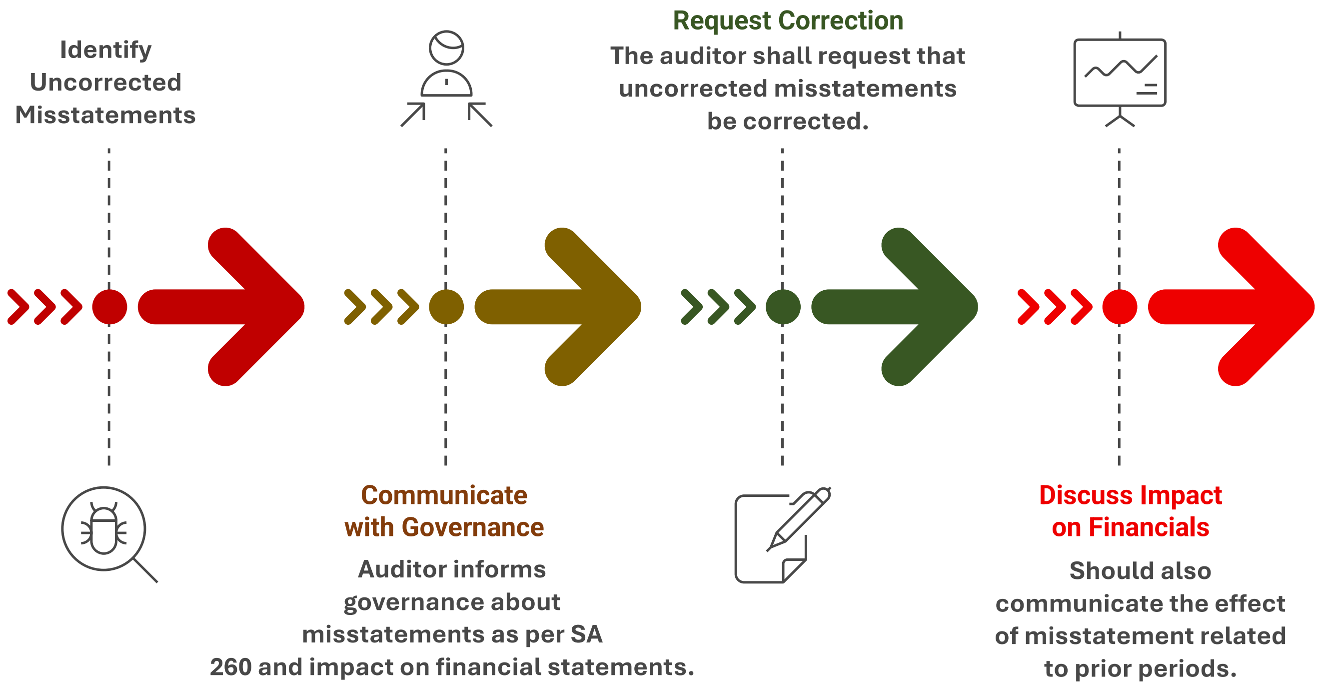
YES | NO

- Management agrees to correct
- Assess impact on financial statements
- Obtain management's reasons for refusal

If management refuses to correct some or all of the misstatements communicated by the auditor, **he shall obtain understanding of management's reasons** for not making any corrections.

- The auditor shall first reassess the materiality determined in accordance with SA 320.
- Size and nature of the misstatements w.r.t. transactions, account balance, disclosures, financial statements.
- The effect of uncorrected misstatements related to prior periods on transactions, account balance, disclosures, financial statements.

Communication with those charged with Governance



Written Presentation and Documentation

Once the auditor has identified a misstatement, accessed the effect on the financial statements and the same has been communicated to the auditors, it is now imperative for the auditor to obtain **written presentation and documentation,** in the following manner:

1	**Written Representation** The auditor shall request a written representation whether they believe the effects of uncorrected misstatements are immaterial individually and in aggregate, to the financial statements as a whole.
2	**Documentation** (a) The amount below which misstatements would be regarded as clearly trivial; (b) All misstatements accumulated during the audit and whether they have been corrected; and (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

TEST YOUR KNOWLEDGE

Case Study 1

While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements?

Solution 1

As per SA 540 the auditor shall obtain an understanding of the following to provide a basis for identification and assessment of the risks of material misstatements for accounting estimates.

(1) Requirements of the applicable financial reporting framework, including disclosures.
(2) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates.
(3) Method adopted by the management:
   (i) The method, including where applicable the model, used in making the accounting estimates.
   (ii) Relevant controls.
   (iii) Whether management has used an expert?
   (iv) The assumption underlying the accounting estimates.
   (v) Whether there has been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
   (vi) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

Case Study 2

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct audit for the financial year 2023-24. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuarial reports. However, Mr. X agreed to Mr. Y's actuary report, though Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in a dilemma. Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later, was found faulty.

Solution 2 **Expert = Actuary person** **Auditor - X, Y and Z**

Provision

As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc. However, responsibility of auditor is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.In case, expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor.

Facts

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as auditors of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on was found faulty. Further, Mr. Z is not in agreement with this report, therefore, he submitted a separate audit report specifically for such gratuity valuation.

Conclusion

it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. Mr. X and Mr. Y will be held responsible for gross negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

Case Study 3
A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?

Solution 3
Overall plan is basically intended to provide direction for audit work programming and includes determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts.

Code to remember : W.A.T.E.R.M.E.L.O.N.

1. Work of the internal auditors and the extent of reliance on their work, if any in the audit.
2. Accounting policies adopted by the clients and changes, if any, in those policies.
3. Terms of his engagement and any statutory responsibilities.
4. Error or fraud which require special attention such as the possibility of or involvement of parties in whom directors or persons who are substantial owners of the entity are interested.
5. Reliance on the accounting system and internal control.
6. Materiality levels for the audit purpose.
7. Evidence to be obtained.
8. Legal or Statutory requirements applicable to the business.
9. Other auditors' involvement in the audit of subsidiaries or branches of the client and involvement of experts.
10. Nature and timing of reports or other communications.

Case study 4
As an auditor of a garment manufacturing company for the last five years, you have observed that new venture of online shopping has been added by the company during current year. What factors would be considered by you in formulating the audit strategy of the company?

Solution 4: Audit Strategy for New Online Shopping Venture

1. Understanding the Business
   - Obtain understanding of new online shopping operations — nature, business model, scale, and integration with existing operations.
   - Identify key systems involved: website platform, payment gateways, logistics, and inventory management.
   - Evaluate whether this venture operates as a separate unit, subsidiary, or division.

2. Transactions, accounts and materiality:
   - How transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements. The records may be in either manual or electronic form.
   - How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
   - Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

3. Audit Approach
   - Involve **IT audit specialists** to evaluate application controls and data security.
   - Check inventory reconciliation between warehouse and online orders.

Case study 5
During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

Solution 5

Provision

As per SA 220 (Quality control for an audit of the Financial statements), Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

(a) Obtain relevant information from the firm to identify and evaluate circumstances & relationships that create threats to independence.

(b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

(c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.

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

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

Fact of the case

Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer

Conclusion

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

Case Study 6

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

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

Solution 6

Provision

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

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

Case Study 7

A private company is engaged in the business of real estate. The auditor of the company requested the information from the management to review the outcome of accounting estimates (like estimated costs considered for percentage completion etc) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor. Please advise.

Solution 7

Provision

As per SA 540, the auditor shall review the outcome of accounting estimates included in prior period financial statements, or, where applicable, their subsequent re- estimation for the purpose of the current period. The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of possible management bias. The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such difference, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process.
- Audit evidence that is pertinent to re-estimation, in the current period, of prior period accounting estimates.
- Audit evidence of matters that may be required to be disclosed in the financial statements.

Facts of the case

The management has refused the information to the auditor saying that the review of prior period information should not be done by the auditor.

Conclusion

In the given case, the management is not correct in refusing the relevant information to the auditor.

Case Study 8

X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had various derivative contracts – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. The auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert. Please advise.

Solution 8

Provision

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances. It is therefore required that these matters are agreed between the auditor and the auditor's expert. In certain situations, the need for a detailed agreement in writing is required such as expert having access to confidential information, complex subject matter etc.

Facts of the case

The auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor did not enter into any formal agreement with the auditor's expert.

Conclusion

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

Case Study 9

Cineplex, a movie theatre complex, is the foremost theatre located in Delhi. Along with the sale of tickets over the counter and online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises. Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue and expenditure considering the above-mentioned facts along with other relevant points relating to such complex.

Solution 9

Audit Programme for Revenue and Expenditure – Cineplex (Movie Theatre Complex, Delhi)

a) Peruse the Memorandum of Association and Articles of Association of the entity and ensure that the object clause permits the entity to engage in this type of business.

b) Below is the tabulated presentation of revenue and expenditure:

Revenue Income	Audit Procedures
Ticket Sales	- Verify system-generated ticket sales reports (counter & online). - Match number of shows, seats, and rates with actual cash/online collections. - Reconcile with cash book and bank deposits. - Review complimentary / cancelled tickets policy.
Online Booking Revenue	- Examine agreements with online platforms (e.g., BookMyShow, Paytm). - Trace net settlements to bank statements. - Verify commission deductions and GST compliance.
Café, Shops, Pubs	- Review lease / license agreements. - Check rent or revenue-sharing computation, if any. - Confirm amounts received with tenants or franchisees.
Advertisement Income	- Examine contracts with advertisers or agencies & rates in the invoices. - Check collection of dues and TDS compliance.
Parking Income	- Evaluate control over parking slips and collection counters. - Verify daily collection summaries vs. cash deposits.
Other Income	- Review interest, scrap, or miscellaneous income. - Trace receipts to bank statements.

Revenue Exp.	Audit Procedures
Film Distribution Charges	- Examine agreements with distributors. - Verify computation of distributor share (percentage of net collection). - Check payments and TDS deductions.
Salary & Wages	- Check attendance and payroll records. - Verify statutory deductions (PF, ESI, TDS).
Utilities Electricity, Water, Maintenance	- Check invoices, meter readings, and payment approvals
Insurance premium	- Verify the insurance premium paid and ensure it covers the entire assets