Chapter 7

Quality Control and Engagement Standards

SA 210 "Agreeing the Terms of Engagement"

1 **Comment on the following: "It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter." Explain those situations where new engagement letter is to be sent.**

Or

R & Co., a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional development. Please elucidate the circumstances that may warrant the revision in terms of engagement. [May 13 (4 Marks)]

Answer: Situations in which new engagement letter is required in case of recurring audit:

- SA 210 "Agreeing the Terms of Engagement" deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management. As per SA 210, in case of recurring audits, the auditor shall assess whether circumstances require revision in terms of the audit engagement and whether there is a need to remind the entity of the existing terms of the audit engagement.
- The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:
  1. Any indication that the entity misunderstands the objective and scope of the audit.
  2. Any revised or special terms of the audit engagement.
  3. A recent change of senior management.
  4. A significant change in ownership.
  5. A significant change in nature or size of the entity's business.
  6. A change in legal or regulatory requirements.
  7. A change in the financial reporting framework adopted in the preparation of the F.S.
  8. A change in other reporting requirements.

2 **X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement. Offer your comments in this regard.**

Answer: Acceptance of changes in Terms of Engagement:

- SA 210 "Agreeing the Terms of Engagement" deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management. As per SA 210, if prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
- The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.
- If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
- If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
  1. Withdraw from the audit engagement where possible under applicable law or regulation; and
  2. Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as TCWG, owners or regulators.

SA 220 "Quality control for an audit of Financial Statements"

3 **Comment as an auditor on the following situations: Mr. X, a partner in X & Co., a firm of a Chartered Accountants, died on 31-3-2015 after completing routine audit work of XYZ Company Ltd.. Mr. Y another partner of the firm of Chartered Accountants signed the financial statements of XYZ Company Ltd., without reviewing the finalization work done by the assistants.**

Answer: Review of Work performed by others:

- As per SA 220, "Quality Control for an Audit of Financial Statements", The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. Review procedures consists of the considerations, whether,
  1. the work has been performed in accordance with professional standards and regulatory and legal requirements;
  2. Significant matters have been raised for further consideration;
  3. appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
  4. the work performed supports the conclusions reached and is appropriately documented;
  5. the evidence obtained is sufficient and appropriate to support the auditor's report; and
  6. the objectives of the engagement procedures have been achieved.
- When the auditor delegates work to assistants or uses work performed by other auditors/experts he will continue to be responsible for forming and expressing his opinion on the financial statements. However, he will be entitled to rely on the work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.
- The auditor should carefully direct, supervise and review work delegated to assistants. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.
- In the instant case, Mr. X, a partner of the firm had completed routine audit work and died on 31 March, 2015. Mr. Y another partner of the firm has signed the financial statement of XYZ Company Ltd, without reviewing the finalization work done by the assistants. Mr. Y will be fully responsible for negligence, he cannot take the shelter that Mr. X had done the work.

Conclusion: Mr. Y has negligently performed his duties.

4 **Mention any four information which assists the auditor in accepting and continuing of relationship with the client as per SA 220.**

Answer: Information assisting auditor in accepting and continuing of relationship with the client:

As per SA 220 "Quality Control for an Audit of F.S." the information which assists the auditor in accepting and continuing of relationship with the client may include the following:

- The Integrity of the principal owners, key management and TCWG of the entity;
- Competency of engagement team to perform the audit engagement and availability of necessary capabilities, including time and resources;
- Compliance with relevant ethical requirements by firm and the engagement team; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

SA 230 "Audit Documentation"	
5	**Discuss the Auditor's responsibilities to provide access to his audit working papers to Regulators and the third parties. [Nov. 14 (3 Marks)]**
	Answer: Access to Working papers to Regulators and Third Parties: • Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that a CA in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by law for the time being in force. • SA 200 on "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of the information obtained and should not disclose any such information to any third party without specific authority or unless there is a legal or professional duty to disclose". If there is a request to provide access by the regulator based on the legal requirement, the same has to be complied with after informing the client about the same. • SQC–1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel. • As per SA 230, Audit documentation serves a number of additional purposes, including the enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements. **Conclusion**: It is auditor's responsibility to provide access to his audit working papers to Regulators when required by law whereas auditor is under no obligation to provide access to working papers to third parties.
6	**As an auditor, how would you deal with the following: The statutory auditor of the Holding Company demands for the working papers of the auditors of the subsidiary company, of which you are the auditor.**
	Answer: Access to working papers: • As per SA 230, "Audit Documentation" working papers are the property of the auditor. The auditor may, at his discretion, make portion of or extracts of his working papers available to his client. • SA 600 "Using the Work of Another Auditors" also states that an auditor should respect the confidentiality of information acquired during the course of his audit work and should not disclose such information unless there is a legal or professional duty to disclose. • As per ICAI Guidelines, statutory auditor of an enterprise do not have right of access to the audit working papers of the branch auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of other auditor. **Conclusion**: Statutory auditor of Holding company can not have access to audit working papers of the subsidiary company's auditor. He can however, ask the auditor to answer certain questions about the manner in which the audit is conducted and certain other clarifications regarding audit.

SA 240 "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements"

7 **In the course of audit A Ltd you suspect the management has indulged in fraudulent financial reporting? State the possible source of such fraudulent financial reporting. [May 12 (6 Marks)]**

Answer: Possible Sources of Fraudulent Financial Reporting:

SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements", deals with auditor's responsibilities in relation to fraud while performing the audit. Auditor is primarily concerned with those frauds that causes material misstatement in financial statements.

Possible sources of fraudulent financial reporting as stated in SA 240 are:

1. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
2. Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
3. Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
4. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
5. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
6. Altering records and terms related to significant and unusual transactions.

8 **Explain briefly duties and responsibilities of an auditor in case of material misstatements resulting from management fraud. [Nov. 09 (6 Marks)]**

Answer: Auditor's duties in case of material misstatement resulting from management fraud:

(a) SA 240 "Auditor's Responsibilities relating to fraud in an audit of financial statements" requires that the auditor is responsible for obtaining reasonable assurance that the F.S. taken as a whole are free from material misstatement, whether caused by fraud or error.

(b) Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls.

(c) When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit.

(d) The auditor should recognize the possibility that a material misstatement due to fraud could exist, notwithstanding his past experience of the honesty and integrity of the entity's management and those charged with governance

(e) If conditions cause the auditor to believe that a document may not be authentic or that terms in a document have been modified, the auditor shall investigate further.

(f) Where responses to inquiries of management or TCWG are inconsistent, the auditor shall investigate the inconsistencies.

(g) Further, Sec. 143(12) of Companies Act 2013 requires that if the auditor in course of the performance of his duties as an 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.

9	**You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit. As a Statutory Auditor, how would you deal?**
	Answer: Auditor's unable to complete the engagement: SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements", deals with auditor's responsibilities in relation to fraud while performing the audit. Accordingly if the auditor conclude that it is not possible to continue performing the auditas a result of misstatement resulting from fraud or suspected fraud, the auditor should: (a) Consider the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; (b) Consider the possibility of withdrawing from the engagement; and (c) If the auditor withdraws: • Discuss with the appropriate level of management and TCWG, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and • Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. Further, as per section 140(2) of the Companies Act, 2013, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the Form ADT-3 with the company and the Registrar. Sec. 143(12) of Companies Act 2013 also requires that 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.
10	**The Managing Director of the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company. As a Statutory Auditor, how would you deal?**
	Answer: Fraud Committed by Managing Director: • SA 240 "Auditor's Responsibilities relating to fraud in an audit of financial statements" requires that the auditor is responsible for obtaining reasonable assurance that the F.S. taken as a whole are free from material misstatement, whether caused by fraud or error. • Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls. • In the instant case, Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240 as stated below: (a) Consider the impact of fraud on financial statements and its disclosure in the audit report. (b) Communicate the matter to the Chairman and Board of Directors. (c) Consider the reliability of audit evidence previously obtained as the fraud has been conducted at a higher level of management which raises a genuine doubt about representations of management. • Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

11	**As a Statutory Auditor, how would you deal with the following cases: In the books of accounts of M/s OPQ Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year.**
	Answer: Difference between Control Accounts and Subsidiary Records: • The huge differences found between control accounts and subsidiary records in the books of M/s OPQ Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. • The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system fails to capture all transactions in time. • Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements. • According to SA 240 "The Auditors responsibilities relating to Fraud in an audit of F.S.", when the auditor comes across such circumstances indicating the possible misstatements resulting from entity's procedure, the auditor shall evaluate whether such a misstatement is indicative of fraud. • In this case, the circumstances indicate the possibility of material misstatements (that might be due to fraud) and accordingly, the auditor must investigate further to consider effect on F.S.
12	**Comment on the following: 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. [May 09 (5 Marks)]**
	Answer: Auditor's duties in case of suspected fraud: • SA 240 "Auditor's Responsibilities relating to fraud in an audit of financial statements" requires that the auditor is responsible for obtaining reasonable assurance that the F.S. taken as a whole are free from material misstatement, whether caused by fraud or error. • When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit. • The auditor should recognize the possibility that a material misstatement due to fraud could exist. • When the auditor comes across such circumstances indicating the possible misstatements resulting from entity's procedure, the auditor shall evaluate whether such a misstatement is indicative of fraud. • In the present case, the circumstances indicate the possibility of fraud and accordingly, the auditor must investigate further to consider effect on financial statements. • The Guidance Note on Audit of Cash and Bank balances also mentions that if the entity is maintaining an unduly large balance of cash, he should carry out surprise verification of cash more frequently to ascertain whether it agrees. If cash in hand is not in agreement with the book balance, he should seek explanations and if the same are not satisfactory, he should state this fact appropriately in his Audit Report.
13	**M/s Honest Limited has entered into a transaction on 5th March, 2015, near year-end, whereby it has agreed to pay Rs. 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2015. Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach?**

Answer: Auditor's duties in case of suspected fraud:

- SA 240 "Auditor's Responsibilities relating to fraud in an audit of financial statements" requires that the auditor is responsible for obtaining reasonable assurance that the F.S. taken as a whole are free from material misstatement, whether caused by fraud or error.
- When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit.
- The auditor should recognize the possibility that a material misstatement due to fraud could exist, notwithstanding his past experience of the honesty and integrity of the entity's management and those charged with governance.
- If conditions cause the auditor to believe that a document may not be authentic or that terms in a document have been modified, the auditor shall investigate further. Where responses to inquiries of management or TCWG are inconsistent, the auditor shall investigate the inconsistencies.
- In the present case, it appears that Company has passed fictitious journal entries near year end to manipulate the operating results. Also Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable.

Conclusion: under the circumstance, auditor should perform the following procedures:

(a) Consider the impact of fraud on financial statements and its disclosure in the audit report.

(b) Communicate the matter to the Chairman and Board of Directors.

(c) Consider the reliability of audit evidence previously obtained as the fraud has been conducted at a higher level of management which raises a genuine doubt about representations of management.

Further, Sec. 143(12) of Companies Act 2013 requires that if the auditor in course of the performance of his duties as an 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.

SA 250 "Considerations of Laws and Regulations in an Audit of Financial Statements"

14 Comment on the following: Management is responsible for compliance with Laws and regulations.

Answer: Management Responsibility for compliance with laws and regulation:

SA 250 "Consideration of Laws and Regulations in an audit of Financial Statements" states that it is the responsibility of management, with the oversight of TCWG, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations.

For this purpose management may apply the following procedures:

1. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
2. Instituting and operating appropriate systems of internal control.
3. Developing, publicising and following a code of conduct.
4. Ensuring employees are properly trained and understand the code of conduct.
5. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
6. Engaging legal advisors to assist in monitoring legal requirements.
7. Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

15 **What are the roles and responsibilities of the statutory auditor in relation to compliance with the laws and regulations by the entity.** **[Nov. 14 (5 Marks)]**

Answer: **Role & Responsibilities of Statutory auditor in relation to compliance of Laws and Regulations**:

- The auditor shall obtain a general understanding of:
  - (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
  - (b) How the entity is complying with that framework.
- The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.
- The auditor shall perform the following audit procedures to identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements:
  - (a) Inquiring of management; and
  - (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.
- During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.
- Obtain written representation that all known instances of non-compliance or suspected noncompliance with laws and regulations have been disclosed to the auditor.

16 **As a statutory auditor of a company, comment on the following: While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.** **[Nov. 12 (5 Marks)]**

Answer: Auditor's Responsibility for consideration of other Laws:

- SA 250 "Consideration of laws and regulations in an Audit of Financial statements" requires the auditor to obtain sufficient appropriate audit evidence regarding the compliance with the provisions of those laws and regulations generally recognized to have a direct impact on the determination of material amounts and disclosures in the financial statements including tax and labour laws.
- For the other laws, the auditor's responsibility is limited to undertake specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.
- Non –compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for.
- In the instant case, major portion of the labour employed was child labour.

Conclusion: Auditor should ensure the disclosure of above fact and provision of the cost of fines, litigation or other consequences. In case auditor concludes that non-compliance may have a material effect on financial statements., he should modify his opinion accordingly.

17 **As an auditor, what are the indicators you would consider while verifying compliance with Laws and Regulations?**

Answer: Indicators to be considered for verifying compliance with laws and regulations:

SA 250 "Consideration of Laws and Regulations in an audit of Financial Statements" deals with the auditor's responsibilities to consider laws and regulations when performing an audit.

To verify the compliance of laws and regulations, auditor is required to consider the following indicators:

1. Investigation by regulatory organisations Government departments or payment of fines, additional taxes or penalties.
2. Payments for unspecified services or loans to consultants related parties or employees.
3. Sales commission or agents fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
4. Purchases at prices significantly above or below market price.
5. Unusual payments in cash.
6. Unusual payments towards legal and retainership fees.
7. Unusual transactions with companies registered in tax havens.
8. Payments for goods or services made other than to the country from which the goods or services originated.
9. Payments without proper exchange control documentation.
10. Existence of an information system which fails to provide an adequate audit trail.
11. Unauthorised transactions or improperly recorded transactions.
12. Adverse media comment.

18 State briefly the Communication/Reporting requirements as per SA 250 on Non- Compliance of laws and regulations in an audit of financial statement:

(a) To the management and TCWG

(b) To the users of the auditor's report on the financial statements.

(c) To the regulatory and enforcement authorities.

Answer: Reporting requirements as per SA 250 on Non-Compliance with Laws and regulations:

(a) Reporting to Management & TCWG:

- The auditor shall communicate with TCWG matters involving non compliance with laws and regulations that come to the auditor's attention.
- If, in the auditor's judgment, the non-compliance is believed to be intentional and material, the auditor shall communicate the matter to TCWG as soon as practicable.
- If the auditor suspects that management or TCWG are involved in noncompliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists the auditor shall consider the need to obtain legal advice.

(b) Reporting in Auditor's Report:

- If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, express a qualified or adverse opinion on the financial statements.
- If the auditor is precluded by management or TCWG from obtaining sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion.
- If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or TCWG, the auditor shall evaluate the effect on the auditor's opinion.

(c) Reporting to regulatory and Enforcement Authorities:

If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

SA 260 "Communication with Those Charged with Governance"

19 Discuss with reference to SAs: The auditor shall communicate all significant findings with those charged with Governance.

Or

"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.

Answer: Communicating Significant Finding to TCWG:

SA 260 "Communication with Those charged with Governance" deals with auditor's responsibilities to communicate with TCWG in an audit of financial statements.

As per SA 260, auditor should communicate all significant findings with the TCWG, stated as below:

1. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
2. Significant difficulties, if any, encountered during the audit;
3. Unless all of those charged with governance are involved in managing the entity:
   - Material weaknesses, if any, in the design, implementation or operating effectiveness of internal control that have been communicated to management;
   - Significant matters, arising from the audit that were discussed, or subject to correspondence with management; and
   - Written representations the auditor is requesting; and
4. Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

20 State the Significant Difficulties encountered during audit with reference to SA 260.

Answer: Significant Difficulties encountered during audit:

SA 260 "Communication with Those charged with Governance" deals with auditor's responsibilities to communicate with TCWG in an audit of financial statements.

As per SA 260 among other things auditor should communicate significant difficulties to the TCWG. Examples of significant difficulties to be communicated are:

1. Significant delays in management providing required information.
2. An unnecessarily brief time within which to complete the audit.
3. Extensive unexpected effort required to obtain SAAE.
4. Unavailability of expected information.
5. Restrictions imposed on the auditor by management.
6. Scope limitation that leads to modification of auditor's opinion.

21 Write short note on: Factors governing modes of communication of auditor with those charged with governance.

Answer: Factors affecting mode of Communication:

SA 260 "Communication with Those charged with Governance" deals with auditor's responsibilities to communicate with TCWG in an audit of financial statements. As per SA 260 the various factors affecting mode of communication are:

1. Whether the matter has been satisfactorily resolved.
2. Whether management has previously communicated the matter.
3. The size, operating structure, control environment, and legal structure of the entity.

4. In the case of an audit of special purpose F.S., whether the auditor also audits the entity's general purpose F.S..
5. Legal requirements. In some jurisdictions, a written communication with TCWG is required in a prescribed form by local law.
6. The expectations of TCWG, including arrangements made for periodic meetings or communications with the auditor.
7. The amount of ongoing contact and dialogue the auditor has with TCWG.
8. Whether there have been significant changes in the membership of a governing body.

22 **Compare and explain the following: Reporting to Shareholders vs. reporting to TCWG.**

[Nov. 14 (3 Marks)]

Answer: Reporting to Shareholders vs. Reporting to those Charged with Governance:

Reporting to Shareholders	Reporting to TCWG
1. SA 700, 705 & 706 and Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders.	1. SA 260 deals with the provisions relating to reporting to those Charged with Governance.
2. Reporting to shareholder generally focuses on true and fair view of financial statements.	2. Reporting to TCWG generally includes auditor's responsibilities, planned scope and timing of audit, significant findings from the audit and independence.
3. Reporting to shareholders is an external report and issued in public domain.	3. Reporting to TCWG is an internal report and not issued in public domain.

SA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance"

23 **What do you mean by deficiencies in Internal Control. Explain various indicators of Significant deficiencies.**

Answer: Deficiencies in Internal Control:

SA 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" states that deficiency in internal control exists when:

(a) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or

(b) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

Indicators of Significant Deficiencies:

1. Evidence of ineffective aspects of control environment.
2. Entity's Risk assessment process – Absent/ineffective.
3. Ineffective response to identified significant Risks.
4. Correction of prior period misstatements arising due to fraud/error.
5. Management inability to oversee F.S. Preparation.
6. Misstatements detected by the auditor's procedures were not prevented, or detected and corrected by the entity internal control.

SA 299 "Responsibility of Joint auditor"	
24	**KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2013-14. 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 actuary 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 dilemma.** **(i) You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.** **(ii) Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.**
	Answer: Responsibilities of Joint auditors: SA 299 "Responsibility of Joint Auditors" deals with the responsibilities of joint auditors. In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible - (a) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them; (b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be noted that proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned; (c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors (d) for examining that the F.S. of the entity comply with the disclosure requirements of the relevant statute; and (e) for ensuring that the audit report complies with the requirements of the relevant statute. Each joint auditor is entitled to assume that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors. **Reporting Responsibilities in case of differences of opinion**: Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement. In the present case, Mr. Z does not agree with the opinion of Mr. X and Mr. Y, therefore he needs to issue a separate report.
25	**ABC & Co. and DEF & Co. Chartered Accountant firms were appointed as joint auditors of Good Health Care Ltd. for 2014-15. An investigation was conducted under Companies Act 2013 during March 2016 and observed gross understatement of Revenue. The revenue aspects were looked after by DEF & Co, but there was no documentation for the division of work between the joint auditors.**

Answer: : Responsibilities of Joint Auditor:

- As per SA 299 "Responsibilities of Joint Auditor" where joint auditors are appointed, they should, by mutual discussion, divide the work among themselves.
- Further the work so divided should be adequately documented and preferable communicated to the entity.
- In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him.
- However for the work not divided, all the joint auditor are jointly and severally responsible.
- In the present case, though the revenue aspects were looked after by DEF & Co., but as there is no documentation for division of the work between them, both the joint auditors will be held responsible for it.

Conclusion: Both Joint auditors are jointly and severally responsible.

SA 300 "Planning an Audit of Financial Statements"

26 **Comment on the following: Auditor shall establish an overall strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan".**

Answer: Establishment of Audit Strategy:

(a) SA 300 "Planning an Audit of Financial Statements" requires that the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

(b) In establishing the overall audit strategy, the auditor shall:

- Identify the characteristics of the engagement that define its scope;
- Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- Consider the factors that are significant in directing the engagement team's efforts;
- Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- Ascertain the NTE of procedures necessary to perform.

SA 315 "Identifying and assessing the Risk of Material Misstatements through Understanding the Entity and its Environment"

27 **What are the points to be remembered while evaluating the knowledge of the business in the conduct of an audit? [May 09 (8 Marks)]**

or

What are the broad matters to be considered while obtaining knowledge of business for a new audit engagement of a manufacturing concern? [May 10 (4 marks)]

Answer: Obtaining an understanding of the entity and its environment:

As per SA 315 "Identifying and Assessing the Risk of Material Misstatements through understanding the entity and its environment" auditor is required to obtain an understating of following as a part of risk assessment procedures:

(a) Industry, regulatory, and other external factors including applicable financial reporting framework.

(b) The nature of the entity, including:

- its operations;
- its ownership and governance structures;
- the types of investments that the entity is making and plan to make; &
- the way that the entity is structured and how it is financed;

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto.

(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(e) The measurement and review of the entity's financial performance.

The auditor shall also obtain an understanding of internal controls relevant for an audit.

28 **Z Ltd. has its entire operations including accounting computerised. As the audit partner you are concerned about inherent and control risk for material financial statement assertions. What could be the areas you look forward for deficiencies and risk identification. [May 11 (4 Marks)]**

Answer: Risk Assessment in CIS Environment:

SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", requires the auditor to make an assessment of inherent and control risk for material financial statement assertions. In a CIS environment, auditor should look into below mentioned area for risk identification:

(i) Program Development and maintenance.

(ii) System software support.

(iii) Operations including processing of data.

(iv) Physical CIS security.

(v) Control over access to specialized utility program.

29 **IT systems also pose specific risks to an entity's internal control? What are those risks? [May 10 (4 Marks)]**

Answer: Risk to Internal Control imposed by IT System:

As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to an entity's Internal Control. These risks are:

(a) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both.

(b) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non existent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.

(c) The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.

(d) Unauthorised changes to data in Master files

(e) Unauthorised changes to systems or programs.

(f) Failure to make necessary changes to systems or programs.

(g) In appropriate manual intervention

(h) Potential loss of data or inability to access data as required.

SA 320 "Materiality in Planning and Performing an Audit"

30 **Mr. X was appointed as the auditor of M/s Easygo Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose. [Nov. 13 (4 Marks)]**

Answer: Use of benchmark in determining Materiality:

SA 320 "Materiality in Planning and Performing an Audit" prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole. Accordingly determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

(i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);

(ii) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);

(iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

(iv) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and

(v) The relative volatility of the benchmark.

31 **As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please guide him. [May 15 (5 Marks)]**

Answer: Re-evaluation of the Materiality Concept:

- SA 320 "Materiality in Planning and Performing an Audit", requires the auditor to determine materiality for the financial statement as a whole, while establishing the overall audit strategy.
- If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.
- The auditor shall revise materiality for the financial statements as a whole and if applicable the materiality levels for particular classes of transactions, account balances or disclosures, in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
- If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.
- In the instant case, Mr. P, auditor of RST Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept, on the basis of additional information of significant contractual arrangements which draws attention to a particular aspect of the company's business.

Conclusion: Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

SA 330 "The Auditor's Responses to Assessed Risks"

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

[May 13 (4 Marks)]

Answer: Factors warranting re-test of controls:

As per SA 330 on "The Auditor's Responses to Assessed Risks", if the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, he shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit.

The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment.

Factors that may warrant a re-test of controls are-

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

33 **While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement?** **[Nov. 12 (8 Marks)]**

Answer: Substantive Procedures to be performed to assess the risk of material misstatement:

- SA 330, "The Auditor's Response to Assessed Risk", defines substantive procedures as an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures.
- **Test of Details**: Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. This requirement reflects the facts that: (i) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (ii) there are inherent limitations to internal control, including management override.
- **Substantive Analytical Procedure**: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, "Analytical Procedures" establishes requirements and provides guidance on the application of analytical procedures during an audit.
- Depending on the circumstances, the auditor may determine that:
  1. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
  2. Only tests of details are appropriate.
  3. A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

34 **As a Statutory Auditor, how would you deal with the following: 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.**

Answer: Assessment of Risk and Acceptable Level:

- SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" and SA 330 "The Auditor's Responses to Assessed Risks" establishes standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components.
- SA 315 and SA 330 require that the auditor should use professional judgement to assess risk of material misstatement and to design audit procedures to ensure that it is reduced to an acceptably low level.
- Risk of Material Misstatements comprises of Inherent risk and Control Risk. "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 risk of material misstatement, 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.

35 **While commencing the statutory audit of ABC Company Limited, what should be the considerations of the auditor to assess Risk of Material Misstatement and his response to such risks? [Nov. 14 (4 Marks)]**

Answer: Considerations of Auditor for Assessing the Risk of Material Misstatement:

SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment", requires the auditor to identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

(i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls;

(ii) Assess and evaluate the identified risks;

(iii) Relate the identified risks to what can go wrong at the assertion level; and

(iv) Consider the likelihood of misstatement.

Auditor's Responses to the Assessed Risk of Material Misstatement:

As per SA 330 "The Auditor's Responses to Assessed Risks", the auditor shall design and implement overall responses to address the assessed risks of material misstatement. In designing the audit procedures to be performed, the auditor shall:

(i) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure; and

(ii) Obtain more persuasive audit evidence for the auditor's assessment of risk.

SA 402 "Audit Considerations in an entity using Service Organisation"

36 **"As per SA 402, the user auditor shall obtain an understanding of how user entity uses the services of a service organization in the user entity operations" Explain the various matters of which understanding is required.**

or

A Company outsourced the activity of accounting data maintenance to the Service Organisation to achieve cost reduction. As a Statutory Auditor of such company, what are the precautions/checks that you would consider for conducting the audit?

or

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.

[May 11 (4 Marks)]

or

G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of G Ltd. as to how he can obtain an understanding of how G Ltd. uses the services of the outsourced agency in its operations. [Nov. 13 (5 Marks)]

Answer: **Matters of which understanding is required by user auditor w.r.t. services of a services organization**:

A client may use a service organisation such as one that executes transactions and maintains related accounts or records transactions and processes related data. If a client uses a service organisation, certain policies, procedures and records maintained by the service organisation might be relevant to the audit of the financial statements of the client. Consequently, the auditor would consider the nature and extent of activities undertaken by service organisations so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.

SA 402 on "Audit Considerations relating to an Entity Using a Service Organisation" deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations. Accordingly, the user auditor is required to shall obtain an understanding of how user entity uses the services of a service organization in the user entity operation, including:

1. Nature of service provided by the service organization and the significance of those services to the user entity.
2. The nature and materiality of the transactions processed or financial reporting processes affected by service organizations.
3. The degree of interaction between activities of service organizations and those of the user entity.
4. The nature of relationship between user entity and the service organization.

37 **When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization? [May 15 (5 Marks)]**

Answer: Information to be obtained w.r.t. controls at a sub-service organisation:

- SA 402 on "Audit Considerations relating to an Entity Using a Service Organisation" deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations, which in turn may use a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting.
- If a service organisation uses a subservice organisation, the service auditor's report may either include or exclude the subservice organisation's relevant control objectives and related controls in the service organisation's description of its system and in the scope of the service auditor's engagement. These two methods of reporting are known as the inclusive method and the carve-out method, respectively.
- If the Type 1 or Type 2 report excludes the controls at a subservice organisation, and the services provided by the subservice organisation are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of this SA in respect of the subservice organisation and accordingly obtain an understanding of the following:
  1. Nature of service provided by the sub-service organization and the significance of those services to the user entity.
  2. The nature and materiality of the transactions processed or financial reporting processes affected by sub-service organizations.
  3. The degree of interaction between activities of sub-service organizations and those of the user entity.
  4. The nature of relationship between user entity and the sub-service organization.
- The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organisation depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

SA 450 "Evaluation of Misstatements Identified During The Audit"

38 **In the course of audit of T Ltd., the audit team is not sure of the possible source of misstatements in the financial statements. As the audit manager identify the sources of misstatements. [May 11 (4 Marks)]**

or

In audit plan for T Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements.

[May 13 (4 Marks)]

Answer: Sources of Misstatement:

SA 450 "Evaluation of Misstatements identified during the Audit", defines the term misstatement as 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. Accordingly miststament may caused due to following:

(i) An inaccuracy in gathering or processing data from which the financial statements are prepared;

(ii) An omission of an amount or disclosure;

(iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; and

(iv) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

39	**Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same. [Nov. 14 (4 Marks)]**
	Answer: Impact of uncorrected misstatements identified during the audit: • SA 450 "Evaluation of Misstatements identified during the audit" deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. • In accordance with SA 450, the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider the size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole. • The auditor shall request the management that uncorrected misstatements be corrected. If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections. • Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320, to confirm whether it remains appropriate in the context of the entity's actual financial results. • The auditor shall communicate with TCWG, uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report. • The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.
40	**While auditing accounts of a public limited company for the year ended 31st March 2014, an auditor found out an error in the valuation of inventory, which affects the financial statement materially – Comment as per standards on auditing.**
	Answer: Errors in Valuation of Inventories and Auditor's Responsibilities: • SA 450 "Evaluation of Misstatements identified during the audit" deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. • In accordance with SA 450 auditor should consider requesting the management to adjust the financial information or consider extending his audit procedures. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate. **Conclusion**: In the instant case, the auditor has detected the material errors affecting the financial statements; the auditor should communicate his findings to the management on a timely basis, consider the implications on true and fair view and also ensure that appropriate disclosures have been made.

SA 500 "Audit Evidence"

41 **Comment on the following: Z Ltd. had appointed an outside expert to assess accrued gratuity liability of the company. Based on the said report, the company provides Rs. 80 lakhs as gratuity in the financial statements.** **[May 09 (4 Marks)]**

or

What are the procedures to be followed by a statutory auditor for verifying the provision for accrued liability for retirement benefits which is based on a certificate of an reputed actuary?

[May 10 (8 marks)]

or

Y Ltd. Engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As the auditor of Y Ltd. You would like to use the report of actuary as an audit evidence. How do you evaluate the work of actuary. **[May 11 (8 Marks)]**

Answer: Evaluating the work of Management Expert:

As per SA 500 "Audit Evidence" when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall perform the following:

(i) **Evaluate the competence, capabilities and objectivity of that expert**: For this purpose, auditor may consider his qualification, membership of a professional body or industrial association license to practice etc.

(ii) **Obtain an understanding of the work of that expert**: it may include areas of specialty, applicable professional standards and other legal requirements.

(iii) **Evaluate the appropriateness of that expert's work**: with respect to following:

(a) Relevance and reasonableness of that expert findings and conclusion.

(b) Relevance and reasonableness of assumptions and methods used; and

(c) Relevance, completeness and accuracy of source data.

42 **As a Statutory Auditor, how would you deal with the following case: M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to the previous year's figures.**

Answer: Using the work of Management Expert as an audit evidence:

- SA 500 (Revised), "Audit Evidence" states that the auditor has to evaluate the work of management expert, say, actuary, before adopting the same.
- The work of management expert is required to be evaluated in terms of following:
  (i) Relevance and reasonableness of that expert findings and conclusion.
  (ii) Relevance and reasonableness of assumptions and methods used; and
  (iii) Relevance, completeness and accuracy of source data.
- This becomes more crucial since M/s LNK's group gratuity scheme's valuation by actuary shows wide variation compared to Important figures. There is no doubt that appropriateness, reasonableness of assumptions and methods used are the responsibility of the expert, but the auditor has to determine whether they are reasonable based on the auditor's knowledge of the client's business and result of his audit procedures.
- In the present case, the auditor must verify the reasonableness of assumptions made and methods adopted by the actuary in the evaluation particularly with reference to factors such as rate of return on investments, retirement age, number and salary of employees, etc.

Conclusion: in view of provisions of SA 500 as discussed above, the auditor has to satisfy himself whether valuation done by the actuary can be adopted, otherwise he may report on his findings for wide variation.

43	**The auditor of SS Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age. Comment.** **Or** **For determining the liability for Gratuity, Actuary's Report is produced to the auditor. On examination auditor notices a serious wrong assumption in the report. Auditor challenges the Actuary's report – Comment.**
	Answer: Using the work of Management Expert as an audit evidence: • SA 500 (Revised), "Audit Evidence" states that the auditor has to evaluate the work of management expert, say, actuary, before adopting the same. • The work of management expert is required to be evaluated in terms of following: (i) Relevance and reasonableness of that expert findings and conclusion. (ii) Relevance and reasonableness of assumptions and methods used; and (iii) Relevance, completeness and accuracy of source data. • There is no doubt that appropriateness, reasonableness of assumptions and methods used are the responsibility of the expert, but the auditor has to determine whether they are reasonable based on the auditor's knowledge of the client's business and result of his audit procedures. • In the instant case, a qualified actuary has issued a certificate for gratuity liability valuation, for which retirement age adopted is 65 years against the existing retirement age of 60 years; however, the company is considering a proposal to increase the retirement age. **Conclusion**: In view of provisions of SA 500 as discussed above, the assumption made by actuary has no relevance and reasonableness as presently retiring age is of 60 years. Hence the auditor is required to bring out the facts to the notice of management and advice the modification accordingly. In case of failure of compliance of the same the auditor may qualify the report.
44	**Write short note on: Inquiry. [Nov. 10 (4 marks)]**
	Answer: Inquiry: • As per SA 500 "Audit Evidence" , inquiry is one of the methods to obtain audit evidences. Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. • Inquiry is used extensively throughout the audit in addition to other audit procedures. • Inquiries may range from formal written inquiries to informal oral inquiries. However in case oral inquiries, the auditor may consider it necessary to obtain written representations from management and, where appropriate, TCWG to confirm responses to such inquiries. • Evaluating responses to inquiries is an integral part of the inquiry process. • Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

45 **Write short note on: Assessing the reliability of Audit Evidence.** **[May 09 (4 Marks)]**

Answer: Assessing the reliability of audit evidence:

As per SA 500 "Audit Evidence" the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

(a) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

(b) The reliability of audit evidence that is generated internally is increased when the related controls, imposed by the entity are effective.

(c) Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly.

(d) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.

(e) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

SA 501 "Audit Evidence – Specific Considerations for Selected items"

46 **You are the auditor of Easy Communications Ltd. for the year 2015–16. The inventory as at the end of the year i.e. 31.3.16 was Rs. 2.25 crores. Due to unavoideable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?** **[Nov. 08 (5 Marks)]**

Answer: Auditor's duties in case of non-attendance of inventory count:

- SA 501 "Audit Evidence – Additional Considerations for Specific Items", requires from the auditor that when inventory is material to the financial statements, he shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable, to:
  (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
  (ii) Observe the performance of management's count procedures;
  (iii) Inspect the inventory; and
  (iv) Perform test counts;
- SA 501 further provides that if the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and perform audit procedures on intervening transactions to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded.
- The auditor may also seek management's written representation on (a) the completeness of information provided regarding the inventory, and (b) assurance with regard to adherence to laid down procedures for physical inventory count.

SA 505 "External Confirmation"

47 Write short note on: External Confirmations in audit. [Nov. 09 (4 Marks)]

Answer: External Confirmations:

- As per SA 505 external confirmation may be defined as Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
- External confirmations are of two types:
  (a) **Positive confirmation request** – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
  (b) **Negative confirmation request** – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
- External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties.

48 Write short notes on Situations where external confirmations can be used.

Answer: Situations where external confirmations can be used:

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties.

Other situations where external confirmation procedures may provide relevant audit evidence include:

(i) Bank balances and other information relevant to banking relationships.
(ii) Accounts receivable balances and terms.
(iii) Inventories held by third parties at bonded warehouses for processing or on consignment.
(iv) Property title deeds held by lawyers or financiers for safe custody or as security.
(v) Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
(vi) Amounts due to lenders, including relevant terms of repayment.
(vii) Accounts payable balances and terms.

49 The management of S Ltd. Request you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an appropriate response? [May 11 (6 Marks)]

or

The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. Accede to this request? [May 13 (4 Marks)]

	Answer: Management refusal to allow auditor to send confirmation request: • SA 505, "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. • The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of some reasons, for example, due to a dispute with the particular creditor or debtor. • If the management refuses to allow the auditor to a send a confirmation request, the auditor shall: a. Inquire as to Management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness, b. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and c. Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with TCWG and also determine its implication for the audit and his opinion.
50	**Moon Limited replaced its statutory auditor for the Financial year 2015-16. 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 he is traceable. Under the circumstances, no confirmation of the credit balance is available. [Nov. 09 (5 Marks)]**
	Answer: Auditor's duties in case of non availability of External Confirmation: • SA 505 "External Confirmations" provides that if the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, and alternative audit procedures will not provide the audit evidence the auditor requires, he should determine the implications for the audit and the auditor's opinion in accordance with SA 705. • In the present case the identities of trade payables are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation. It might be a case that an income of Rs. 5 lakhs had been hidden in previous year/s. • The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members.
51	**As an auditor how would you deal with the following: When the audit team visited the client to perform substantive audit of debtor, the client produced ledger account of customers and confirmations for the top 10 customers. One of the debtors was more than 5 years old, but it had confirmed his balance. [May 10 (5 Marks)]**

	Answer: Auditor's duties in case of doubt over reliability of external confirmations: • SA 505 "External Confirmations" deals with the auditor's use of external confirmation procedures to obtain audit evidence. External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by the management in the financial statements. • As per SA 505, the auditor is required to maintain a control over the process of selecting those to whom a request will be sent out, the preparation and sending of confirmation requests and responses to those requests. This is because there have been several cases of clients presenting forged confirmation to auditors when such control was absent. • In the present case, one of the debtors of more than 5 years old had confirmed his balance. The auditor should enquire into the debtor whose dues are outstanding for 5 years or more about his financial abilities and why he has not paid, reasons behind the same, and if found adverse, the client should be advised to provide for "Provision for bad debts' and also to confirm that it is not a forged confirmation.
52	**During the course of audit of Star Limited the auditor received some of the confirmation of the balances of trade payables outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of trade payables, there are number of trade payables of small balances except one, old outstanding of Rs. 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.**
	Answer: **Response to Negative Confirmation Request**: • As per SA 505, "External Confirmation", Negative Confirmation is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. • Negative confirmations provide less persuasive audit evidence than positive confirmations. In case of negative confirmation request, confirming parties may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise. • In the instant case, the auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of rupees 15 lacs has not sent the confirmation on the credit balance. • Non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request. • In the present case, considering the materiality of the account balance, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.

SA 510 "Initial Audit Engagements – Opening Balances"

53 **What are Initial Audit Engagement**

Answer: Initial Audit Engagements:

As per SA 510 "Initial Audit Engagements - Opening Balances", initial audit engagement is an engagement in which either:

(i) The financial statements for the prior period were not audited; or

(ii) The financial statements for the prior period were audited by a predecessor auditor.

54 **Comment on the following: You have been appointed as the auditor of Good Health Ltd. for 2015-16 which was audited by CA Trustworthy in 2014-15. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2014-15 have been brought to account in 2015-16 as Opening Balances and the Opening Balances do not contain misstatements. [Nov. 08 (5 Marks)]**

Or

What are the procedures to be followed by a Statutory Auditor in the audit of opening balances if the financial statements for the preceding year were audited by another auditor?

Answer: **Audit procedures for verification of opening balances in case of initial audit engagement**:

As per SA 510 "Initial Audit Engagements- Opening Balances", the objective of the Auditor while conducting an initial audit engagement with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

(i) opening balances of the preceding period have been correctly brought forward to the current period;

(ii) opening balances do not contain any misstatement that materially affect the current period's financial statements; and

(iii) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

55 **In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening balances' to ensure that they are free from instatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report? [May 15 (5 Marks)]**

Answer: **Audit procedures for verification of opening balances in case of initial audit engagement**:

As per SA 510 "Initial Audit Engagements-Opening Balances", the objective of the Auditor while conducting an initial audit engagement with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

(i) opening balances of the preceding period have been correctly brought forward to the current period;

(ii) opening balances do not contain any misstatement that materially affect the current period's financial statements; and

(iii) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the audit of financial statements is being conducted for the first time, the auditor has to perform auditing procedures to obtain sufficient appropriate audit evidence. Since opening balances represent effect of transaction and events of the preceding period and accounting policies applied in the preceding period, the auditor need to obtain evidence having regard to nature of opening balances, materiality of the opening balances and accounting policies. Since it will not be possible for auditor to perform certain procedures, e.g., observing physical verification of inventories, etc. the auditor may obtain confirmation, etc. and perform suitable procedures in respect of fixed assets, investments, etc. The auditor can also obtain management representation with regards to the opening balances.

Considerations while drafting Report:

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

SA 520 "Analytical Procedures"

56 **What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client.** **[May 09 (6 Marks)]**

Answer: Auditor's considerations while performing analytical procedures:

SA 520 "Analytical Procedures" deals with the auditor's use of analytical procedures as substantive procedures and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

Accordingly, when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:

1. Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
2. Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
3. Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
4. Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

57	**In the audit of Hotel Great Hay Limited its auditor wants to use the analytical procedure as substantive procedure in respect of room rental income as well as pay roll costs, guide him as to how it can be done. [Nov. 13 (4 Marks)]**

Answer: Applying analytical procedures as substantive procedures:

- SA 520 "Analytical Procedures" deals with the auditor's use of analytical procedures as substantive procedures and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.
- Accordingly, in some cases, predictive model may be effective as an analytical procedure.
- In case of Payroll cost - Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.
- In case of Room Rental Income of Hotel, different types of analytical procedures provide different levels of assurance. Analytical procedures involving the prediction of total rental income in case of hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.

SA 530 "Audit Sampling"

58	**Write short note on: Sampling Risk.** **or** **While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind? [May 10 (4 marks)]**

Answer: **Risk Factors while Sampling technique**:

- SA 530 deals with the auditor's use of statistical and non-statistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample.
- While using sampling technique, auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This is known as sampling risk.
- Sampling risk can lead to two types of erroneous conclusions:
  1. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does.
     The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
  2. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not.
     This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

SA 540 "Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures

59 **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? [May 11 (6 Marks)]**

Answer: <u>Evaluation of financial statement assertions based on management estimates</u>:

As per SA 540 "Auditing Accounting Estimates, including Fair Value Accounting Estimates" auditor shall obtain an understanding of the following in order to identify and assess the risks of material misstatement for accounting estimates:

(a) The **requirements of the applicable FRF** relevant to accounting estimates.

(b) **How management identifies** those transactions, events and conditions that may give rise to the need for accounting estimates.

In obtaining this understanding, the auditor shall make **inquiries of management** about changes in circumstances that may give rise to new, or the need to revise existing accounting estimates.

(c) The **estimation making process** adopted by the management including:

- (a) The method, including where applicable the model used in making the accounting estimates.
- (b) Relevant controls
- (c) Whether management has used an expert.
- (d) Assumptions underlying the accounting estimates.
- (e) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so why.
- (f) Whether and if so, how the management has assessed the effect of estimation uncertainty.

(d) The auditor shall **review the outcome of accounting estimates** included in the prior period financial statements.

SA 550 "Related Parties"

60 **Elaborate how the statutory auditor can verify the existence of related parties for the purpose of reporting under AS 18.**

or

As a statutory auditor how do you verify the existence of related parties and disclosures of related party transactions. [Nov. 09(8 Marks)]

or

In the course of audit of Q Ltd, its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information. [May 12 (8 Marks)]

Or

As an Auditor, how will you verify the existence of related parties. [Nov. 12 (8 Marks)]

Answer: <u>Possible sources of related Party Information</u>:

As per SA 550 "Related Parties" the auditor shall remain alert, when inspecting records or documents with respect to arrangements or information indicating the existence of related party relationships or transactions, not previously identified or disclosed to the auditor.

During the audit, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and TCWG.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or TCWG.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator (for example, prospectuses)

61 A statutory auditor is required to follow the procedures so as to identify the risk of material misstatement associated with related parties. What are the auditor's duties when he identifies related parties or related party transactions that management not previously disclosed to him.

Answer: Verification of existence of related parties:

SA 550 "Related Parties" requires the auditor to perform procedures so as to identify the risk of material misstatement associated with related parties. Accordingly auditor should perform the following:

(a) Inquire the management regarding
- Identity of entity's Related Party, changes from prior period.
- Nature of relationships between entity and Related Party.
- Type & purpose of transactions with Related Party during the period.

(b) The auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

(c) If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
   (i) Promptly communicate the relevant information to the other members of the engagement team;
   (ii) Where the applicable FRF establishes related party requirements:

- Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and
- Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;

(iii) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;

(iv) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and

(v) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.

62 In the course of your audit you have come across a related party transaction which prima facie appears to be biased. How would you deal with this? [Nov. 14 (4 marks)]

Answer: Related Parties:

As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties and for this purpose, he may inspect records or documents that may provide information about related party relationships and transactions.

In this case, the auditor is finding a related party transaction which *prima facie* appears to be biased. So the auditor is required to confirm the same. For identified significant related party transactions outside the entity's normal course of business, the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

(i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets,

(ii) The terms of the transactions are consistent with management's explanations; and

(iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

The auditor should also obtain audit evidence that the transactions have been appropriately authorised and approved.

Conclusion: If the auditor concludes that the related party transaction is biased, he should report that the related party relationships and transactions prevent the financial statements from achieving true and fair presentation.

SA 560 "Subsequent Events"

63 Briefly Explain: Audit procedures on subsequent events. **[Nov. 09 (4 Marks)]**

Or

Briefly describe auditor's responsibility regarding subsequent events.

Answer: Audit Procedures on subsequent Events:

- SA 560 "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.
- As per SA 560 the term, Subsequent Events may be defined as the events occurring between the dates of balance sheet and audit report and the facts that become known to the auditor after the date of the auditor's report.
- The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
- The auditor's procedures on subsequent events shall include the following:
  - (a) Obtaining an understanding of the procedures through which management has identified subsequent events.
  - (b) Inquiring of management and, TCWG as to occurrence of subsequent events which might affect the financial statements.
  - (c) Reading minutes of management & TCWG meetings that have been held after the date of the financial statements.
  - (d) Reading the entity's latest subsequent interim financial statements, if any.
- When, as a result of the procedures performed as required the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

64 Comment on the following: A Co. Ltd. has not included in the Balance Sheet as on 31-03-2015 a sum of Rs. 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2015. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2015. The auditor came to know the result of the negotiations on 15-05-2015.

[Nov. 10 (5 Marks)]

Answer: Treatment of subsequent Events:

- SA 560 "Subsequent Events" requires that in respect of events occurring between the date of F.S. and date of the Audit Report, the auditor shall perform audit procedures to obtain sufficient & appropriate audit evidence to ensure that events which require adjustments or disclosure in the F.S. have been identified.
- If auditor identifies events that require adjustment or disclosure in the F.S., the auditor should determined whether each such event is appropriately reflected in the F.S.
- The auditor shall request the management to provide a "Written Representation" that all events occurring subsequent to the date of the F.S. and requires adjustment or disclosure have been adjusted or disclosed.

	• In the instant case, the amount of Rs. 1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. As per the provisions of AS-4 and AS-29, the obligation requires provision for outstanding expenses. **Conclusion**: The facts of the case indicates the event as of adjusting nature as per AS–4 "Contingencies and Events Occurring after the Balance Sheet date" and requires adjustment in assets and liabilities, which has not been made by the management. Auditor should request management to adjust the sum of Rs. 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the Audit Report.
65	**As a statutory auditor of a company, comment on the following: A fire broke out on 15th May, 2015, in which material worth Rs. 50 lakhs which was lying in inventory since 1st March, 2015 was totally destroyed. The financial statements of the company have not been adopted till the date of fire. The management of the company argues that since the loss occurred in the year, 2015-16, no provision for the loss needs to be made in the financial statements for 2014-15. [Nov. 12 (5 Marks)]**
	Answer: Event Occurring after the Balance Sheet Date: • As per AS- 4 on 'Contingencies and Events Occurring After the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. • AS – 4 also requires disclosure of the non-adjusting event, in the report of approving authority. • Further as per SA 560 "Subsequent Events" the auditor should ensure that all events occurring subsequent to the date of financial statements and for which applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. • In the instant case, fire took place after the close of the accounting year and does not relate to conditions existing at the balance sheet date. **Conclusion**: The event will have no impact on items appearing at the Balance Sheet date and hence not required any adjustment, subject to satisfaction in respect of non-violation of going concern concept. Hence management is correct by not providing provision. However, auditor is required to ensure the proper disclosure in report of approving authority.

SA 570 "Going Concern"

66	**ABC Company files a law suit against Unlucky Company for Rs. 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation?**
	Answer: Evaluating appropriateness of going concern assumption: • AS 29 "Provisions, Contingent liabilities and Contingent Assets", requires that if any future event may cause a possible obligation, a provision should be made in the accounts to recognize the obligation where there is sufficient evidence that the event will occur.

	• SA 570 "Going Concern" requires that the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event. • When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions. • In the instant case, ABC Company has filed a law suit against Unlucky Company for Rs. 5 crores. The attorney of Unlucky Company feels that the suit is without merit, so the company merely discloses the existence of law suit in the notes accompanying its financial statements. **Conclusion**: Auditor should evaluate the source data on which basis the opinion is formed and evaluate the appropriateness of use of going concern assumption. If the auditor finds the uncertainty, he may request the management to adjust the sum of Rs. 5 crore by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.
67	**A Company's net worth is eroded and creditors are unpaid due to liquidity constraints. The management represents to the statutory auditor that the promoter's wife is expected to give an unsecured loan to meet the liquidity constraints and that negotiations are underway to secure large export orders. [May 09 (4 Marks)]**
	Answer: Appropriateness of Going Concern Assumption : • SA 570 "Going Concern" requires that the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Eroded net worth and nonpayment to creditors are one of the examples of such event. • As per SA 570, when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. • In the present case, it is subjective, but prima-facie a mere expectation of future cash flows from the promoter's wife without any firm commitment and the possibility of an export order being negotiated, may not that be sufficient appropriate audit evidence of mitigating factors for resolving the going concerns question under SA 570 "Going Concern". **Conclusion**: Based on the results of evaluation of appropriateness of going concern assumption, auditor is required to modify the opinion.
68	**R & Co. is the statutory auditor of S Ltd. for the financial year ended on 31st March 2015, S Ltd had disclosed in the notes (Note No. X) "The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit. Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd include financial statements of certain branches which are audited by other auditors. What are the reporting responsibilities of R & Co? [May 12 (10 Marks)]**

Answer: Reporting responsibilities of Auditor:

(A) Evaluation of appropriateness of Going concern Assumption:

- As per SA 570 "Going Concern" auditor is required to obtain sufficient appropriate audit evidence about the appropriateness of management use of going concern assumption in the preparation and presentation of financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.
- When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:
  - (a) Adequately describe the principal events that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
  - (b) Disclose clearly that there is a material uncertainty related to going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.
- If adequate disclosure is made in the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report.

Conclusion: In the present case, as disclosure is given in financial statements, R & Co. should include an Emphasis of Matter paragraph in the Auditor's Report.

(B) Reporting of Branches audited by other auditors:

- As per SA 600 "Using the work of Another Auditor", when the principal auditor has to base his opinion on the financial information of an 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.

Conclusion: R & Co. should include an "Other Matter" paragraph in the audit report on this matter.

69 **While examining the going concern assumption of an entity, what important indications should be evaluated and examined?**

or

What are the Financial indications to be considered by an auditor for evolution of the going Concern assumption? **[Nov. 08 (4 Marks)]**

Answer: Indications to be considered while evaluating Going Concern Assumption:

SA 570 "Going Concern", requires that auditor should obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements. Accordingly, when performing risk assessment procedures as required by SA 315, the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Examples of such events or conditions are:

Financial Indications

1. Net liability or net current liability position.
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
3. Indications of withdrawal of financial support by trade payables.
4. Negative operating cash flows indicated by historical or prospective financial statements.
5. Adverse key financial ratios.
6. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
7. Arrears or discontinuance of dividends.
8. Inability to pay trade payables on due dates.
9. Inability to comply with the terms of loan agreements.
10. Change from credit to cash-on-delivery transactions with suppliers.
11. Inability to obtain financing for essential new product development or other essential investments.

Operating Indications

1. Management intentions to liquidate the entity or to cease operations.
2. Loss of key management without replacement.
3. Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
4. Labour difficulties.
5. Shortages of important supplies.
6. Emergence of a highly successful competitor.

Other Indications

1. Non-compliance with capital or other statutory requirements.
2. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
3. Changes in law or regulation or government policy expected to adversely affect the entity.
4. Uninsured or underinsured catastrophes when they occur.

SA 580 "Written Representations"

70 Explain what is meant by "Written Representations" and indicate to what extent an auditor can place reliance on such representations.

Answer: Meaning of Written Representation:

- As per SA 580 "Written Representations" it is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.
- Written representations are necessary information that the auditor requires in connection with the audit, hence they are recognized as audit evidence as a response to inquiries.
- Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.
- The written representations shall be in the form of a representation letter addressed to the

auditor.

Extent of Reliance:

- If the auditor has concerns about the competence, integrity, ethical values or diligence of management, the auditor shall determine their effect on the reliability of representations (oral or written) and audit evidence in general.
- In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter.
- If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion
- If he claims that there is sufficient doubt about integrity of management, he shall issue a disclaimer of opinion.

71 State briefly the basic elements of Management Representation Letter.

Answer: Basic Elements of a Management Representation Letter:

As per SA 580 "Written Representations", some of the basic elements of a Management Representation letter are-

(1) It is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.

(2) It does not include financial statements, the assertions therein, or supporting books and records.

(3) The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.

(4) The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

(5) The written representations shall be in the form of a representation letter addressed to the auditor.

72 In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty? [May 10 (4 Marks)]

Answer: Duty of an Auditor if management refuses to provide written representations:

As per SA 580 "Written Representations", if the management does not provide one or more of the requested written representations, the auditor shall:

(i) Discuss the matter with management,

(ii) Re-evaluate the Integrity of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general, and

(iii) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

(iv) Disclaim an opinion on the financial statements in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

73	**An auditor of Mohan Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?** **Or** **The Auditor of PQR Pvt. Ltd. having turnover of Rs. 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach?** **[Nov. 14 (5 Marks)]**
	Answer: Validity of Management Representation: • The physical verification of fixed assets (Inventory) is the primary responsibility of the management. The auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence, ownership and valuation of fixed assets (inventory). • In the case of Mohan Ltd., the auditor has not been able to verify the existence and value of some machinery (inventory) despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry. • As per SA 580 "Written Representation" the representations received from management are recognised as audit evidence, but they do not constitutes Sufficient and appropriateness. • Auditor is required to seek corroborative audit evidence from other sources inside or outside the entity, to evaluate whether such representations are reasonable and consistent with other evidences. Representation received from Management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. • If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter, which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. **Conclusion**: The approach adopted by the auditor is not right.
74	**In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a special audit conducted at the instance of the management on a possible suspicion of a fraud and requested for a copy of the report to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided with at least a written representation in respect of fraud on/by the company. For this request also, the management remained silent. Please guide Mr. 'N'.**
	Answer: Auditors Responsibilities Relating to Fraud: • As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements", the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. In addition an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

- *As per SA 580, "Written Representations", if management does not provide the requested written* representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.
- The auditor shall disclaim an opinion on the financial statements if the auditor concludes that there is sufficient doubt about the integrity of management such that the written representations are not reliable; or management does not provide the written representations.
- In the instant case, in the course of audit of K Ltd., its auditor Mr. N observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report, which was not provided by the management despite of many reminders. Mr. N also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

Conclusion: Auditor is required to state the facts in his report and he should also disclaim an opinion on the financial statements.

SA 620 "Using the work of Auditor's Expert"

75 **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?**

[Nov. 10 (4 Marks)]

Answer: Types of Reports / Opinion:

As per SA 620, "Using the work of an Auditor's Expert", the auditor can obtain the following types of reports, or opinions or statements of an expert for the purpose of audit evidence:

1. The valuation of complex financial instruments, land and buildings, plant and machinery, jewellery, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
2. The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
3. The estimation of oil and gas reserves.
4. The valuation of environmental liabilities, and site clean-up costs.
5. The interpretation of contracts, laws and regulations.
6. The analysis of complex or unusual tax compliance issues.

Extent to which Expert work can be relied upon:

When the auditor intends to use the work of an expert, he shall evaluate the adequacy of the auditor's expert's work, w.r.t. the following:

1. **Findings and Conclusions**: To ensure the evaluate the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
2. **Significant Assumptions and Methods**: If the expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods should be evaluated.
3. **Source Data used**: Auditor is required to evaluate the relevance, completeness, and accuracy of that source data.

If the auditor determines that the work of the auditor's expert is not adequate for the 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 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements"

76 **The audit report of P Ltd. for the year 2013-14 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2014-15, how would you report, if:**

(a) The company does not make provision for doubtful debts in 2014-15?

(b) The company makes adequate provision for doubtful debts in 2014-15? [May 09 (8 Marks)]

Answer: Auditor's responsibilities w.r.t. Corresponding figures:

- As per SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements" When the auditor's report on the prior period, as previously issued, included a modified opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable FRF, the auditor's opinion on the current period need not refer to the previous modification.
- SA 710 further states that if the auditor's report on the prior period, as previously issued, included a modified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements.
- In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
  (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
  (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

Conclusion:

(a) 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.

(b) If however, the provision is made, the auditor need not refer to the earlier year's modification.

SRE, SAE, SRS

77 **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. What an ordinary procedure includes for the review of financial statements?**

or

You are engaged to review the system and the information generated from financial statements. Discuss the procedures that may be performed by you as company auditor for review of financial statements.

Answer: Procedures for Review of Financial Statements: As per SRE 2400 "Engagements to Review Financial Statements", procedures for the review of financial statements will ordinarily include:

1. Obtaining an understanding of the entity's business and the industry in which it operates.
2. Inquiries concerning the entity's accounting principles and practices.
3. Inquiries concerning the entity's procedures for recording, classifying and summarising transactions, accumulating information for disclosure and preparation of F.S.
4. Inquiries concerning all material assertions in the financial statements.
5. Analytical procedures designed to identify relationships and individual items that appear unusual. Such procedures would include:
   - Comparison of the financial statements with statements for prior periods.
   - Comparison of the financial statements with anticipated results and financial position.
   - Study of the relationships of the elements of the F.S. that would be expected to conform to a predictable pattern based on the entity's experience or industry norm.
6. Inquiries concerning actions taken at meetings of shareholders, the board of directors, committees of the board of directors and other meetings that may affect the financial statements.
7. Reading the F.S. to consider, on the basis of information coming to the practitioner's attention, whether the F.S. appear to conform with the basis of accounting indicated.
8. Obtaining reports from other practitioners, if any.
9. Inquiries of persons having responsibility for financial and accounting matters concerning, for example:
   - Whether all transactions have been recorded.
   - Whether the financial statements have been prepared in accordance with the basis of accounting indicated.
   - Changes in the entity's business activities and accounting principles and practices.
   - Matters as to which questions have arisen in the course of applying the foregoing procedures.
   - Obtaining written representations from management when considered appropriate.

78 **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.**

Answer: SCOPE

Review Assignment	Statutory Audit
Scope of Review assignments generally falls in agreement between parties.	Scope of Statutory audit should be in accordance with the Companies Act, 2013 or in accordance with other statute.
Scope of Review assignments are 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, Statements and Guidance Notes.

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.

79 **T & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the projected financial statements and give report thereon. What things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements?**

Answer: Acceptance of Engagement

As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

(1) the intended use of the information;
(2) whether the information will be for general or limited distribution;
(3) the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
(4) the elements to be included in the information; and
(5) the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

80 **C & Co. hired Mr. A, Chartered Accountant, to compile its financial statements for the interim period ending on 31^{st} Dec. 2014. Kindly assist Mr. A in drafting scope of engagement letter with specific focus on C & Co. responsibility.** **[Nov. 13 (4 Marks)]**

Answer: **Scope of engagement letter w.r.t. Management Responsibilities**:

As per SRS 4410 "Engagement to Compile Financial Information" an accountant is required to send an engagement letter to the management listing therein the key terms of appointments so as to avoid any misunderstanding. In particular, the engagement letter should provide for the management responsibility with respect to followings:

- Ensuring correctness, completeness and reliability of financial information generated in the entity.
- Maintaining Accounting Records and Internal Controls
- Selecting and applying appropriate accounting policies.
- Establishing controls for safeguarding the assets and detecting frauds.
- Ensuring compliance with laws and regulation
- Complete disclosure of all material and relevant information to the accountant.

A compilation engagement carried out by the accountant does not relieve the management of these responsibilities. The accountant should, accordingly, obtain an acknowledgement from the management of its responsibility for the appropriate preparation and presentation of the financial statements or other information.

81	**While compiling the financial statements of Discrepancy Ltd., you observed that the information supplied by the company is incomplete, incorrect and few of the Accounting Standards have not been followed. Describe, in brief, the procedure you will follow in the above situation.**
	Answer: Compilation of Financial Information: As per SRS 4410 "Engagement to Compile Financial Information", if in the course of compilation of financial statements, it is observed that the information supplied by the entity is incorrect, incomplete or otherwise unsatisfactory, the accountant should perform following procedures: (i) Make any enquiries of management to assess the reliability and completeness of the information provided; (ii) Assess internal controls prevailing in the entity; and (iii) Verify any matters or explanations. (iv) **Obtaining additional information**: Accountant is required to request management to provide additional information. This may be asked in the form of management representation letter covering significant information or explanations given orally on which he considers representations are required. If the management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for such withdrawal. (v) **Non compliance of Accounting Standard**: If one or more accounting standards are not complied with, the same should be brought to the notice of the management and if the same is not rectified by the management, the accountant should include the same in notes to the accounts and the compilation report to the management. (vi) The accountant should read the compiled information and consider whether it appears to be appropriate in form and free from obvious material misstatements. (vii) The identified financial reporting framework and any known departures therefrom should be disclosed within the financial information, though their effects need not be quantified.
82	**Comment on the following: You are appointed to compile financial statements 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. [May 09 (5 Marks)]**
	Answer: Misstatements identified during compilation of financial statements: • As per SRS 4410 "Engagement to Compile Financial Information if an accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the Financial Statements or other compiled financial information. • If such amendments are not made and the financial statements are still considered to be misleading the accountant should withdraw from the engagement. • As per guidance note on Tax Audit u/s 44AB of the Income Tax Act, 1961, the tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof. The tax auditor should also examine the basis adopted for ascertaining the cost and ensure that this basis is consistently followed. It is very necessary for an auditor to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains.

- In the instant case, AB & Co, Chartered Accountants was appointed to compile financial statements for tax audit purpose of Y & Co, a firm. It is the duty of AB & Co, to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains. In this case, the stock valuation was grossly understated. Consequently, the disclosure of profit is also not correct.

Conclusion: The contention of the management of Y & Co, that AB & Co are not the auditors, so they need not be concerned about valuation of stock is not correct. Hence, the accountant may withdraw from the engagement if the management insists on their stand.

83 Write a short note on Reporting on a compilation engagements.

Answer: Reporting on a compilation engagements:

As per SA 4410 "Engagements to Compile Financial Information", the report on compilation engagements should, ordinarily, be in the following layout:

(a) Title: The title of the report should be "Accountant's Report on Compilation of Unaudited Financial Statements" (and not "Auditor's Report");

(b) Addressee: The report should ordinarily be addressed to the appointing authority;

(c) Identification of the financial information also noting that it is based on the information provided by the management;

(d) When relevant, a statement that the accountant is not independent of the entity;

(e) A statement that the management is responsible for:

- completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant;
- maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any;
- establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities;
- establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance;

(f) A statement that the engagement was performed in accordance with this Standard on Related Services;

(g) A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information;

(h) A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework;

(i) Date of the report;

(j) Place of signature; and

(k) Accountant's signature.

The financial statements or other financial information compiled by the accountant should contain a reference such as "Unaudited," "Compiled without Audit or Review" and also "Refer to Compilation Report" on each page of the financial information or on the front of the complete set of financial statements.

84	**You have been asked by a company to compile financial statements for the purpose of obtaining loan from a Bank. Draft a report to be given to the Management for the same. (8 Marks)**

Answer:

ACCOUNTANT'S REPORT ON COMPILATION OF UNAUDITED FINANCIAL STATEMENTS

To.......

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled, the unaudited balance sheet of ……………….(name of the entity) as at March 31, XXXX and the related profit and loss account and the cash flow statement for the period then ended.

The management of the _______ (name of the entity) is responsible for:

(a) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.

(b) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;

(c) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.

(d) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.

(e) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non compliance.

The compilation engagement was carried out by us in accordance with the Standard on Related Services (SRS) 4410 , "Engagements to Compile Financial Information", issued by the ICAI.

The balance sheet and the profit and loss account are in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

For ABC & Co.
Chartered Accountants
…………………………..
Signature
(Name of the accountant and membership number)
Designation

Date:
Place:

85	**Draft an illustrative engagement letter for an engagement to compile financial statements of DEF Ltd. (8 Marks)**

Answer:

To the Board of Directors (or other appropriate representatives of senior management):

You have, vide your letter dated ______ requested that we compile the balance sheet of _______(name of the company) as at __________(date) and the related profit and loss account and the (cash flow statement) for the year ended on that date. We are pleased to confirm our acceptance and understanding of the engagement by means of this letter. As no audit or review engagement procedures would be carried out, no opinion on the financial statements will be expressed. Further, our engagement cannot be relied upon to disclose whether frauds or defalcations, or illegal acts exist. However, we will inform you of any such matters which might come to our attention in the course of the engagement.

As management, you are responsible for:

(a) the accuracy and completeness of the information supplied to us, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.

(b) preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.

(c) safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.

(d) ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.

You will confirm that events and transactions are recorded in accordance with the applicable Accounting Standard(s), issued by the Institute of Chartered Accountants of India and other recognised accounting principles and practices and inform us of any departures therefrom.

As part of our normal procedures, we may request you to provide written confirmations of any information or explanations given to us orally during the course of our work.

We understand that the intended use and distribution of the information we have compiled is ____________ (specify).

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information requested in connection with our engagement.

Our fees will be billed as the work progresses.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our compilation of your financial statements.

XYZ & Co.
Chartered Accountants
....
Signature
(Name of the Member)
Designation
Date:______

For ABC & Co.

Acknowledged on behalf of __________(name of the company)

Signature

Name and Designation

Date

Address
