CA
INTERMEDIATE

JAAHNVI
COMMERCE ACADEMY

Svādhyāya Series

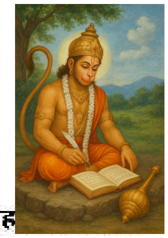
CA INTER || PAPER -5

AUDITING AND ETHICS

CA AKHIL MITTAL

More Than Just notes — It's Dedication in Every Page

|| श्री हनुमान चालीसा ||



|| दोहा ||

श्रीगुरु चरन सरोज रज, निज मनु मुकुरु सुधारि।
बरनऊं रघुबर बिमल जसु, जो दायकु फल चारि।।
बुद्धिहीन तनु जानिके, सुमिरौं पवन-कुमार।
बल बुद्धि बिद्या देहु मोहिं, हरहु कलेस बिकार।।

|| चौपाई ||

जय हनुमान ज्ञान गुन सागर। जय कपीस तिहुं लोक उजागर।।
रामदूत अतुलित बल धामा। अंजनि-पुत्र पवनसुत नामा।।
महाबीर बिक्रम बजरंगी। कुमति निवार सुमति के संगी।।
कंचन बरन बिराज सुबेसा। कानन कुंडल कुंचित केसा।।
हाथ बज्र औ ध्वजा बिराजै। कांधे मूंज जनेऊ साजै।।
संकर सुवन केसरीनंदन। तेज प्रताप महा जग बन्दन।।
विद्यावान गुनी अति चातुर। राम काज करिबे को आतुर।।
प्रभु चरित्र सुनिबे को रसिया। राम लखन सीता मन बसिया।।
सूक्ष्म रूप धरि सियहिं दिखावा। बिकट रूप धरि लंक जरावा।।
भीम रूप धरि असुर संहारे। रामचंद्र के काज संवारे।।
लाय सजीवन लखन जियाये। श्रीरघुबीर हरषि उर लाये।।
रघुपति कीन्ही बहुत बड़ाई। तुम मम प्रिय भरतहि सम भाई।।
सहस बदन तुम्हरो जस गावैं। अस कहि श्रीपति कंठ लगावैं।।
सनकादिक ब्रह्मादि मुनीसा। नारद सारद सहित अहीसा।।
जम कुबेर दिगपाल जहां ते। कबि कोबिद कहि सके कहां ते।।
तुम उपकार सुग्रीवहिं कीन्हा। राम मिलाय राज पद दीन्हा।।
तुम्हरो मंत्र विभीषन माना। लंकेस्वर भए सब जग जाना।।
जुग सहस्र जोजन पर भानू। लील्यो ताहि मधुर फल जानू।।
प्रभु मुद्रिका मेलि मुख माहीं। जलधि लांघि गये अचरज नाहीं।।
दुर्गम काज जगत के जेते। सुगम अनुग्रह
राम दुआरे तुम रखवारे। होत न आज्ञा बिनु पैसारे।।
सब सुख लहै तुम्हारी सरना। तुम रक्षक काहू को डर ना।।
आपन तेज सम्हारो आपै। तीनों लोक हांक तें कांपै।।
भूत पिसाच निकट नहिं आवै। महाबीर जब नाम सुनावै।।
नासै रोग हरै सब पीरा। जपत निरंतर हनुमत बीरा।।
संकट तें हनुमान छुड़ावै। मन क्रम बचन ध्यान जो लावै।।
सब पर राम तपस्वी राजा। तिन के काज सकल तुम साजा।।
और मनोरथ जो कोई लावै। सोइ अमित जीवन फल पावै।।
चारों जुग परताप तुम्हारा। है परसिद्ध जगत उजियारा।।
साधु-संत के तुम रखवारे। असुर निकंदन राम दुलारे।।
अष्ट सिद्धि नौ निधि के दाता। अस बर दीन जानकी माता।।
राम रसायन तुम्हरे पासा। सदा रहो रघुपति के दासा।।
तुम्हरे भजन राम को पावै। जनम-जनम के दुख बिसरावै।।
अन्तकाल रघुबर पुर जाई। जहां जन्म हरि-भक्त कहाई।।
और देवता चित्त न धरई। हनुमत सेइ सर्ब सुख करई।।
संकट कटै मिटै सब पीरा। जो सुमिरै हनुमत बलबीरा।।
जै जै जै हनुमान गोसाईं। कृपा करहु गुरुदेव की नाईं।।
जो सत बार पाठ कर कोई। छूटहि बंदि महा सुख होई।।
जो यह पढ़ै हनुमान चालीसा। होय सिद्धि साखी गौरीसा।।
तुलसीदास सदा हरि चेरा। कीजै नाथ हृदय मंह डेरा।।

|| दोहा ||

पवन तनय संकट हरन, मंगल मूरति रूप।
राम लखन सीता सहित, हृदय बसहु सुर भूप।।

|| [illegible] ||

"A WORD FROM AUTHOR"

Svādhyāya Series

It gives us immense pleasure in presenting our 1st edition of book on Paper-5 i.e., "Auditing and Ethics" for CA Intermediate students for Nov 25 exams and onwards. We have named audit series "Svādhyāya" which means study yourself & book is based on this "mantra".

This book is purely based on institute study material topics, key words, examples, and case studies but prepared with a "mind-set" of a student who requires a book that eases his/her understanding of subject matter.

About the book:

- **Book is divided in to 2 modules (As per institute SM) – Module 1 and Module 2.**
- **Tabular and graphic presentation to facilitate easy understanding and learning.**
- **Inclusion of flowcharts on various topics, including Standards on Auditing.**
- **Use of Hinglish language to make the topic more understandable.**

We have prepared this book with utmost care, but some errors may creep in unintentionally. We apologize for the same but as we say, "Experience is simply the name we give our mistakes" and will be glad to rectify errors in further editions.

SCAN ME

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Disclaimer

Every effort has been made to avoid errors in this publication. In spite of this, some printing errors may be in. Any Error may be brought to our notice which shall be taken care of in our next edition.

MODULE 1

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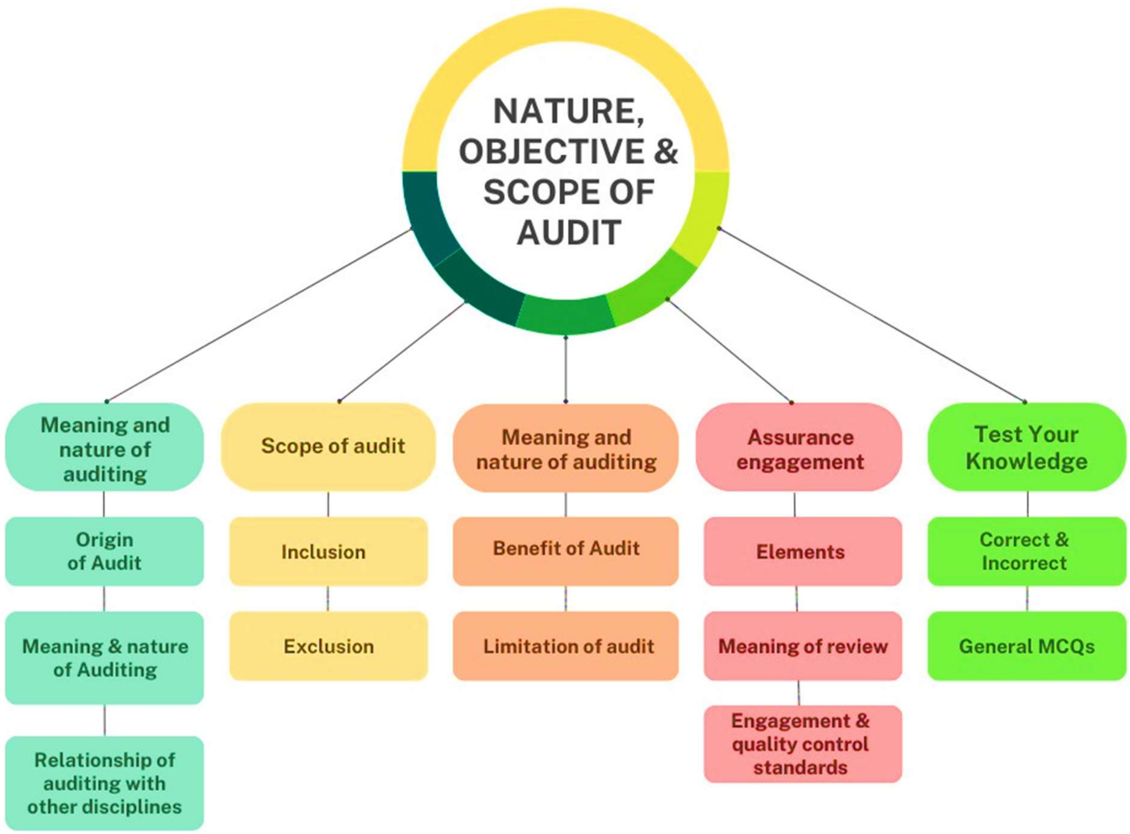
Nature, objectives, and scope of Audit

Chapter Sitemap



CHAPTER 1
NATURE, OBJECTIVE & SCOPE OF AUDIT

"

"Audit evidence" is the very core on the basis of which conclusions are drawn, and opinion is formed by an auditor. In fact, it is the foundation upon which

An Audit is independent examination of financial information of any entity, whetherprofit orientedornot,andirrespectiveofitssizeorlegalform,whensuch anexamination isconductedwitha viewtoexpressinganopinionthereon".

1. Origin of Audit:

Why there has been so much talking about the "audit" process everywhere? Does anyone know the origin of this process! Though some "Old time" connections were found, but word "audit" means "Audire" meaning "to hear" and in medieval time, auditors used to hear the accounts read out to them. In India, under the Britishers, First Auditor General of India was appointed in British India in 1860 to perform both accounting and auditing functions.

Presently, Comptroller and Auditor General (CAG) of India is an independent constitutional authority responsible for auditing government receipts and expenditures. The Institute of Chartered Accountants of India was established as a statutory body under an Act of Parliament in 1949 for regulating the profession of Chartered Accountancy in the country.

2. Meaning and nature of auditing:

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

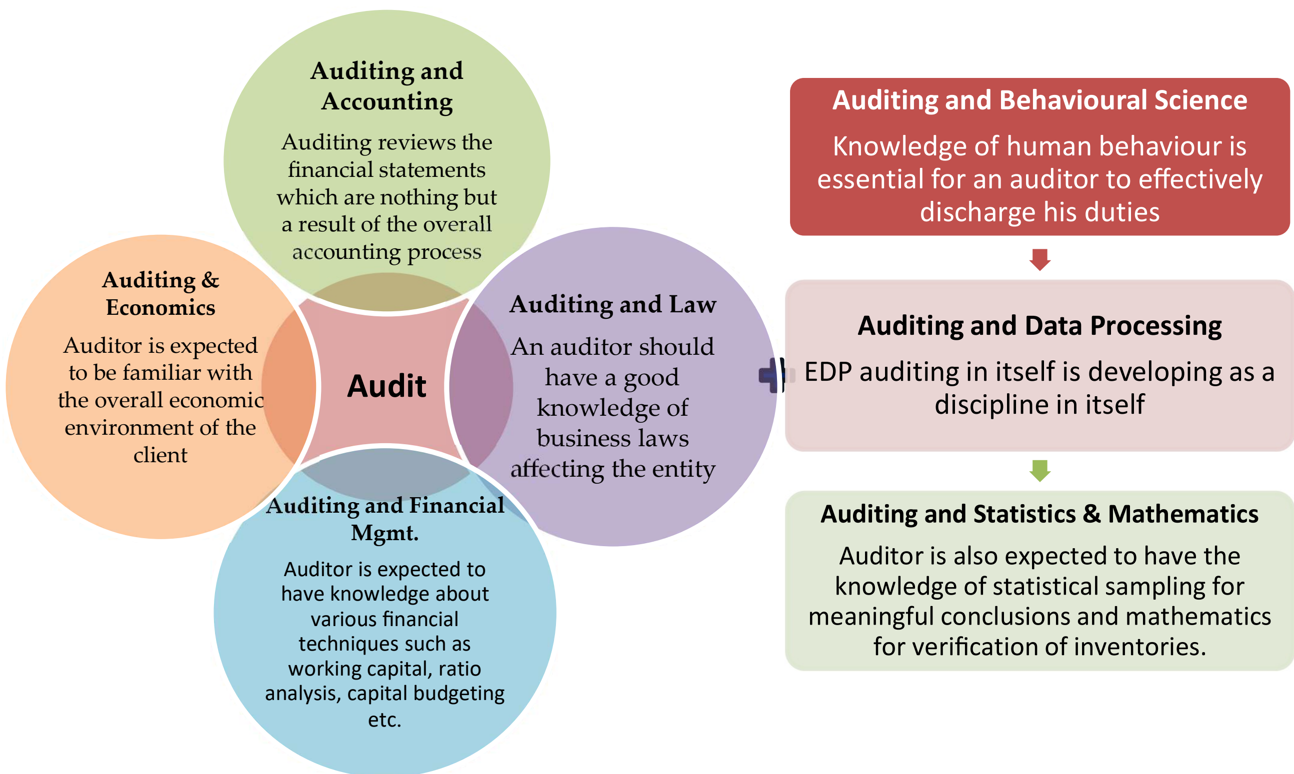
We can divide the above definition in to 3 parts:

An audit is independent **examination of financial information**	***Independent***, implies that judgement of a person is not impacted by wishes or direction of person who might have engaged him. E.g., Mr. A requested his CA brother to conduct the audit of his company. Is it **OK!!** **NO,** since result of examination of records are subject to influence from brother.
Entity whose financial information is examined **need not necessarily be profit oriented**.	It can be a **non-profit organization like an NGO** or a charitable trust. Audit can be undertaken in respect of any organization be it a small, medium, or large. Entity can be an OPC, LLP, private or public company etc.
Purpose of audit is to express an opinion on the financial statements	***Opinion*** of auditor shall be based on thorough understanding & checking of the accounts of a business. He must ensure that books of accounts are complete in all aspects and are supported by adequate evidence. Financial statement including disclosures and classification as per applicable Accounting Standards are done.

3. Relationship of auditing with other diverse subjects:

Auditing is interdisciplinary in nature. It draws from diverse subjects including accountancy, law, behavioral science, statistics, economics, & financial management and makes use of these subjects.

Suppose you are an auditor of a company & have been entrusted with the task of checking not only the taxation and accounting aspects, but also secretarial compliances and other things including interaction with different stakeholders. So, here you need to have strong knowledge of taxation and accounting rules but also need to interact with lot of people for seeking information and making inquiries. Since, an auditor cannot check each and every transaction and for this sampling is done by him. Auditors use statistical methods to draw samples in a scientific manner. Knowledge of subjects like economics helps auditors to be familiar with overall economic environment in which business is operating. Financial management deals with issues Like funds flow, working capital management, ratio analysis etc.



4. Objectives of Audit:

Checkbox	Objectives of audit
✓	Obtaining a reasonable assurance that financial statements as a whole are free from material misstatement due to fraud or error.
✓	Gaining reasonable assurance leads to formation of opinion whether financial statements are prepared, in all material respect, in accordance with applicable financial reporting framework.
✓	To report on the financial statements.
✓	Reporting of opinion in accordance with audit findings.
✓	Communication of reporting.
✓	Reporting and communication in accordance with Standards on Auditing.

5. Scope of audit – Inclusion:

Scope refers to "range" or "reach" of something. The purpose of an audit is to enhance degree of confidence of intended users in the financial statements. Users – Government, employees, trade unions, banks, creditors, debtors etc. Below are the considerations related to scope of audit:

Code to Remember: C.A.R.D.S.

(What is on the tarot cards will happen in life, similarly what is in the scope of audit, will be done)

- Constraints on scope of the audit of the financial statement that impair auditor's ability to express opinion on financial statements should be set out in his report.
- The audit should cover all aspects of the enterprise relevant to the financial statements being audited.
- Auditor assesses reliability and sufficiency of information contained in the underlying accounting records.
- Auditor should also decide whether the relevant information is properly disclosed in the financial statements.
- The auditor should be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable.

6. Scope of audit – Exclusion:

Scope refers to "range" or "reach" of something. However, auditor will not do anything which is not in the scope of audit. Following conclusion can be drawn in respect of exclusion from the scope of audit and auditor cannot be held wholly responsible.

- Physical condition of certain assets cannot be determined by him.
- An auditor is not an expert in authentication of documents.
- An audit is not an official investigation into alleged wrong doing. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.

Below is the summary of POINT 5 & 6 above:

Checkbox	Scope of audit of financial statements
✓	Coverage of all aspects of entity relevant to financial statements being audited
✓	Reliability and Sufficiency of financial information
✓	Proper disclosure of financial information
✓	Expression of an opinion on financial statements
X	Responsibility of preparation & presentation of financial statements.
X	Duties outside scope of competence of auditor
X	Expertise in authentication of documents
X	Investigation

7. Inherent limitation of audit:

As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing –

"There are various inherent* limitations to internal controls because of which auditor is not expected to, & cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error".

*** Inherent meaning - स्वाभाविक or पैदायशी**

These fundamental limitations arise due to the following factors –

Nature of Financial Reporting

The preparation of financial statements involves judgment by management in applying requirements of the entity's applicable financial reporting framework. Many financial statement items **involve subjective decisions**. There may be range of acceptable interpretations.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit.

There is a balance to be struck between the reliability of information and its cost

Nature of Audit procedures

There are practical and legal limitations on auditor's ability to obtain audit evidence like-

* Possibility that management or others may not provide, the complete information.

* Fraud may involve carefully organised schemes.

Future events

Adverse future events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models etc. Therefore, **an auditor cannot provide a guarantee** that financial statements are free from material misstatements due to errors

Not in nature of investigation

Audit is not an official investigation. Hence, **auditor cannot obtain absolute assurance** that financial statements are free from material misstatements due to frauds or errors.

8. Engagement & External audit engagement:

Meaning - means an arrangement to do something. In auditing, it means a formal agreement between auditors and the client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

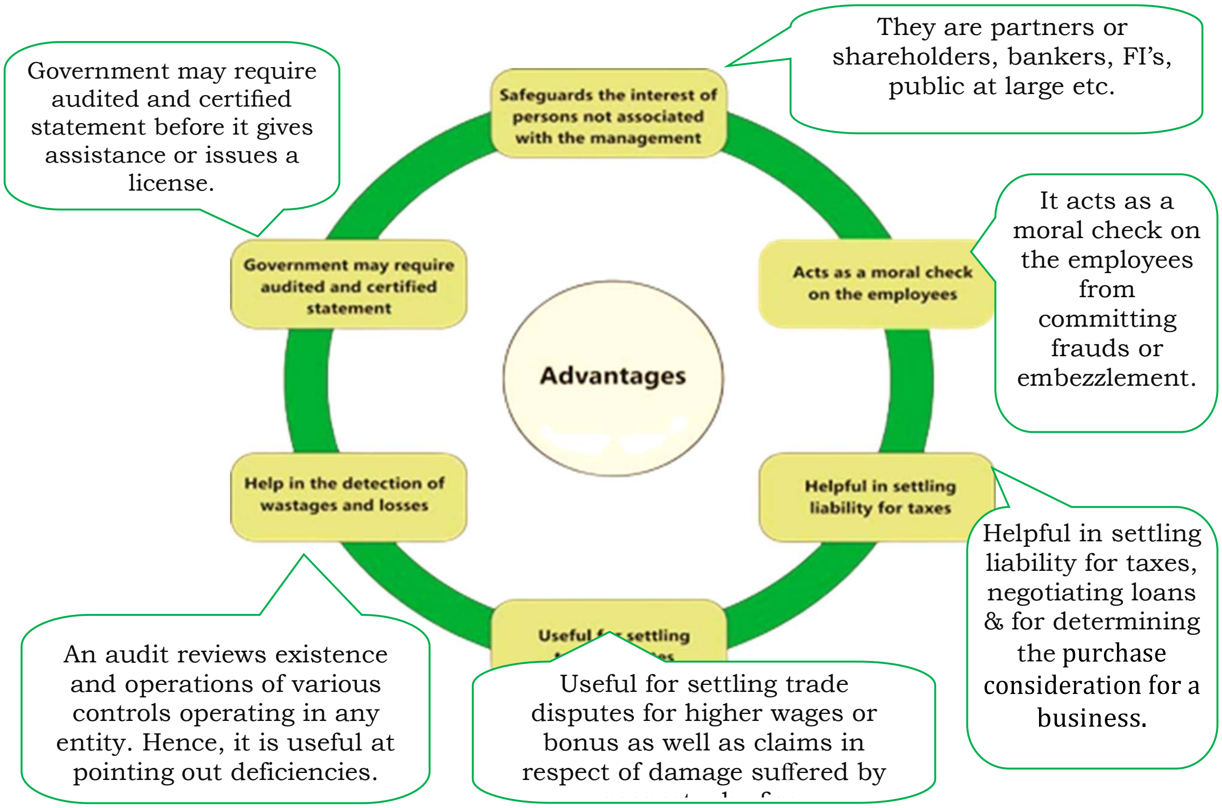
External audit Engagement – The main purpose of external audit engagement is to enhance degree of confidence of intended users of financial statements. This includes audit of the accounts of a company by an external auditor.

9. Benefit of Audit:

We can remember the benefits of the audit below in the following manner:

Insiders – Employees, internal fraud, or errors, shareholders.

Outsiders – Government (taxes), Bankers/lenders (financial health).



10. More about the audit:

Most of us wonder why there is a requirement for an audit of financial statements although it is prepared by experts! Also, is audit of accounts mandatory for all the entities?

IS AUDIT MANDATORY?

No, it is not mandatory for all entities to get their accounts audited by the professional members. Audit is required in case a company crosses the turnover limit as per law or a school may require to gets its account audited if any grant(s) is receivable from the government, or some companies may get their account audited as per established internal controls of that company.

WHO APPOINTS AUDITOR-

In case of privately owned companies	:	Owner of the company
In case of public owned companies	:	Shareholder approves appointment in AGM
In case of government companies	:	Auditor is appointed by Comptroller and Auditor General of India (CAG).

TO WHOM REPORT IS SUBMITTED BY AN AUDITOR-

1. **Who submits report –** Auditor. The outcome of an audit is written audit report in which auditor expresses an opinion.

2. **To whom the report is submitted –**
    - **To person making the appointment.**
    - **So, in case of-**
      Companies : Shareholders
      A firm : To partners who have engaged him.

CASE STUDY 1

A, B, C and D are friends since their school days based in Delhi. They have cleared CA foundation exams in same attempt and now plan to appear for CA Intermediate exams. All of them are keen news listeners and regularly keep track of business news even on social media.

They are trying to understand new subjects including auditing. A, B and C have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. D has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch up with her friends very soon. C had also joined the classes, but he had skipped some lectures.

During one informal get-together, their discussions centered around new subjects of auditing. They discussed many things regarding its nature, scope, benefits, and other general practical issues. D was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

C also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to D. B was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies. Not to be left behind, A also jumped in the fray. He supported B and also added something of his own.

Based on the above, answer the following questions:

1. **B is of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide?**
    a. It provides reasonable assurance, meaning a moderate level of assurance.
    b. It provides reasonable assurance, meaning a low level of assurance.
    c. It provides reasonable assurance, meaning a high level of assurance.
    d. It provides reasonable assurance, meaning an absolute level of assurance.

2. **A added that auditor can force an employee of the company to provide him required information and documents. Can he do so?**
    a. Yes, he can do so. It is necessary to obtain audit evidence.
    b. Yes, he can do so. There are express rights given to him in this respect.
    c. No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.
    d. No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.

3. **C had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. D also seemed to be in agreement with him, but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?**

   a. Yes, he can do so. It is necessary to obtain audit evidence.
   b. Yes, he can do so. There are express rights given to him in this respect.
   c. No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.
   d. No, he cannot do so. He has no right to seek information and documents. Therefore, question of forcing does not arise.

4. **All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?**

   a. Since auditing is connected to future events, audited information can be easily relied by users.
   b. Errors or frauds may be discovered during audit.
   c. Government authorities can make use of audited accounts for different purposes.
   d. It can help in bringing out deficiencies in maintenance of financial records.

5. **D told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?**

   a. It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
   b. Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
   c. Auditors have to conduct audits by exercising professional skills. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
   d. Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare, odd cases.

Solution to Case Study 1:

1. (c) **2. (c)** **3. (d)** **4. (a)** **5. (c)**

11. Meaning of assurance engagement:

It is an engagement in which-
- Practitioner expresses a conclusion designed to enhance,
- The degree of confidence of intended user,
- About the outcome of evaluation or measurement of subject matter against criteria.

Elements of assurance engagement-

Auditee/Company **(Responsible Party)** | **Auditor** **(Practitioner)** | **User of Information** **(Intended User)**

1. **A 3-party relationship involving a practitioner, a responsible party & intended user:**
   In such engagement, three parties are involved.
   Practitioner - A practitioner is a person who provides the assurance.
   Responsible Party – Who prepares the subject matter (E.g. -Financial statement).
   Intended Users- are people for whom an assurance report is prepared. These people may use the report in making decisions.

2. **Sufficient appropriate evidence:**
   The practitioner performs an "assurance engagement" to obtain sufficient appropriate evidence. It is on the basis of evidence only that conclusions are arrived & an opinion is formed by auditor.
   Sufficient - quantity of evidence obtained by auditor.
   Appropriate - quality of evidence obtained by auditor.

3. **A written assurance report in appropriate form:**
   A written report is provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is outcome of an assurance engagement.

4. **An appropriate subject matter:**
   It refers to the information to be examined by practitioner and this includes financial statements, or any engagement undertaken by him.

12. Meaning of review:

However, review is a limited assurance engagement.

(a) It provides lower level of assurance than audit.

(b) Review involves less procedures & gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.

Code to remember: P - A.C.E^2

(A company after audit, can Professionally ACE in terms of financials)

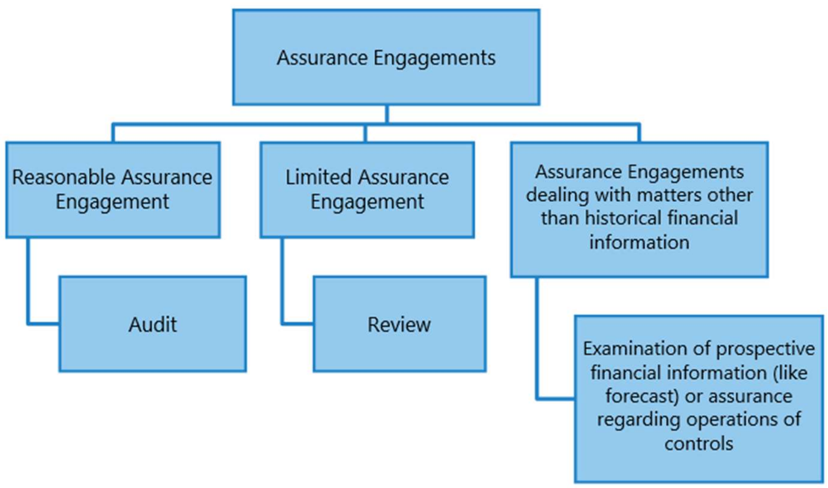
Points	Reasonable assurance engagement (AUDIT)	Limited assurance engagement (REVEIW)
Procedures adopted	It performs elaborate & extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
Assurance	Such engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance.
Conclusion	It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example	Example - Audit engagement.	Example - Review engagement.
Emphasis	Emphasis is on the examination & verification of financial statements & accounting records.	Emphasis in review is given to overviewing accounting records.

While doing audits, most of the activities are directed towards obtaining assurance of financials of the company which are based on historical financial information. But there exists 1 more type of financial information which relates to events in the future.

"Prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.

"Historical financial information" relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods.

SUMMARY



13. Qualities of auditor:

An auditor is concerned with the reporting on financial matters of business and as such should possess the following qualities:

Code to remember : A – U.P.I.

(Always UPI)

1. An exhaustive knowledge of accounting principles and techniques.
2. The auditor should be equipped with an Understanding of the special features peculiar to a particular business.
3. Patience, caution, firmness, good temper, integrity, discretion, industry, judgment, clear headedness, and reliability.
4. He must have the highest degree of integrity backed by adequate independence.

14. Engagement and quality control standards:

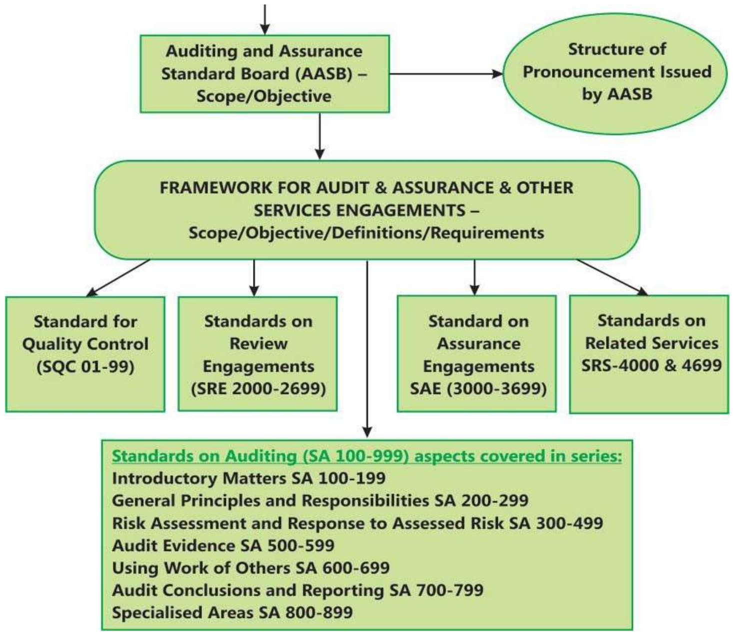
following standards issued under authority of ICAI Council are known as Engagement Standards:

Standards on auditing
- It apply in audit of historical financial information

Standards on review engagement
- It apply in review of historical financial information

Standards on Assurance engagements
- It apply in assurance engagements other than audits and review of historical financial information

Standards on Related Services
- It apply in agreed upon procedures to information, compilation engagements & other service engagements.



Before attempting below questions, please read about assurance engagement

Me & You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day-to-day working capital requirements like for purchase of raw materials, labour payment etc. However, just within 6 months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager has been insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management. The management approaches CA P, who has qualified recently and started practicing. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard. Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

Based on above, answer the following questions-

1. **Management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?**
   (a) Standards on Review Engagements
   (b) Standards on Auditing
   (c) Standards on Related Services
   (d) There are no standards for issuing reports in such situations.

2. **Which of the following statements is MOST APRROPRIATE in given case situation?**
   (a) CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
   (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
   (c) CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.

(d) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.

3. **In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify most appropriate statement?**
   (a) Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.
   (b) Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
   (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement.
   (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.

4. **The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?**
   (a) Standards on Review Engagements
   (b) There are no standards for issuing such type of reports.
   (c) Standards on Related Services
   (d) Standards on Assurance Engagements

5. **Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. Management has projected turnover of Rs. 100 cores for next year, Rs. 150 crore and Rs. 200 crores for following years respectively as compared to present turnover of Rs. 25 crores in current half year. Identify most appropriate statement in this situation?**
   (a) CA P has to satisfy himself regarding arithmetical accuracy of projected data.
   (b) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
   (c) CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
   (d) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentations.

Solution to Case Study 2:

1. (c) 2. (c) 3. (c) 4. (d) 5. (d)

State with reasons (in short) whether the following statements are correct or incorrect:

(1) Basic objective of audit does not change with reference to nature, size or form of an entity.
(2) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.
(3) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

Solution-

(1) **Correct:** An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

(2) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared in accordance with an applicable financial reporting framework.

(3) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of audit evidence on which the auditor draws conclusions & bases the auditor's opinion.

GENERAL MCQS

1. Which of the following is not an advantage of audit?

(a) It provides high quality financial information.
(b) It acts as a moral check on employees.
(c) It enhances risk of management bias.
(d) It helps in safeguarding interests of shareholders.

2. Which of the following is NOT TRUE about an assurance engagement?

(a) It relates to providing assurance about historical financial information only.
(b) The practitioner obtains sufficient appropriate evidence.
(c) There is some information to be examined by practitioner.
(d) A written assurance report in appropriate form is issued by practitioner.

3. Which of the following is TRUE about Engagement Standards?

(a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
(b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
(c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
(d) Engagement standards ensure savings in resources of clients.

4. Consider following statements in relation to "Limited assurance engagement":

Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.
Statement II - Review of interim financial information of company is an example of limited assurance engagement.

a. Statement I is correct. Statement II is incorrect.
b. Both Statements I and II are correct.
c. Both Statements I and II are incorrect.
d. Statement I is incorrect. Statement II is correct.

Solutions to general MCQ:

1.(c) 2.(a) 3.(c) 4. (d) - We can draw limited conclusion only.