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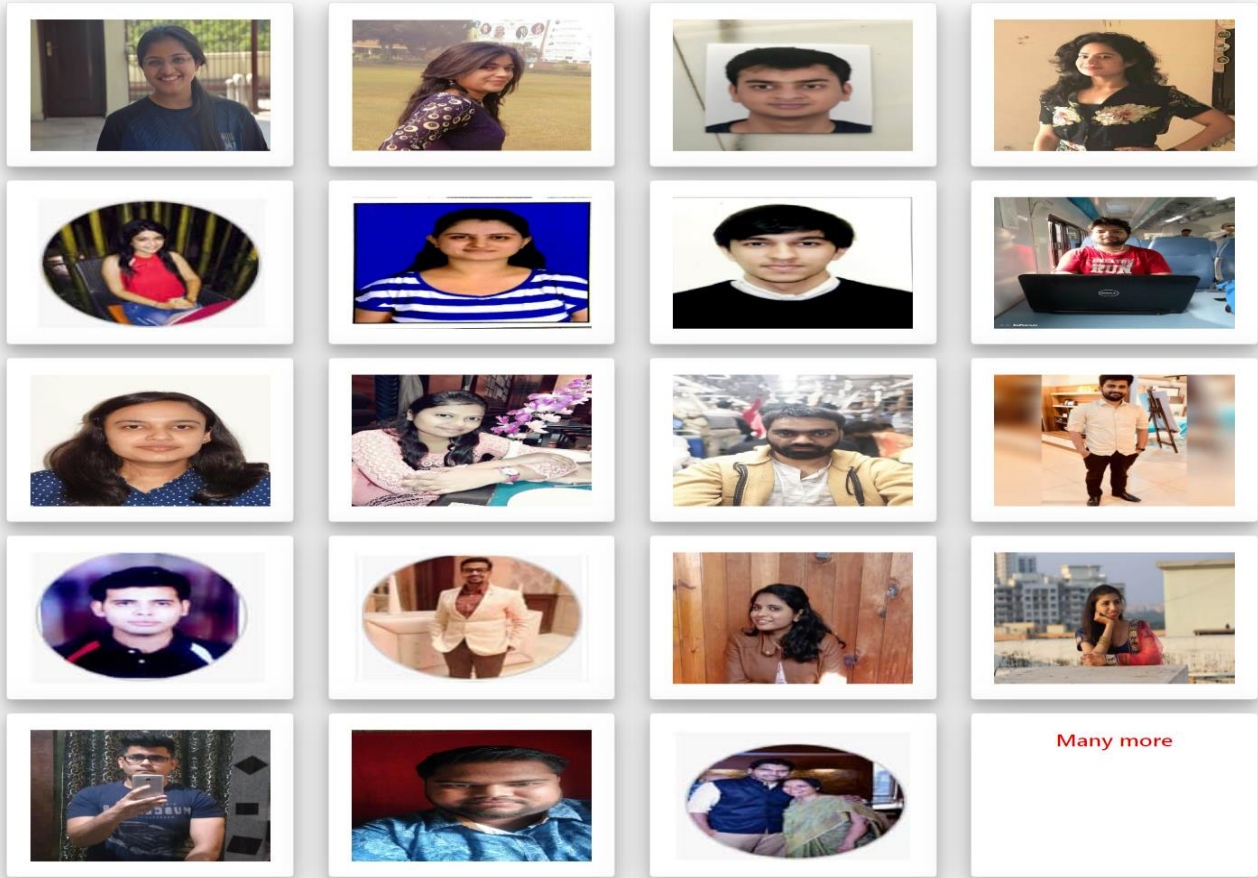
NOTE'S
100
IMPORTANT
QUESTION'S
CA INTER AUDIT

CA Final Inter IPCC Foundation
Jan / May 2021 Test Series

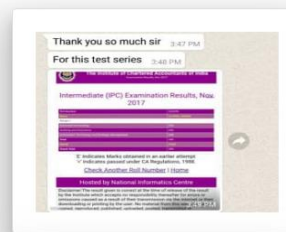
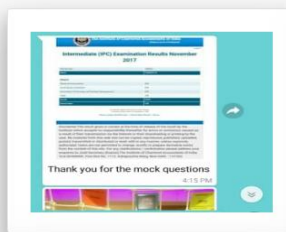


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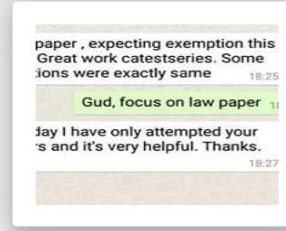
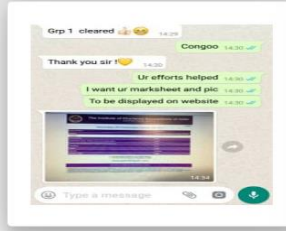
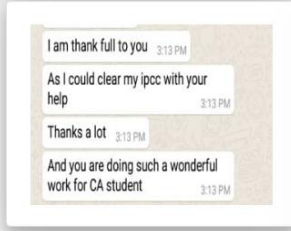
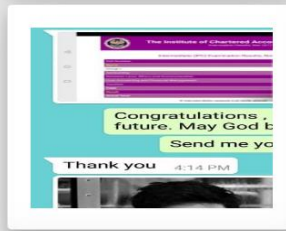
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Accounting	505
Professional Ethics	502
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Accounting	501
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Accounting	505
Professional Ethics	502
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Inter Audit

Important Questions

Question 1

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 environment. Please elucidate the circumstances that may warrant the revision in terms of engagement.

Ans- As per SA 210 on “Agreeing the Terms of Audit Engagements”, 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:

- (i) Any indication that the entity misunderstands the objective and scope of the audit.
- (ii) Any revised or special terms of the audit engagement.
- (iii) A recent change of senior management.
- (iv) A significant change in ownership.
- (v) A significant change in nature or size of the entity’s business.
- (vi) A change in legal or regulatory requirements.
- (vii) A change in the financial reporting framework adopted in the preparation of the financial statements.
- (viii) A change in other reporting requirements.

Question 2

BSS & Associates is a partnership firm of Chartered Accountants which was established five years back. The firm was offering only advisory services at the beginning, however, after audit rotation and advent of GST, firm sees lot of potential in these areas also and started looking for opportunities in these areas also. These services being assurance in nature, the firm required some internal restructuring and set up some policies and procedures for compliance year on year.

The firm started getting new clients for these new services and is now looking to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it has been setting up a process to document how the issues were resolved.

The firm is now looking to work with only select clients which are in line with the policies of the firm. The firm understands that the extent of knowledge it will have regarding the integrity of a client will grow within the context of an ongoing relationship with that client. With regard to the integrity of a client, you are required to give some examples of the matters to be considered by the firm as per the requirements of SQC 1.

Ans. The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved. With regard to the integrity of a client, matters that the firm considers include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.

- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm
- The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

Question 3

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

Ans. As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- Evaluate information on identified breaches, if any, of the firm’s independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- Engagement Partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures.

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

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

Question 4

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor’s report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018. Comment.

Ans. Review by Engagement Partner: 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. For audits of financial statements of listed entities, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed;
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- Not date the auditor’s report until the completion of the engagement quality control review.

SA 700, “Forming an Opinion and Reporting on Financial Statements”, requires the auditor’s report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor’s opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer’s satisfaction on or before the date of the auditor’s report.

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor’s report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.

Thus, in the given case, signing of auditor’s report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.

Question 5

M/s Suresh Chandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2015-16. CA. Suresh, one of the partners of M/s Suresh Chandra & Co., completed entire routine audit work by 29th May, 2016. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA. Chandra, another partner of M/s Suresh Chandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA. Suresh. State with reasons whether CA. Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor.

Ans. Relying on Work Performed by Another Auditor: As per SA 220 “Quality Control for an Audit of Financial Statements”, an engagement partner taking over an audit during the engagement may apply the review procedures such as the work has been performed in accordance with professional standards and regulatory and legal requirements; significant matters have been raised for further consideration; appropriate consultations have taken place and the resulting conclusions have been documented and implemented; there is a need to revise the nature, timing and extent of work performed supports the conclusions reached and is appropriately documented the evidence obtained is sufficient and appropriate to support the auditor’s report; and the objectives of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor’s professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information.

However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.

However, the auditor should carefully direct, supervise and review work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose. In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Suresh. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Chandra signed the report relying on the work performed by CA. Suresh.

Here, CA. Chandra is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Suresh provided he further exercises adequate skill and due care and review the work performed by him.

Question 6

Discuss the Auditor's responsibility to provide access to his audit working papers to Regulators and third parties.

Ans. Audit Working Paper: The auditor should not provide access to working papers 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.

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.

Therefore, it is auditor's responsibility to provide access to his audit working papers to Regulators whereas it's at auditor's discretion, to make portions of, or extract from his working paper to third parties.

Question 7

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'.

Ans. Auditor's Responsibilities Relating to Fraud: As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor 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 modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor 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. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of 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.

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 (in case amount of fraud is ₹ 1 crore or above or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ₹ 1 crore within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (i) Determine 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;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (iii) If the auditor withdraws:

(1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(2) 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.

Question 8

M/s Innocent Limited has entered into a transaction on 25th February, 2018, near yearend, whereby it has agreed to pay Rs.5 lakhs per month to Mr. Yuvraj as annual retainership fee for "engineering consultation". No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2018. 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 Innocent Limited, what would be your approach?

Ans. As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

Keeping in view the above, it is clear 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.

Accordingly, the auditor would adopt the following approach-

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

(i) Determine 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;

(ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and

(iii) If the auditor withdraws:

(1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(2) 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 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 (in case amount of fraud is Rs. 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than Rs. 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2016, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; if yes, the nature and the amount involved is to be indicated.

Question 9

While auditing accounts of a public limited company for the year ended 31st March 2015, an auditor found out an error in the valuation of inventory, which affects the financial statement materially. Comment as per standards on auditing.

Ans. Errors in Valuation of Inventories and Auditor's Responsibilities: SA 240, "The Auditor's Responsibilities Relating Fraud in an Audit of Financial Statements", requires that if circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate.

SA 240 also requires that when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence.

Further, SA 320 Materiality in Planning and Performing an Audit, also requires that in such circumstances, the 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.

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.

Question 10

While conducting statutory Audit of ABC Ltd., you come across I Owe you amounting to 2 crores as against a cash balance shown in books of 2.10 crores. You also observe that despite similar high balances throughout the year, small amounts of 50,000 are withdrawn from the bank to meet day-to-day expenses

Ans. Material Misstatements: According to SA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” when the auditor comes across such circumstances indicating the possible misstatements resulting from the fraud then the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. In this case, the circumstances indicate that the possible misstatement in financial statements is due to fraud and error and 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 should state the said fact appropriately in his Audit Report.

Question 11

You are appointed as an auditor of Global Ltd. Explain the risk factors relating to misstatements arising from misappropriation of assets.

Ans. Risk Factors Relating to Misstatements Arising from Misappropriation of Assets: As per SA 240, “The Auditor’s Responsibilities Relating to Fraud in audit of Financial Statements”, misappropriation of assets involves the theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Risk factors that relate to misstatements arising from misappropriation of assets are classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. The following are examples of risk factors related to misstatements arising from misappropriation of assets:

Incentives/Pressures: Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

1. Known or anticipated future employee layoffs.
2. Recent or anticipated changes to employee compensation or benefit plans.
3. Promotions, compensation or other rewards inconsistent with expectations.

Opportunities: Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Inventory items that are small in size, of high value, or in high demand.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.
- Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets.
- Inadequate segregation of duties or independent checks. Attitudes/Rationalizations
- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.

- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.

Question 12

R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non-compliance with Laws and Regulations

Ans. As per SA 250, "Consideration of Laws and Regulations, the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements by inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

However, when the auditor becomes aware of the existence of, or information about, the following matters, it may also be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.

- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- Unusual payments towards legal and retainership fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorized transactions or improperly recorded transactions.
- Adverse media comment.

Question 13

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.

Ans. Compliance with Other Laws: As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

Further, 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 financial statements, but are not considered to have a direct effect on the financial statements.

In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of

financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that noncompliance 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 statement.

Question 14

What are the roles and responsibilities of the statutory auditors in relation to compliance with the laws and regulations by the entity?

Ans. Roles and Responsibilities of the Auditor in relation to compliance with the Laws and Regulations: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statements”, as part of obtaining an understanding of the entity and its environment the auditor shall obtain a general understanding of:

1. The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
2. 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 recognised 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 help identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements:

1. Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
2. 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. The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

Thus, the auditor 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. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

Question 15

State the reporting responsibility of an auditor in the context of non-compliance of Law and Regulation in an audit of Financial Statement.

Ans. Reporting responsibility of an auditor in the context of non-compliance of Law and Regulation: According to SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", the reporting responsibilities of an Auditor may be divided into the following categories-Reporting Non-Compliance to Those Charged with Governance: Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.

If, in the auditor's judgment, the non-compliance referred above is believed to be intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable. If the auditor suspects that management or those charged with governance are involved in non-compliance, 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, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

Reporting Non-Compliance in the Auditor's Report on the Financial Statements: 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, in accordance with SA 705 express a qualified or adverse opinion on the financial statements.

If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with SA 705.

If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with SA 705.

Reporting Non-Compliance 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.

Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the

responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor 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. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. 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.

Further, the auditor is required to report under clause (vii) (a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including employees' state insurance with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, even though accrual principles have been followed, disclosure of nonpayment is necessary. The auditor should disclose the fact of non-payment of rupees 7.50 lakhs in his report.

Question 16

XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-18 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:

Income Tax relating to Assessment Year 2014-15 Rs. 125 lakhs - Appeal is pending before Hon'ble ITAT since 30-9-16.

Customs duty Rs. 85 lakhs - Demand notice received on 15-9-17 but no action has been taken to pay or appeal. Comment.

Ans. Non-Compliance of Laws and Regulations: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor 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. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

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.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2016 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii) (b) of Para 3 of CARO, 2016, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis.

Therefore, as per AS 29 “Provisions, Contingent Liabilities and Contingent Assets”, partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

Question 17

“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.

Ans. Communications of audit matters with those charged with governance: As per SA 260 “Communication with those Charged with Governance”, the auditor shall communicate with those charged with governance, the responsibilities of the auditor in relation to the financial statement audit, including that,

A. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance, and

B. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

The auditor shall communicate with those charged with governance the following,

1. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity,
2. Significant difficulties, if any, encountered during the audit
3. Unless all of those charged with governance are involved in managing the entity
 - Significant matters, if any, 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

Question 18

During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

Ans. Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and

(ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

(1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.

(2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.

(3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.

(4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

Question 19

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 2015-16. 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.

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.

Ans. Difference of Opinion Among Joint Auditors: SA 299 on, “Responsibility of Joint Auditors” deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

(ii) 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;

(iii) 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;

(iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute;

(v) for ensuring that the audit report complies with the requirements of the relevant statute;

(vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;

(vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;

(viii) Each joint auditor is entitled to assure 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.

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 their own opinion through a separate report. A joint auditor is not bound by the views of majority of 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 instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditor) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.

Hence, as per SA 299, Mr. Z is suggested to express his own opinion through a separate report whereas Mr. X and Mr. Y may provide their joint report for the same.

Question 20

The identified risks are assessed by Auditor as to its significance on account of its likely impact, by way of material misstatement appearing in financial statements or by affecting internal control system. What may be the points of indication that may direct the Auditor to judge that the risks identified may be significant?

Ans. Points of Indication that may direct the Auditor to Judge that the Risks Identified may be Significant: As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment", as part of the risk assessment the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In

exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(i) Whether the risk is a risk of fraud;

(ii) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

(iii) The complexity of transactions;

(iv) Whether the risk involves significant transactions with related parties;

(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty, and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

Question 21

IT systems also pose specific risks to an entity's internal control? What are those risks?

Ans. Specific Risk to an Entity's internal Control: 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. They are-

1. Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both.
2. 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.
3. The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
4. Unauthorised changes to data in Master files.
5. Unauthorised changes to systems or programs.
6. Failure to make necessary changes to systems or programs.
7. In appropriate manual intervention.

Potential loss of data or inability to access data as required.

Question 22

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?

Ans. SA 315 “Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment”, the auditor shall 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-

1. Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
2. Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
3. Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
4. Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

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

1. 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, including:
2. The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure; and
3. Whether the risk assessment takes into account the relevant controls, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively; and
4. Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

Question 23

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.

Ans. Re-evaluation of the Materiality Concept: In the instant case, Mr. P, as an 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.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. 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 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.

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

Question 24

Mr. X was appointed as the auditor of M/s Easy go 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.

Ans. SA 320 “Materiality in Planning and Performing an Audit” prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

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.

Question 25

In the course of audit of ZED 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.

Ans. As per SA 330 on “The Auditor’s Responses to Assessed Risks”, changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor’s decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

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

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls

Question 26

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?

Ans. Substantive Procedures to be performed to assess the risk of material misstatement: As per SA 330, “The Auditor’s Response to Assessed Risk”, substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures.

Test of Details: The nature of the risk and assertion is relevant to the design of tests of details.

For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence.

On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.

In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample Size. Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor’s assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, 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. The use of widely recognized trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

Alternative Solution:

SA 330 'The Auditor's Responses to Assessed Risks' requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement.

This requirement reflects the facts that:

1. The auditor's assessment of risk is judgmental and so may not identify all risk of
2. There are inherent limitations to internal control, including management override. Depending on the circumstances, the auditor may determine that:
3. Performing only substantive analytical procedures will be sufficient to reduce the audit risk to an acceptably low level;
4. Only tests of detail are appropriate;
5. A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

Based on the above, the auditor's substantive procedures would include the following audit procedures related to the financial statement closing process:

1. Agreeing or reconciling the financial statements with the underlying accounting records and
2. Examining material journal entries and other adjustments made during the course of preparing the financial statements.

Question 27

JIO 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 JIO Ltd. as to how he can obtain an understanding of how JIO Ltd. uses the services of the outsourced agency in its operations.

Ans. As per SA 402 on “Audit Considerations Relating to an Entity Using a Service Organisation when obtaining an understanding of the user entity in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity’s operations, including:

(i) The nature of the services provided by the service organization and the significance of those services to the user entity, including the effect thereof on the user entity’s internal control;

(ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization ;

(iii) The degree of interaction between the activities of the service organization and those of the user entity; and

(iv) The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization.

Question 28

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?

Ans. Controls at a Sub-Service Organisation: In accordance with SA 402“Audit Considerations relating to an Entity Using a Service Organisation”, a user entity may use a service organization

that in turn uses 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. The sub-service organisation may be a separate entity from the service organisation or may be related to the service organisation.

A user auditor may need to consider controls at the sub-service organisation. In situations where one or more sub-service organisations are used, the interaction between the activities of the user entity and those of the service organisation is expanded to include the interaction between the user entity, the service organisation and the sub-service organisations. The degree of this interaction, as well as the nature and materiality of the transactions processed by the service organisation and the sub-service organisations are the most important factors for the user auditor to consider in determining the significance of the service organisation's and sub-service organisation's controls to the user entity's controls.

Further, the user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement. If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding by application of the following two methods of presenting description of internal controls i.e.

1. Type 1 report; or
2. Type 2 report.

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. In either method, the service organisation includes in its description

of controls a description of the functions and nature of the processing performed by the sub-service organisation.

If the Type 1 or Type 2 report excludes the control at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of the SA 402 in respect of the subservice organization.

The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organization depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

Question 29

In audit plan for TELCO 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.

Ans. According to SA 450 "Evaluation of Misstatements identified during the Audit", the following are the sources of misstatements arising from other than fraud -

- (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.

Question 30

Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same.

Ans. Uncorrected Misstatements identified during the Audit: In accordance with SA 450 "Evaluation of Misstatements identified during the Audit", the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider-

1. 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, and the particular circumstances of their occurrence; and
2. The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures and the financial statements as a whole.

The auditor shall communicate this with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

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.

As per management, if effect of such uncorrected misstatement is immaterial then the auditor shall request for a written representation from management and, where appropriate, those charged with governance that whether they believe the effects of uncorrected misstatements

are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

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 report accordingly.

Question 31

CA. Needle had been appointed as an Auditor of M/s Fabric Ltd. In the course of audit, it had been observed that inventory including work-in-process had been valued by Management by using experts hired by them. Analyse relevant factors to decide as to whether or not to accept the findings from the work of Management expert in valuation of inventories.

Ans. Evaluating the Work of Management's 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, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes-

- (1) Evaluate the competence, capabilities and objectivity of that expert;
- (2) Obtain an understanding of the work of that expert; and
- (3) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert.

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

- (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- (ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- (iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Question 32

Obtaining audit evidence in performing compliance and substantive procedures. Comment.

Ans. Obtaining Audit Evidence: As per SA 500 "Audit Evidence", in performing compliance and substantive procedures, the auditor may obtain audit evidence by following methods-

1. Inspection: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorization. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a

financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

2. Observation: Observation consists of looking at a process or procedure being performed by the others. For example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which process or procedure is performed.

3. External Confirmation: An external confirmation represents audit evidence obtained by the auditor 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 confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.

4. Recalculation: Recalculation consists of checking the arithmetical accuracy of documents or records. Recalculation may be performed manually or electronically.

5. Re performance: It involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

6. Analytical Procedure: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

7. Inquiry: 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. Evaluating responses to inquiries is an integral part of the inquiry process.

Question 33

XYZ Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. XYZ Ltd. appointed M/s MNO & Co. to conduct its audit for the financial year 2016-17. Mr. O, partner of M/s MNO & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason. You are required to advise M/s MNO & Co.,

(a) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

(b) How an auditor is supposed to deal when attendance at physical inventory counting is impracticable?

Ans. (a) Special Consideration with Regard to Inventory: As per SA 501 “Audit Evidence-Specific Considerations for Selected Items”, when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

- (1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (2) Observe the performance of management's count procedures;
- (3) Inspect the inventory; and(4) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(b) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of General inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures.

In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Question 34

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 2.2 crores. Due to unavoidable 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?

Ans. As per SA 501 “Audit Evidence - Additional Considerations for Specific Items”, the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting.

SA 501 is additional guidance to that contained in SA 500, “Audit Evidence”, with respect to certain specific financial statement amounts and other disclosures. 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 where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management’s written representation on

1. The completeness of information provided regarding the inventory, and
2. Assurance with regard to adherence to laid down procedures for physical inventory count.

By following the above procedure it will be ensured that the physical verification conducted by the management was in order.

Question 35

Mr. Z who is appointed as auditor of Elite Co. Ltd. wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when

designing a confirmation request? Also state the effects of using positive external confirmation request by Mr. Z.

Ans. As per SA 505, “External Confirmation”, factors to be considered when designing confirmation requests include:

(i) The assertions being addressed.

(ii) Specific identified risks of material misstatement, including fraud risks.

(iii) The layout and presentation of the confirmation request.

(iv) Prior experience on the audit or similar engagements.

(v) The method of communication (for example, in paper form, or by electronic or other medium).

(vi) Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.

(vii) The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of

“blank” confirmation request may result in lower response rates because additional effort is required of the confirming parties.

Question 36

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 ₹15 Lakhs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing.

Ans. External Confirmation: 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.

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also 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 ₹ 15 lakhs has not sent the confirmation on the credit balance. In case of non-response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further 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 .But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

Question 37

Never permit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond?

Ans. SA 505 “External Confirmations”, establishes standards on the auditor’s use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to a send a confirmation request, the auditor shall:

- (i)** Inquire as to Management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
- (ii)** 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
- (iii)** 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 those in charge of governance in accordance with SA 260 “Communication with Those Charged with Governance”

and also determine its implication for the audit and his opinion in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Question 38

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 5 lakhs. On enquiry, the company explained him that it is, a very old credit balance. The trade payable had neither approached for the payment nor he is traceable. Under the circumstances no confirmation of the credit balance is available.

Ans. External Confirmation: This is a case of external confirmation, covered by SA 505 “External Confirmations”. 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 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.

Question 39

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 misstatements, 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?

Ans. Audit Procedure for ensuring correctness of Opening Balances: As per SA 510 "Initial Audit Engagements-Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by -

- (i) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- (ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (iii) By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Approach for drafting Audit Report: 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, as appropriate, in accordance with SA 705 and in case where 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, in accordance with SA 705.

Question 40

You have been appointed as the auditor of Good Health Ltd. for 2017-18 which was audited by CA Trustworthy in 2016-17. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2016-17 have been brought to account in 2017- 18 as Opening Balances and the Opening Balances do not contain misstatements.

Ans. As per SA 510 "Initial Audit Engagements—Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (ii) 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.

Being new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. For example, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

Question 41

CA. Mack, a recently qualified practicing Chartered Accountant got his first audit assignment of Captura (P) Ltd. for the financial year 2017-18. He obtained all the relevant appropriate audit evidence for the items related to Statement of Profit and Loss. However, while auditing the Balance Sheet items, CA. Mack left out obtaining appropriate audit evidence, say, confirmations, from the outstanding Accounts Receivable amounting Rs.145 lakhs, continued as it is from the last year, on the affirmation of the management that there is no receipts and further credits during the year. CA. Mack, therefore, excluded from the audit programme, the audit of accounts receivable on the understanding that it pertains to the preceding year which was already audited by predecessor auditor. Comment.

Ans. Verification of Accounts Receivable: As per SA 510 “Initial Audit Engagements – Opening Balances”, while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

(i) Opening balances contain misstatements that materially affect the current period’s financial statements; and

(ii) 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 financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of 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.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 580 "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Captura (P) Ltd. has restrained CA. Mack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Mack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Mack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

Question 42

What are 'Initial Audit Engagements'?

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

1. The financial statements for the prior period were not audited; or
2. The financial statements for the prior period were audited by a predecessor auditor.

Question 43

In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level.

Ans. Investigating Results of Analytical Procedures: As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- (i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

(ii) Performing other audit procedures as necessary in the circumstances.

Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Question 44

While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

Ans. Risk Factors while applying sampling techniques: As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. 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 tests 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 test of controls, the controls are less effective than they actually are, or in the case of tests 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.

Question 45

Statutory auditor of O Ltd requested the management for a written representation in respect of obsolescence of inventory and warranty obligations recognized by the company in its financial statements. The management denied the representation on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report. Please comment.

Ans. As per SA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures, the auditor shall obtain written representations from the management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognized or disclosed in the financial statements may include representations:

- About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.
- For those accounting estimates not recognized or disclosed in the financial statements, written representations may also include representations about:

- The appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.
- The appropriateness of the basis used by management to overcome the presumption relating to the use of fair value set forth under the entity applicable financial reporting framework, for those accounting estimates not measured or disclosed at fair value.

Thus, management's contention on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report, for not providing written representation is not correct. The management should provide written representations to the auditor.

Further as per SA 580 Written Representation, if management does not provide one or more of the requested written representations, the auditor shall

- (a) Discuss the matter with management;
- (b) 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
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

Question 46

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?

Ans. As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain an understanding of the following in order to

provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

1. The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
2. How Management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed, in the financial statements. 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.

Question 47

In the course of audit of QRT 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.

Ans. Identification of possible sources for Related Parties' information: 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. However, it is the management, which is primarily responsible for identification of related parties. The duties of an auditor with regard to reporting of related party transaction as required by Accounting Standard 18 "Related Party Disclosures" is given in SA 550.

(i) SA 550 requires that to identify names of all known related parties, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity's principal shareholders, statements of conflicts of interest from management and those charged with governance, records of the entity's investments and those of its pension plans, contracts and agreements with key management or those charged with governance, significant contracts and agreements

not in the entity's ordinary course of business, specific invoices and correspondence from the entity's professional advisors, life insurance policies acquired by the entity, significant contracts renegotiated by the entity during the period, internal auditors' reports, documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

(ii) Some arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions as an arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the establishment of a business relationship through appropriate vehicles or structures, the conduct of certain types of transactions under specific terms and conditions or the provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include participation in unincorporated partnerships with other parties, agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business, guarantees and guarantor relationships etc.

(iii) Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement. In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples of transactions outside the entity's normal course of business may include complex equity transactions, such as corporate restructurings or acquisitions, transactions with offshore entities in jurisdictions with weak corporate laws, the leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged, sales transactions with unusually large discounts or returns, transactions with circular arrangements, for example, sales with a commitment to repurchase, transactions under contracts whose terms are changed before expiry etc.

(iv) Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identification of related parties.

Question 48

JY & CO. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding 'related party transactions in the normal course of business. Describe the steps to be followed.

Ans. Review of Records and Documentation Regarding Related Party Transaction: According to SA 550 "Related Parties", during the audit, 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.

In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

- (a) Bank, legal and third party confirmations obtained as part of the auditor's procedures;
- (b) Minutes of meetings of shareholders and of those charged with governance; and
- (c) Such other records or documents as the auditor considers necessary in the circumstances of the entity.

The auditor may inspect records or documents that may provide information about related party relationships and transactions, for example entity income tax returns, information supplied by the entity to regulatory authorities, shareholder registers to identify the entity/s principal shareholders, statements of conflicts of interest from management and those charged

with governance, records of the entity investments and those of its pension plans, contracts and agreements with key management or those charged with governance, significant contracts and agreements not in the entity ordinary course of business, specific invoices and correspondence from the entity professional advisors, life insurance policies acquired by the entity, significant contracts re-negotiated by the entity during the period, internal auditors' reports, documents associated with the entity filings with a securities regulator etc.

Question 49

Elaborate how the Statutory Auditor can verify the existence of related parties for the purpose of reporting under Accounting Standard 18.

Ans. Verification of Existence of Related Parties: As per SA 550 "Related Parties", during the audit 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.

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 those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
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 regulate (e. g ,prospectuses).
- Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions.

Question 50

Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of Rs. 5800 crore kept pending on account of incentives pertaining to Financial Year 2017- 18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial officer of the Company by the Board, it was informed that this amount had not been recognized in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018.

Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors.

Ans. Facts Which Become Known to the Auditor after the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

- (i) Discuss the matter with management and, where appropriate, those charged with governance.
- (ii) Determine whether the financial statements need amendment and, if so,
- (iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of rupees 5800crore on account of incentives pertaining to year 2017-18 in the month of May 2018 Le. After finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Anudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Anudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

Question 51

Briefly describe the auditor's responsibility regarding subsequent events

Ans. Subsequent Events and Auditor's Responsibility: When the auditor draws up his audit plan, checking of subsequent events is an important audit procedure irrespective of the level of test checks employed for checking of the transactions during the year. In fact more detailed check is normally required for subsequent events to confirm certain assertions contained in the financial statements, e.g., the payment made by debtors after the close of accounting period would confirm that outstanding debtors on the date of the balance sheet date have been realized. SA 560 on "Subsequent Events" establishes standards on the auditor's responsibility regarding subsequent events.

SA 560 on "Subsequent Events" states that the term "subsequent events" refers to events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. AS 4 on "Contingencies and Events Occurring after the Balance Sheet Date" deals with all those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and by the corresponding approving authority in the case of any other entity.

As per AS 4, two types of events can be identified:

1. Those which provide further evidence of conditions that existed at the balance sheet date; and
2. Those which are indicative of conditions that arose subsequent to the balance sheet date.

SA 560 lays down that the auditor should consider the effect of subsequent events on the financial statements and on the auditor's report. When the time between the close of the

yearend and the adoption of accounts is about to take place, examination of subsequent events gains more importance.

SA 560 further requires that 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 is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

- 1.** Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- 2.** Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- 3.** Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- 4.** Reading the entity's latest subsequent interim financial statements, if any.

When, as a result of the procedures performed above, 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.

Question 52

As a statutory auditor of a company, comment on the following:

(a) A fire broke out on 15th May, 2015, in which material worth ` 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.

Ans. Event occurring after the balance sheet date: This case requires attention to SA 560 "Subsequent Events" and AS 4 "Contingencies and Events occurring after the Balance Sheet Date". As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.

AS 4 also requires disclosure of the non-adjusting event, in the report of the approving authority.

Further, as per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. The event took place after the close of the accounting year and does not relate to conditions existing at the balance sheet date. Thus, it will have no effect on items appearing at the balance sheet date because as per AS 4 "Contingencies and Events Occurring after Balance Sheet Date" have to be adjusted that provide evidence of conditions existing as at the balance sheet date. However, the auditor has to ensure that this loss will not materially affect the substratum of the enterprises as per its size, nature and complexity of operations.

Thus, subject to satisfaction in respect of non-violation of going concern concept, the company has correctly accounted by not providing provision. However, the auditor is required to ensure the proper disclosure of abovementioned event.

Question 53

ABC Company files a law suit against Unlucky Company for ₹ 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?

Ans. Existence of Contingent Liability: As per AS 29 "Provisions, Contingent liabilities and Contingent Assets", a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

As per SA 570 "Going Concern", there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. 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; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue

as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

In the instant case, ABC Company has filed a law suit against Unlucky Company for ₹5 crores. Though, 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. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of ₹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.

Question 54

Todd/e Limited had definite plan of its business being closed within a short period from the close of the accounting year ended on 31st March 2017. The Financial Statements for the year ended 31/03/2017 had been prepared on the same basis as it had been in earlier periods with an additional note that the business of the Company shall cease in near future and the assets shall be disposed of in accordance with a plan of disposal as decided by the Management. The Statutory Auditors of the Company indicated this aspect in Key Audit Matters only by a reference as to a possible cessation of business and making of adjustments, if any, thereto to be made at the time of cessation only. Comment on the reporting by the Statutory Auditor as above.

Ans. Closure of Business: As per SA 570 “Going Concern”, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern.

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in

view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Further, as per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report", when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasizes on auditor's responsibility to communicate key audit matters in the auditor's report.

As per the facts given in the case, intention of the Toddle Limited had definite plan of its business being closed down within short period from 31 March 2017. However, financial statements for the year ended 31.03.2017 had been prepared on the same basis as it had been in earlier periods with an additional note.

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern is a key audit matter. Therefore, the auditor is required to communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, be made at the time of cessation only by the auditor in his report is not sufficient.

Question 55

M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent

break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter.

Ans. Reporting requirements in case of Uncertainty clamping on the Going Concern: As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

1. Adequately disclose 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;
2. Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a 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 about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

1. Draw attention to the note in the financial statements that discloses the matters set out above; and

2. State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future.

Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity/s ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Question 56

Write short notes on the following:

a) Financial indications to be considered for evaluating the assumption of going concern

Ans. Financial Indications and Going Concern: SA 570 on "Going Concern," aims to establish standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements. The following are the financial indications be considered:

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.
- Inability to obtain financing for essential new product development or other essential investments.

Question 57

AQP Limited is one of the prominent players in the chemicals industry. The company is a public company domiciled in India and listed on BSE and NSE. The Company was facing extreme liquidity constraints and there were multiple indicators that casted doubt over the company ability to continue as a going concern. The Company was led into insolvency proceedings by consortium of banks led by PNB and the NCLT ordered the commencement of corporate insolvency process against the Company on 31 August 2017. The company invited prospective lenders, investors and others to submit their resolution plans to the Resolution Professional (RP) latest by 1 January 2018. The RP reviewed the resolution plans and ensured conformity

with Insolvency and Bankruptcy Code 2016. The compliant plans were presented to Committee on Creditors (COC) on 2 February 2018 and the resolution plan submitted by PQR Ltd. was evaluated as highest evaluated Compliant Resolution Plan. COC of AQP Ltd approved the Resolution Plan submitted by PQR Ltd. on 2 March 2018. The approval of NCLT was finally obtained on 4 May 2018. PQR Ltd submitted detailed plans and commitments as part of the resolution plan including clearance of all outstanding debts which were leading to negative cash flows. Please suggest how you would deal with this situation as the auditors of AQP Ltd.

Ans. As per SA 570 Going Concern, if events or conditions have been identified that may cast significant doubt on the entity ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity ability to continue as a going concern (hereinafter referred to as “material uncertainty”) through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

1. Where management has not yet performed an assessment of the entity ability to continue as a going concern, requesting management to make its assessment.
2. Evaluating management’s plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management’s plans are feasible in the circumstances.
3. Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the
4. Evaluating the reliability of the underlying data generated to prepare the forecast; and
5. Determining whether there is adequate support for the assumptions underlying the forecast.
6. Considering whether any additional facts or information have become available since the date on which management made its assessment.

7. Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

If events or conditions have been identified that may cast significant doubt on the entity ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

In the instant case, the approval of the resolution plan is a significant mitigating factor to counter the going concern issues of AQP Ltd. PQR Ltd has submitted a detailed plan and commitments that has been given as part of the resolution plan which includes clearance of all outstanding debts which were leading to negative cash flows. Therefore, it can be said that the company that the events and conditions are mitigated effectively and there is no material uncertainty in relation to the ability of the company to continue as a going concern.

Question 58

M/s T K Projects Limited, a manufacturing company in the Steel industry was Allegedly involved in some irregularity relating to allotment of coal blocks for which a complaint was lodged against the company by the government. The financial institutions stopped additional working capital finance which caused a financial crisis resulting in stoppage of production. The company incurred a massive loss during the year 2015-16.

There were delays in salary and other payments. Certain key managerial personnel including GM Finance and certain other employees left the company. The company has no sound action

plan to mitigate these situations. Guide the statutory auditor on how he should deal with this situation.

Ans. Inability to Continue as a Going Concern: As per SA 570 on “Going Concern”, it is the responsibility of the auditor to 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 and to conclude whether there is a material uncertainty about the entity’s ability to continue as a going concern. The auditor shall evaluate management’s assessment of the entity’s ability to continue as a going concern. In evaluating management’s assessment, the auditor shall consider whether management’s assessment

Inability to Continue as a Going Concern:

As per SA 570 on “Going Concern”, it is the responsibility of the auditor to 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 and to conclude whether there is a material uncertainty about the entity’s ability to continue as a going concern.

The auditor shall evaluate management’s assessment of the entity’s ability to continue as a going concern. In evaluating management’s assessment, the auditor shall consider whether management’s assessment

Question 59

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

Ans. Evaluating Going Concern Assumption: SA 570 “Going Concern”, requires that while planning a performing audit procedure and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of

the financial statements. In assessing such a risk, the auditor should examine the following indications-

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 creditors.
4. Negativity 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 creditors 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.
7. Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.
8. 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.
9. Changes in law or regulation or government policy expected to adversely affect the entity.
10. Uninsured or underinsured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

Question 60

A Company's net worth is eroded and trade payables 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.

Ans. Going Concern Assumption: In this 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”.

Question 61

An auditor of Sagar 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?

Ans. Validity of Written Representation: The physical verification of fixed assets 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. In the case of Sagar Ltd., the auditor has not been able to verify the existence and value of some machinery 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 Representations”, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence from other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. “Written Representations” 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. Therefore, the approach adopted by the auditor is not right.

Question 62

PRSH & Co is the statutory auditor of Make My Journey Ltd. The company is in the business of tours and travels. Annual turnover of the company is INR 2000crores and profits are INR 190crores. During the planning meeting of the management and the auditors, it was discussed that the management needs to provide written representation letter to the auditors for the preparation of the financial statements and for the completeness of the information provided to the auditor. At the time of closure of the audit, there has been some confusion about the requirements of the written representation letter. Management argued that representation need not be written, it can also be verbal which has been provided to the audit team during the course of their audit. Auditors have completed their documentation and hence in a way, representation based on verbal discussions with the auditors has also got documented. Auditors explained that this is mandatory to obtain written representation in accordance with the requirements of SA 580. However, still some confusion remains regarding the date and period covered by the written representation. You are required to advise about the date of and period covered by written representation in view of SA 580.

Ans. As per SA 580, “Written Representations”, as written representations are necessary audit evidence, the auditor’s opinion cannot be expressed, and the auditor’s report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor’s report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor’s report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period.

This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Question 63

In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty?

Ans. 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:

1. Discuss the matter with management,
2. 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
3. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor should disclaim an opinion on the financial statements if management does not provide written representations in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

Question 64

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

Ans. Written Representation: 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. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Thus written representations are necessary information that the auditor requires in connection with the audit of the entity’s financial statements.

Accordingly, similar to responses to inquiries, written representations are audit evidence. 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.

Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management’s responsibilities, or about specific assertions.

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. Other SAs require the auditor to request written representations.

If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

Extent of Reliance: SA 580, “Written Representations”, states that If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have 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 matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. 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 in the auditor’s report.

Question 65

State briefly the basic elements of Management Representation Letter.

Ans. 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.

Question 66

In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty?

Ans. 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:

1. Discuss the matter with management,
2. 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
3. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor should disclaim an opinion on the financial statements if management does not provide written representations in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

Question 67

B is the Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, required them to share the working papers compiled by them for his review and return. Is Principal Auditor within his right in asking for such sharing of working papers?

Ans. Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor". It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

(1) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the

audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and

(2) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor.

The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, 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." In the light of aforesaid, principal auditor was not within his right for asking for such sharing of working papers. It depends upon the discretion of auditor.

Question 68

"There should be sufficient liaison between a principal auditor and other auditors."

Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by other auditor.

Ans. SA 600 on “Using the Work of Another Auditor” lays down the procedure to be applied in situations where a principal auditor reporting on the financial statement of the entity uses the work of another independent auditor.

SA 600 contemplates coordination between auditors and requires that there should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor. The other auditor, knowing the context in which his work is to be used by the principal auditor, should coordinate with the principal auditor. For example, by bringing to the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level, adhering to the timetable for audit of the component, etc. He should ensure compliance with the relevant statutory requirements. Similarly, the principal auditor should advise the other auditor of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.

When considered necessary by him, the principal auditor may require the other auditor to answer a detailed questionnaire regarding matters on which the principal auditor requires information for discharging his duties. The other auditor should respond to such questionnaire on a timely basis.

When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.

In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance, in relation to the financial information of the entity on which the principal auditor is reporting that it requires a modification of the principal auditor's report.

Question 69

Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

Ans. Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance: SA 610 'Using the work of Internal Auditor' Deals about the concept of direct assistance of internal auditor. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

(1) The amount of judgment involved in:

1. Planning and performing relevant audit procedures; and
2. Evaluating the audit evidence gathered;
3. The assessed risk of material misstatement; and
4. The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance.

If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

Question 70

CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA. Kishore, the statutory auditor of the Company, for his view and reporting. Can CA. Kishore rely on such report?

Ans. Using the Work of Internal Auditor: As per SA 610 “Using the Work of Internal Auditors”, while determining whether the work of the internal auditors can be used for the purpose of the audit, the external auditor shall evaluate-

- (a) The extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of the internal auditors;
- (b) The level of competence of the internal audit function; and
- (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Further, the external auditor shall not use the work of the internal audit function if the external auditor determines that:

- (a) The function’s organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- (b) The function lacks sufficient competence; or
- (c) The function does not apply a systematic and disciplined approach, including quality control.

In the instant case, CA. Kishore should ascertain the internal auditor’s scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check few items and he can also observe the procedures performed by the internal auditors. If the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds

that the verification is not in order, he has to decide otherwise. The final responsibility to express opinion on the financial statement remains with the statutory auditor.

Question 71

State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes?

Ans. Evaluating the Adequacy of the Auditor's Expert's Work: As per SA 620 Using the work of an Auditor's Expert, the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that experts findings or conclusions, and their consistency with other audit evidence, etc. Specific procedure to evaluate the adequacy of the auditor's expert's work are —

1. Enquiries of the auditor's expert.
2. Reviewing the auditor's expert's working papers and reports
3. Corroborative procedure such as-
 - (a) Observing the auditor's expert's work
 - (b) Examining the published data, such as statistical reports from reputed source
 - (c) Confirming the relevant matters with third parties
 - (d) Performing detailed analytical procedure to see whether principles of materiality aspects Considered
 - (e) Re performing calculations

1. Discussions with another expert with relevant expertise when, for example, the findings or the conclusion of the auditor's expert are not consistent with other audit evidence.
2. Discussing the expert's report with the management.

Question 72

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?

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

When the auditor intends to use the work of an expert, he shall evaluate the adequacy of the auditor's expert's work, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; if that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and if that expert's work involves the use of source data that is significant to his work, 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.

Question 73

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

Ans. As per SA 620 "Using the work of an Auditor's Expert", the auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:

1. The nature, scope and objectives of that expert's work;
2. The respective roles and responsibilities of the auditor and that expert;

3. The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and

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

In the instant case X Ltd. had various derivative contracts - options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the fair valuation done through an external third party. The statutory auditors of the company involved an auditor's expert to audit valuation of derivatives. Considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him in accordance with SA 220.

Question 74

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 2015-16. 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 actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

Explain the responsibility of auditors, in case, report made by Mr. Y actuary, later on, found faulty.

Ans. 1. Using the work of an Auditor's Expert: As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has

sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

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

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion. Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

Question 75

Enumerate the 'Basic Elements of Audit Report' as enshrined in SA 700.

Ans. Basic Elements of Auditor's Report: As per SA 700, "Forming an Opinion and Reporting on Financial Statements", the auditor's report includes the following basic elements:

1. Title: The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

2. Addressee: The auditor's report shall be addressed as required by the circumstances of the3. Auditor's Opinion: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also:

(a) Identify the entity whose financial statements have been audited;

(b) State that the financial statements have been audited;

(c) Identify the title of each statement comprising the financial statements;

(d) Refer to the notes, including the summary of significant accounting policies; and

(e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

4. Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

(a) States that the audit was conducted in accordance with Standards on Auditing;

(b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;

(c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.

The statement shall refer to the Code of Ethics issued by ICAI;

(d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

5. Going Concern: Where applicable, the auditor shall report in accordance with SA 570 (Revised)

6. Key Audit Matters: For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.

When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

7. Responsibilities for the Financial Statements: The auditor's report shall include section with a heading "Responsibilities of Management for the Financial Statements." The auditor's report shall use the term that is appropriate in the context of the legal framework applicable to the entity and need not refer specifically to "management". In some entities, the appropriate reference may be to those charged with governance.

8. Auditor's Responsibilities for the Audit of the Financial Statements.

9. Location of the description of the auditor's responsibilities for the audit of the financial statements.

10. Other Reporting Responsibilities.

11. Signature of the Auditor.

Question 76

Write a short note on Corresponding figures.

Ans. Corresponding Figures: As per SA 710 “Comparative Information—Corresponding Figures and Comparative Financial Statements”, “corresponding figures” is a comparative information where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period. These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.

Question 77

What are the professional obligations of the auditor who has withdrawn from the audit before completion of his term due to non-cooperation of the Management in completing certain audit procedures?

Ans. Resignation due to Management Imposing Limitation on the Scope of Audit: SA 705 “Modifications to the Opinion in the Independent Auditor’s Report” provides the consequence of an inability to obtain sufficient appropriate audit evidence due to a management – imposed limitation after the auditor has accepted the engagement. The practicability of withdrawn from the audit may depend upon the stage of completion of the engagement at the time that management imposes the scope limitation. When the auditor concludes that withdrawn from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity’s owners.

In the case of resignation from the company, provisions of the Companies Act, 2013 applies. Section 140(2) of the Companies Act, 2013, requires the auditor, who has resigned from the company, to file within a period of 30 days from the date of resignation, a statement with the company and the registrar, and in case of government companies, the auditor shall file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other

facts as may be relevant with regard to his resignation. In case of failure the auditor will be liable for penal provisions.

Question 78

There are certain circumstances in which Emphasis of Matter in Auditor's Report is mandated to be included. Explain this statement in the light of mandatory requirements of matters that are to be emphasised in Auditor's Report when the Audit Report is on Financial Statements prepared in accordance with Special Purpose Framework.

Ans. Circumstances in which Emphasis of Matter Paragraph in Auditor's Report is mandated in case of Financial Statements prepared in accordance with a Special Purpose Framework: As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" and/or SA 800, "Special Considerations—

Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks", the auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting user of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading.

The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose.

Restriction on Distribution or Use: In addition to the alert required above, the auditor may consider it appropriate to indicate that the auditor's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by

restricting the distribution or use of the auditor's report. In these circumstances, the emphasis of matter paragraph given above maybe expanded to include these other matters, and the heading may be modified accordingly.

Question 79

Write short notes on the following: Auditor's responsibilities regarding comparatives.

Ans. Auditor's responsibilities regarding comparatives: SA 710, "Comparative Information Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives.

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

1. The comparative information agrees with the amounts and other disclosures presented in the prior period; and
2. The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised).

As required by SA 580 (Revised), the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

Question 80

The audit report of P Ltd. For the year 2014-15 contained a qualification regarding non-provision of doubtful debts. As the statutory auditor of the company for the year 2015-16, how would you report, if:

1. The company does not make provision for doubtful debts in 2015-16?
2. The company makes adequate provision for doubtful debts in 2015-16?

Ans. Auditor's responsibility in cases where audit report for an earlier year is qualified is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements".

As per SA 710, When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse 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 financial reporting framework, 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 qualified 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:

1. 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

2. 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.

3. In the instant Case, if P Ltd. Does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

Question 81

Difference between Intangible Asset and Intangible Item.

Ans. Intangible Asset vs. Intangible Item: As per Accounting Standard 26 on "Intangible Assets", enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences intellectual property, market knowledge and trademarks (including brand names and publishing titles.

Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

If above discussed items fulfils the conditions given in the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing

to the enterprise, will be considered as intangible asset. But if any of such discussed items does not satisfied these 3 conditions then it will not constitute intangible asset, like expenditure to acquire it or generate it internally is recognized as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognized at the date of the amalgamation.

Further, Intangible assets are shown in Balance Sheet whereas intangible items which are not intangible assets are provided as expenditure in Statement of Profit and Loss.

Question 82

Z Ltd changed its employee remuneration policy from 1st of April 2017 to S provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or an cash it. As at 31st March 18 the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment.

Ans. As per Para 11 of AS-15 on "Employee Benefits", issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise

expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

Question 83

A firm of a father and a son is receiving Rs.2 lakhs towards job work done for XYZ Ltd. during the year ended on 31.03.16. The total job work charges paid by XYZ Ltd. during the year are over Rs.50 lakhs. The father is Managing Director of XYZ Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in the activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction. He further contended that such a payment made in the last year was not disclosed. Advise whether Managing Director is right in his approach.

Ans. Related Party Disclosures: As per definition given in the AS 18 "Related Party Disclosures" parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In the instant case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid Rs.2 lakhs as job work charges. The managing director is having a substantial holding in XYZ Ltd. The case is squarely covered by AS 18. According to AS-18, in the case of related party transactions, the reporting enterprise should disclose the following:

- (i) the name of the transacting related party;
- (ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) Amounts written off or written back in the period in respect of debts due from or to related parties.”

Further, SA 550 on “Related Parties”, also prescribes the auditor’s responsibilities and audit procedures regarding related party transactions.

The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also it has to be seen whether section 184 of the Companies Act, 2013 regarding disclosure of interest by director has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

Question 84

The Property, Plant and Equipment of ABC Ltd. included Rs.25.75crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern as regards matters specified above?

Ans. Disclosure in Audit Report: The auditor is required to specifically include certain matters as per CARO, 2016 under section 143 of the Companies Act, 2013. According to clause (i) (a) of CARO, 2016 the auditor has to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; and as per clause (i) (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

In the given case, ABC Ltd. has intention to sale its earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down and these assets are appearing at residual value. Further, inspection of such machines (though it is a retired machine, however value is € 25.75 crores which is material amount) was done 10 years back, is not in compliance with CARO, 2016. Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2016.

Question 85

You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was Rs.12000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for 850crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with IND AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report.

Ans. Related Party Disclosures: As per IND AS 24, “Related Party Disclosures”, a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity, and (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

- (1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
- (2) the following information in sufficient detail to enable users of the entity’s financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850crore from abroad through a corporation namely

Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of IND AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.) Contention of Management of

Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise in not tenable.

Question 86

As an Auditor give your comments for the following disclosures made by a Company which adopted IND A8 for compilation of Financial Statements:

(i) In the Balance Sheet, the sub-head inventories contained an item "goods In transit" in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified.

(ii) Provision for doubtful debts of trade debtors was grouped in, "Provisions" under current liabilities.

(iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".

(iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income".

(v) Payment towards a one-time voluntary retirement scheme introduced during the year was included In "Employee Benefit Expense".

Ans. (i) Goods in Transits: As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct.

(ii) Provision for Doubtful Debts of Trade Debtors was grouped in "Provisions" under current liabilities: The term "doubtful debts" is an adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37 "Provisions, Contingent Liabilities and Contingent Assets". Thus, provision should be shown net in trade receivable.

(iii) In Statement of Profit and Loss, Prior Period Income was shown under Other Income: As per Ind-AS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”, Prior Period Income should not be shown in statement of profit and loss. The entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

(iv) Sale Proceeds of Scrap incidental to manufacture were included in “Other Income”: As per Ind-AS 2 “Inventories”, sale proceeds of scrap incidental to manufacture should be deducted from the cost of the main product. Thus, disclosure of sale proceeds of scrap as other income is not correct.

(v) Payment towards a onetime VRS during the year included in Employee Benefit Expenses: As per Ind-AS 19 “Employee Benefits”, if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits, in case it is not expected to be settled before twelve months the entity shall apply the requirements for long term employee benefits. In the instant case, it should be shown as short term employee benefits in place of Employee Benefit Expenses. Thus, treatment of such payment as employee benefit expenses is not correct.

Question 87

Zed Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are en cashed and transferred to current accounts. As of 31st March, 2018 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances. Comment.

Ans. Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013: The instructions in accordance with which current assets being “cash and cash equivalents” should be made out to Part I of Schedule III to the Companies Act, 2013 states as follows:

(i) Cash and cash equivalents shall be classified as:

(a) Balances with banks;

(b) Cheques, drafts on hand;

(c) Cash on hand;

(d) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical setoff has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts. The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

Question 88

As an auditor of ABC Limited, in view of given circumstances, you are required to draft qualified opinion and basis for qualified opinion due to the departure from the applicable Financial Reporting Framework:

- Audit of a complete set of financial statements of an company other than a listed company (registered under the Companies Act, 2013) using a fair presentation framework.
- The financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- A departure from the applicable financial reporting framework resulted in a qualified opinion.
- The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.

- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

Ans. Qualified Opinion We have audited the standalone financial statements of ABC Limited (“the Company”), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company’s branches located at (location of branches))

2. In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Basis for Qualified Opinion

The Company’s short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company’s records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of Rs xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders’ equity would have been reduced by Rs xxx, Rs .xxx and Rs. xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of

the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Question 89

A Review Report of an Auditor is negative in form in expression of conclusion- Explain.

Ans. Negative Review Report in expression of conclusion: According to Standards on Review Engagement (SREs) review report is a limited assurance engagement. The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter information. SAs, SREs and SAEs establish basic elements for assurance reports. In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with.

In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, this form of expression conveys "reasonable assurance". However, in a limited assurance engagement, the practitioner expresses the conclusion in the negative form, for example, "based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on XYZ criteria".

This form of expression conveys a level of "limited assurance" that is proportional to the level of the practitioner's evidence-gathering procedures given the characteristics of the subject matter and other engagement circumstances described in the assurance report.

The format of Review report in SRE in conclusion caption of the report provides as follows-
"nothing has come to our attention that causes to believe that these financial statements do

not give a true and fair view of (Or presents fairly in all material respects) the financial position of the company and of its financial performance and cash flows for the period then ended in accordance with the Accounting standards referred to in Companies Act 2013 and other accounting principles generally accepted in India" .

Thus, in view of above it is clear that in a review report instead of positive form, the negative form of expression is being used. Also it is to be noted that the Review report contains caption - conclusion and not opinion.

