MATERIAL NO. 66, SUPPLEMENTARY MATERIAL ON AUDITING AND ASSURANCE_42e

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CHAPTER 2. NATURE, OBJECTIVE & SCOPE OF AUDIT

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

1) **STANDARD SETTING PROCESS:**

The International Federation of Accountants (IFAC) was set up with a view to bring harmony in the profession of accountancy on an international scale.

In pursuing this mission, IFAC Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue high quality auditing standards for use around the world.

The IAASB achieves its objectives by:

a) Establishing high quality auditing standards and guidance for
   i) financial statement audits that are generally accepted
   ii) other types of assurance services on both financial and non-financial matters;
   iii) other related services;
   iv) quality control

b) Publishing other **pronouncements on auditing and assurance** matters

2) **International Auditing and Assurance Standards Board (IAASB):** It functions as an independent standard-setting body under the IFAC.

3) **Auditing and Assurance Standards Board (AASB):** ICAI is a member of the IFAC and is committed to work towards the implementation of the guidelines issued by the IFAC. ICAI constituted the AASB to review the existing auditing practices in India and to develop engagement and Quality Control Standards.

4) **Role of Auditing and Assurance Standards Board:**

a) The Institute of Chartered Accountants of India constituted the **Auditing Practices Committee (APC)**. The main function of the APC is to review the existing auditing practices in India and to develop Statements on **Standard Auditing Practices (SAPs)** so that these may be issued by the Council of the Institute.

b) These Standards will apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

c) While discharging their attest function, it will be the duty of members of the Institute to ensure that the Standards are followed in the audit of financial information covered by their audit reports.

d) **If for any reason a member has not been able to perform an audit in accordance with the Standards, his report should draw attention to the material departures in his audit report.**

e) **All Standards are mandatory** from the date mentioned herein and it is obligatory upon members of Institute to adhere to these whenever an audit is carried out.

5) **Compliance with Documents Issued by the Institute**: The Institute has issued '**Guidance Notes**' and '**Statements (Standards on Audit/ Auditing Pronouncements)**' on a number of matters. **'Statements' are mandatory.**

6) '**Guidance Notes**' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may rely in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. **Guidance Notes are recommendatory in nature**.

7) **QUALITIES OF AN AUDITOR:** Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "An auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

8) As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

a) The importance to audit quality of:

1. Performing work that complies with professional standards and regulatory and legal requirements;
2. Complying with the firm's quality control policies and procedures as applicable;
3. Issuing auditor's reports that are appropriate in the circumstances; and
4. The engagement team's ability to raise concerns without fear of reprisals;

b) The fact that quality is essential in performing audit engagements.

9) **ENGAGEMENT PERFORMANCE**: The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

a) How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.

b) Processes for complying with applicable engagement standards.

c) Processes of engagement supervision, staff training and coaching.

d) Methods of reviewing the work performed, the significant judgments made and the form of report being issued.

e) Appropriate documentation of the work performed and of the timing and extent of the review.

f) Processes to keep all policies and procedures current.

10) **Monitoring**: The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an on going consideration and evaluation of the firm's system of quality control, including a

periodic inspection of a selection of completed engagements. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

a) Adherence to professional standards and regulatory and legal requirements;

b) Whether the quality control system has been appropriately designed and effectively implemented; and

c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

11) **CASE STUDY:** Mr. Veeru of Delhi has started a new business of selling of Handloom items. He purchases these items from a factory situated in Ludhiana and sells to local customers at a price which gives him reasonable amount of profit. All gets well in the first year and he earns some income from the business.

However, he feels that he could expand this business if he was able to bring more items to the place where he sells them and also he is aware of the fact that there are several other locations as well where he could sell these items. He could achieve this by buying a van and by employing other people who will assist him in his business on the other locations.

He needs more money to achieve this expansion of his business. He decides to ask his friend Raju to invest in the business.

Having seen the potential of Veeru's business, Raju wants to invest, but neither he wants to manage nor wants to have ultimate liability for the debts of the business in case business fails. He therefore suggested that they should set up a proprietary firm. He will be the owner of the firm and will be entitled to profits. On the other hand, Veeru would be the Manager and be paid a salary.

At the end of the first year of trading when Raju receives copy of the financial statements, he finds that Profits are much lower than what was expected. Raju knows that Veeru is paid salary so he may not care for low profits. Raju is concerned by the level of profits and feels that he wants further assurance on the accounts. He does not know whether the accounts give a true and fair view of the last year's trading because the profits do not seem as high as those Veeru had predicted when he agreed to invest.

Raju seeks solution for his problem.

Answer: The solution is that Raju is seeking may be given by an Independent Audit of accounts.

PART 2: QUESTIONS TO BE READ BY ALL

Q.No.1. "The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement shall emphasise various matters on quality" Elaborate the statement. (B)

Leadership responsibilities for Quality on Audits as per SA 220 "Quality Control for an audit of Financial Statements":

The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

a) The importance to audit quality of:

i) Performing work that complies with professional standards and regulatory and legal requirements

ii) Complying with the firm's quality control policies and procedures as applicable;

iii) Issuing auditor's reports that are appropriate in the circumstances; and

iv) The engagement team's ability to raise concerns without fear of reprisals; and

b) The fact that quality is essential in performing audit engagements.

ENGAGEMENT PARTNER: The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

NOTE: This answer is newly added in ICAI Study material.

Q.No.2. Analysis of the Definition "Audit" (B)

a) Audit is Independent examination of financial information.

b) Of any entity - that entity may be profit oriented or not and irrespective of its size or legal form. For example - Profit oriented - Audit of Listed Company engaged in business. On the other hand, Audit of NGO - not profit oriented.

c) The objective of the audit is to express an opinion on the financial statements.

NOTE: This answer is newly added in ICAI Study material.

Q.No.3. MNO Ltd requested the auditor CA. P to provide for absolute assurance in respect of its ten branches scattered in Delhi and confirm that the financial statements are free from material misstatement due to fraud or error. Advice CA. P. (B)

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

In view of the above, CA P cannot provide audit absolute assurance to MNO Ltd in respect of its branches.

NOTE: This answer is newly added in ICAI Study material.

Q.No.4. DEF & Co. Chartered Accountants successfully carried out the audit of Shree Garments for the F.Y. 2019-2020. After the completion of the audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the auditor. Management alleges that it is failure on the part of auditor. Comment (A)

a) Because of the limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

b) Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs.

c) However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.

d) Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

NOTE: This answer is newly added in ICAI Study material.

Q.No.5. M/s Suresh Chandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2018-19. CA. Suresh, one of the partners of M/s Suresh Chandra & Co., completed entire routine audit work by 29th May, 2019. 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. You are required to state with reasons whether CA. Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor. (A)

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

- **a)** the work has been performed in accordance with standards on audit
- **b)** significant matters have been raised for further consideration
- **c)** appropriate consultations have taken place and the resulting conclusions have been documented and implemented
- **d)** there is a need to revise the nature, timing and extent of work performed
- **e)** the work performed supports the conclusions reached and is appropriately documented
- **f)** the evidence obtained is sufficient and appropriate to support the auditor's report
- **g)** The objectives of the engagement procedures have been achieved.

Even though the work is delegated to expert or staff of auditor or any other person, auditor 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.

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.

NOTE: This answer is newly added in ICAI Study material.

PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS

NIL

CHAPTER 3. COMPANY AUDIT

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

NIL

PART 2: QUESTIONS TO BE READ BY ALL

Q.No.1. The Institute of Chartered Accountants of India has issued Standard on Auditing (SA) 299 (Revised), "Joint Audit of Financial Statements." It lays down the principles for effective conduct of joint audit to achieve the overall objectives of the auditor. The special considerations in carrying out audit by joint auditors are explained in the standard." You are required to state the special considerations by the joint auditors. (B)

- **a)** The engagement partner and other key members of the engagement team from each of the joint auditors should be involved in planning the audit.
- **b)** The joint auditors should jointly establish an overall audit strategy which sets the scope, timing and direction of the audit, and also guides the development of the audit plan.
- **c)** Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:
  - **i)** identify division of audit areas and common audit areas;
  - **ii)** ascertain the reporting objectives
  - **iii)** communicate among all joint auditors significant matters
  - **iv)** direct the engagement team's efforts
  - **v)** consider the results of preliminary engagement activities
  - **vi)** Ascertain the nature, timing and extent of resources for completion of audit.

d) Each of the joint auditors should consider and assess the risks of material misstatement and communicate to other joint auditors.

e) The joint auditors should discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas

f) The joint auditors should obtain common engagement letter & common management representation letter.

g) The work allocation document should be signed by all the joint auditors

In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor.

RELEVANT QUESTION:

1) Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should develop a joint audit plan. Explain **A.** Write **Point (iii)** above.	**N19 (N)-4M**

Q.No.2. All Joint auditors are jointly and severally responsible for the audit work. Comment. (A)

All the joint auditors shall be jointly and severally responsible for:

a) Work that is not divided and is carried out by all joint auditors;

b) Decisions taken by all the joint auditors

c) Matters which are brought to the notice of the joint auditors by any one of them

d) Examining that the financial statements of the entity comply with the requirements of the relevant statutes

e) Presentation and disclosure of the financial statements as required by the AFRF

f) Audit report complies with the requirements of the relevant statutes

In case a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

Note:

i) The joint auditors are required to issue common audit report.

ii) However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.

iii) In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

NOTE: This answer is newly added in ICAI Study material.

Q.No.3. State the contents of certificate to be obtained by management before appointment of auditor. (B)

The certificate to be obtained from the auditor shall certify that the-

a) The auditor is eligible for appointment and is not disqualified for appointment.

b) The auditor or firm satisfies the criteria provided in section 141 of the Companies Act, 2013.

c) The proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013.

d) The list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

NOTE: This answer is newly added in ICAI Study material.

PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS

NIL

CHAPTER 5. AUDIT DOCUMENTATION AND EVIDENCE

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

1) COMPLETION MEMORANDUM OR AUDIT DOCUMENTATION SUMMARY:

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

1. the significant matters identified during the audit and
2. how they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist auditor's consideration of the significant matters. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor

2) USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS: In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

a) The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;

b) The risks arising from the characteristics of the control, including whether it is manual or automated;

c) The effectiveness of general IT-controls;

d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;

e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and

f) The risks of material misstatement and the extent of reliance on the control

3) EXTERNAL CONFIRMATION PROCEDURES: When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

a) Determining the information to be confirmed or requested;

b) Selecting the appropriate confirming party;

c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and

d) Sending the requests, including follow-up requests when applicable, to the confirming party.

4) GOING CONCERN: Additional Audit Procedures When Events or Conditions Are Identified

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's 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:

a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

b) 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.

c) 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 evaluation of management's plans for future actions:

   i) Evaluating the reliability of the underlying data generated to prepare the forecast; and

   ii) Determining whether there is adequate support for the assumptions underlying the forecast.

d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

e) Requesting written representations from management regarding their future action plans and the feasibility of these plans.

f) Audit procedures that are relevant to the requirement as stated above may include the following:

   i) Analyzing and discussing cash flow, profit and other relevant forecasts with management.

   ii) Analyzing and discussing the entity's latest available interim financial statements.

   iii) Reading the terms of debentures and loan agreements and determining whether any have been breached.

   iv) Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.

   v) Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.

   vi) Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

   vii) Evaluating the entity's plans to deal with unfilled customer orders.

   viii) Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.

   ix) Confirming the existence, terms and adequacy of borrowing facilities.

   x) Obtaining and reviewing reports of regulatory actions.

   xi) Determining the adequacy of support for any planned disposals of assets

CHAPTER 8. AUDIT OF BANKS

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

NIL

PART 2: QUESTIONS TO BE READ BY ALL

Q.No.1. What are the reports generally that the statutory central auditor of the bank furnish? (B)

Types of Audit Reports to be issued (generally): Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting

b) Long Form Audit Report.

c) Report on compliance with SLR requirements.

d) Report on whether the treasury operations of the bank

e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI.

f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.

g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the

- **i)** Ghosh Committee (relating to frauds and malpractices) and
- **ii)** Jilani Committee (internal control and inspection/credit system).

h) Report on instances of adverse credit-deposit ratio in the rural areas.

NOTE: This answer is newly added in ICAI Study material.

PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS

NIL

CHAPTER 10. RISK ASSESSMENT AND INTERNAL CONTROL

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

Study of various aspects of internal control is divided into four sections, as follows:

1) General Nature and characteristics of Internal Control
2) Controls relevant to the Audit
3) Nature and Extent of the understanding of relevant controls
4) Components of Internal Control

1) GENERAL NATURE AND CHARACTERISTICS OF INTERNAL CONTROL:

a) Purpose of Internal Control: Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern:

- **i)** The reliability of the entity's financial reporting;
- **ii)** The effectiveness and efficiency of its operations;
- **iii)** Its compliance with applicable laws and regulations; and
- **iv)** Safeguarding of assets.

The way in which internal control is designed, implemented and maintained varies with an entity's size and complexity.

b) Components of Internal Control: The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit

- **i)** The control environment;
- **ii)** The entity's risk assessment process
- **iii)** The information system, including the related business processes, relevant to financial reporting, and communication
- **iv)** Control activities
- **v)** Monitoring of controls

c) Control Environment - Component of Control Environment: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- **i)** Management has created and maintained a culture of honesty and ethical behavior; and
- **ii)** The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

The control environment includes:

- **i)** The governance and management functions and

ii) The attitudes, awareness, and actions of those charged with governance and management .

iii) The control environment sets the tone of an organization, influencing the control consciousness of its people.

d) Elements of the Control Environment: Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

i) Communication and enforcement of integrity and ethical values: These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.

ii) Commitment to competence: Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

iii) Participation by those charged with governance: Attributes of those charged with governance such as:

- Their independence from management.
- Their experience and stature.
- The extent of their involvement and the information they receive, and the scrutiny of activities.
- The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.

iv) Management's philosophy and operating style Characteristics such as management's:

- Approach to taking and managing business risks.
- Attitudes and actions toward financial reporting.
- Attitudes toward information processing and accounting functions and personnel.

v) Organisational structure: The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.

vi) Assignment of authority and responsibility: Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.

vii) Human resource policies and practices: Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

e) The Entity's Risk Assessment Process - Component of Control Environment: The auditor shall obtain an understanding of whether the entity has a process for:

i) Identifying business risks relevant to financial reporting objectives;

ii) Estimating the significance of the risks;

iii) Assessing the likelihood of their occurrence; and

iv) Deciding about actions to address those risks.

The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assists the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

f) The Information System, including the Related Business Processes, Relevant to Financial Reporting and Communication - Component of Control Environment: The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following:

i) The classes of transactions in the entity's operations that are significant to the financial statements

ii) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;

iv) How the information system captures events and conditions that are significant to the financial statements;

v) The financial reporting process used to prepare the entity's financial statements;

vi) Controls surrounding journal entries

2) **CONTROL ACTIVITIES - COMPONENT OF INTERNAL CONTROL:**

a) The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process.

b) Control activities are the policies and procedures that help ensure that management directives are carried out.

c) Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

d) Control activities that are relevant to the audit are:

i) Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or

ii) Those that are considered to be relevant in the judgment of the auditor;

iii) 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 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.

e) Identifying Significant Risks: Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.

f) Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement. The auditor assess assertions affected by a significant risk as higher inherent risk. The following are always significant risks:

i) Risks of material misstatement due to fraud

ii) Significant transactions with related parties that are outside the normal course of business for the entity

iii) Risks of Material Misstatement: Greater for Significant Non-Routine Transactions

iv) Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

v) Greater management intervention to specify the accounting treatment.

vi) Greater manual intervention for data collection and processing.

vii) Complex calculations or accounting principles.

viii) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks

g) Risks of material misstatement - Greater for Significant Judgmental Matters:

i) Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

ii) Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.

iii) Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value

3) **<u>MONITORING OF CONTROLS - COMPONENT OF INTERNAL CONTROL:</u>** The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

a) Monitoring of controls Defined: Monitoring of controls is a process to assess the effectiveness of internal control performance over time.

b) Helps in assessing the effectiveness of controls on a timely basis: It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.

c) Management accomplishes through ongoing activities, separate evaluations etc.: Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

d) Management's monitoring activities include: Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

e) **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

f) **Monitoring of Controls:** If the entity has an internal audit function

If the entity has an internal audit function, the auditor shall obtain an understanding of the following:

i) The internal audit function's responsibilities and how the internal audit function fits in the entity's organisational structure; and

ii) The activities performed, or to be performed, by the internal audit function.

g) **The following points merit consideration in this regard:**

i) **Internal Audit Function relevant to the Audit:** The entity's internal audit function is likely to be relevant to the audit if its activities are related to the entity's financial reporting. Also if the auditor expects to use the work of the internal auditors to modify the audit procedures to be performed. When the auditor determines that the internal audit function is likely to be relevant to the audit, SA 610 applies.

ii) **Size and Structure of the Entity:** The objectives of an internal audit function vary widely depending on the size and structure of the entity and the requirements of management.

iii) **Internal audit function may include:** The responsibilities of an internal audit function may include, for example, monitoring of internal control, risk management, and review of compliance with laws and regulations. On the other hand, the responsibilities of the internal audit function may be limited to the review of the economy, efficiency and effectiveness of operations, for example, and accordingly, may not relate to the entity's financial reporting.

iv) **External auditor's activities- on the basis of Internal Audit activities:** If the internal audit function's responsibilities are related to the entity's financial reporting, the external auditor's consideration of the activities performed may include review of the internal audit function's audit plan for the period.

v) Satisfactory Control Environment - not an absolute deterrent to fraud.

<u>PART 2: QUESTIONS TO BE READ BY ALL</u>

NIL

<u>PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS</u>

NIL

CHAPTER 11. AUDIT STRATEGY, PLAN AND PROGRAMME

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

For the purpose of programme construction, the following points should be kept in mind:

1) Stay within the scope and limitation of the assignment.
2) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
3) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
4) Consider all possibilities of error.
5) Co-ordinate the procedures to be applied to related items.

CHAPTER 14. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

NIL

PART 2: QUESTIONS TO BE READ BY ALL

Q.No.1. How do you verify the Goods Sent Out on Sale or Return Basis? (B)

1) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
2) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
3) Ensure that the goods, in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
4) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

NOTE: This answer is newly added in ICAI Study material.

Q.No.2. How do you verify Borrowing from Banks? (A)

Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows-

a) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
b) Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
c) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
d) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
e) Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

NOTE: This answer is newly added in ICAI Study material.

Q.No.3. How do you verify Goods Sent on Consignment? (A)

a) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.

b) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.

c) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.

d) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.

e) See that goods in hand with the consignee have been shown separately under the head inventories.

NOTE: This answer is newly added in ICAI Study material.

Q.No.4. How do you verify Foreign Travel Expenses? (C)

a) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.

b) Verify that the tour programme was properly authorised by the competent authority.

c) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.

d) See that the tour report accompanies the T.A. bill.

e) The tour report will show the purpose of the tour.

f) Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.

g) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

NOTE: This answer is newly added in ICAI Study material.

Q.No.5. How do you verify Receipt of Capital Subsidy? (B)

a) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

b) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

c) Ensure that the conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.

d) Check relevant entries for receipt of subsidy.

e) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

NOTE: This answer is newly added in ICAI Study material.

Q.No.6. How do you verify Provision for Income Tax? (B)

a) Obtain the computation of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.

b) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.

c) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.

d) Compute tax payable as per the latest applicable rates in the Finance Act.

e) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.

f) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

Q.No.7. How do you verify vouching of Payment of Taxes? (A)

a) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.

b) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.

c) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.

d) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.

e) The entity can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.

f) It is not necessary for the entity to make payment of taxes from his own account in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.

<u>**NOTE:**</u> This answer is newly added in ICAI Study material.

Q.No.8. How to verify advertisement Expenses? (A)

a) Verify the bills/invoices from advertising agency to ensure that rates charged for different types of advertisement are as per the contract.

b) See that the advertisement relates to client's business.

c) Inspect the receipt issued by the agency.

d) Ascertain the nature of expenditure - revenue or capital expenditure and see that it has been recorded properly.

<u>**NOTE:**</u> This answer is newly added in ICAI Study material.

Q.No.9. How to verify sale of scrap? (B)

a) Review the internal control as regards generation, storage and disposal of scrap.

b) Check whether the organization is maintaining reasonable record for generation of scrap.

c) Analyse the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.

d) Check the rates at which scrap has been sold and compare the rate with previous year.

e) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.

f) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.

g) Make an overall assessment of the value of realization from scrap as to its reasonableness.

NOTE: This answer is newly added in ICAI Study material.

PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS

NIL

CHAPTER 15B. AUDIT OF DIFFERENT TYPES OF ENTITIES

PART 1: IT IS SUFFICIENT TO GIVE ONE NOVEL READING OF BELOW GIVEN CONTENT (USEFUL TO ANSWER MCQs)

NIL

PART 2: QUESTIONS TO BE READ BY ALL

Q.No.1. What are the matters to be considered by the auditor before start of audit of a partnership firm? (B)

MATTERS TO BE CONSIDERED BEFORE STARTING AUDIT: The auditor should examine the partnership agreement and note the provisions therein as regards the following matters:

a) The name and style under which the business shall be conducted.

b) The duration of the partnership, if any, that has been agreed upon.

c) The amount of capital that shall be contributed by each partner

d) The period at the end of which the accounts of the partnership will be closed periodically

e) The provisions as regards maintenance of books of account

f) Borrowing capacity of the partnership

g) The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.

h) Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?

i) Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.

j) Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?

k) Limitations and restrictions that have been agreed upon, the rights and powers of partners and on their implied authority to pledge the firm's credit or to render it liable.

RELEVANT QUESTION:

1) Write any four pints relevant for auditor to be considered before the start of audit of RAM & Co, a partnership firm at Mumbai.

A. Write **any 4 points.**

Q.No.2. What are the documents of LLP that are available for public inspection? (B)

The following documents/information will be available for inspection by any person:

a) Incorporation document

b) Names of partners and changes, if any, made therein

c) Statement of Account and Solvency

d) Annual Return

The fees for such inspection of an LLP is Rs 50/- and fees for certified copy or extract of any document u/s 36 shall Rs. 5/- per page.

NOTE: This answer is newly added in ICAI Study material.

Q.No.3. What are the advantages of audit of LLP? (B)

Advantages / Purpose / Need of Audit:

a) Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements.

b) Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts.

c) Banks & financial institutions lend money to the firms only on the basis of audited accounts.

d) Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP.

e) For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc. audited accounts are accepted by those concerned who have dealings with the LLP.

NOTE: This answer is newly added in ICAI Study material.

PART 3: QUESTIONS FOR ADVANCED STUDY - SUFFICIENT TO BE READ BY RANK EXPECTED STUDENTS

NIL

THE END