

## **PAPER – 6: AUDITING AND ASSURANCE**

### **PART – I : ACADEMIC UPDATE**

**(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by  
Regulating Authority)**

#### **Chapter 9-Audit of Items of Financial Statements**

In section 53 of the principal Act, for subsection (3), the following sub-section shall be substituted, namely:— "(3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued."

Penalty has been linked with amount raised through the issue of shares at a discount or a penalty of ₹ 5 lakhs whichever is less. Further, in case of default, the company is required to refund the amount alongwith 12% interest per annum.

**(Reference to page no. is 9.8 and 9.9 of the study module 2)**

### **PART – II: QUESTIONS AND ANSWERS**

#### **PART – II A: Multiple Choice Questions based on Integrated Case Scenarios**

##### **Integrated Case Scenario-1**

M/s NSG & Associates have been appointed as auditors of Viaan Ltd. for the financial year 2019-20. The processes, operations, accounting and decisions are carried out by using computers in Viaan Ltd. The auditors understand that there are several aspects that they should consider to determine the level of automation and complexity in the business environment of Viaan Ltd. While planning the audit work, the engagement partners discussed with the audit staff about the various types of controls in the automated environment.

The different types of audit tests that can be used in audit of an automated business environment were also discussed within the engagement team. The responsibility regarding the Internal Financial Controls was also discussed in detail. Further the tools and techniques that can be used to deal with the enormous data and information of Viaan Ltd. were briefed to the audit staff by the engagement partners.

Based on the above facts, answer the following:-

1. .... are the manual controls that make use of some form of data or information or report produced from the IT systems and applications.
  - (a) Application Controls

- (b) IT dependent Controls
  - (c) Automated Controls
  - (d) General IT Controls
2. Statement 1: Application controls include both manual and automated controls that operate at a business process level.  
Statement 2: General IT Controls apply to mainframe, miniframe as well as end user environment.
- (a) Only Statement 1 is correct
  - (b) Only Statement 2 is correct
  - (c) Both Statements 1 & 2 are correct
  - (d) Both Statements 1 & 2 are incorrect
3. .... are also known as pervasive or indirect controls :-
- (a) General IT Controls
  - (b) Application Controls
  - (c) IT dependent Controls
  - (d) None of the above
4. Which of the following are not the types of audit tests that can be used in the audit in an automated environment?
- (a) Observation
  - (b) Inspection
  - (c) Re performance
  - (d) None of the above
5. .... is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information:-
- (a) Computer Assisted Audit Techniques
  - (b) Automated Controls
  - (c) Data Analytics
  - (d) None of the above

**Integrated Case Scenario-2**

M/s JK & Associates have been appointed as auditors of Venus Ltd. for the financial year 2019-20. The team consist of Mr. J & Mr. K both Chartered Accountants as also the engagement partners and the audit staff consisting of 2 article assistants. While starting the audit work of

Venus Ltd, the engagement partners briefed the audit staff about the audit work, areas to be covered and the various auditing concepts and their application in the audit of Venus Ltd along with applicable Standard on Auditing.

Various topics like audit planning, overall audit strategy, audit programme were discussed in detail. The team was told about the purpose and implication of various statements and guidance notes issued by the Institute of Chartered Accountants of India (ICAI) from time to time. Mr. K also briefed the team about the concept of materiality to be applied while planning and performing audit. The team was also explained in detail about the area where benchmark materiality can be applied in case of Venus Ltd.

Based on the above facts, answer the following:-

1. .... sets the scope, timing & direction of the audit and guides the development of the more detailed plan.
  - (a) Audit Programme
  - (b) Overall Audit Strategy
  - (c) Completion Memorandum
  - (d) Audit Plan
2. Statement 1: The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential process but are closely inter-related.  
Statement 2: The auditor shall establish an overall audit strategy that guides the development of audit plan.
  - (a) Only Statement 1 is correct
  - (b) Only Statement 2 is correct
  - (c) Both Statements 1 & 2 are correct
  - (d) Both Statements 1 & 2 are incorrect
3. .... means the amount set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatement exceeds materiality for the financial statements as a whole :-
  - (a) Benchmark Materiality
  - (b) Materiality in Planning
  - (c) Performance Materiality
  - (d) Materiality.

4. Which of the following is not an example of benchmark that can be used in determining the materiality in the case of financial statements:-
- (a) Total Revenue
  - (b) Profit before tax
  - (c) Net Asset Value
  - (d) None of the above
5. (i) Guidance notes issued by ICAI provide guidance to members on matters which may arise in the course of their professional work.
- (ii) Statements are issued by ICAI with a view to secure compliance by members on some matters.
- (iii) Guidance notes are recommendatory in nature.
- (iv) Statements are mandatory in nature.
- (a) All the above statements are correct.
  - (b) Statements 1 & 2 are correct
  - (c) Statements 1, 2 & 3 are correct
  - (d) Statements 1,2 & 4 are correct

**MCQ's not based on Case Scenario**

1. Statement 1: Audit procedures consist of Risk Assessments Procedures and other procedures.
- Statement 2: Substantive procedures consist of test of details and analytical procedures.
- (a) Only Statement 1 is correct
  - (b) Only Statement 2 is correct
  - (c) Both 1 & 2 are correct
  - (d) Both 1 & 2 are incorrect
2. With respect to the forms specified by companies (Cost Records & Audit) Rule 2014, which of the following is incorrect combination:
- (a) Form CRA 1- Maintenance of cost records by the Company.
  - (b) Form CRA 2- Intimation of appointment of another cost auditor to Central Government.
  - (c) Form CRA 3- Submission of Cost Audit Report to the Board of Directors of the company.
  - (d) Form CRA 4- Submission of Cost Audit Report by the company to the Registrar.

3. Statement I As per the Standard on Auditing (SA) 520 “Analytical Procedures”, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among financial data.

Statement II Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

- (a) Only Statement I is correct
  - (b) Only Statement II is correct
  - (c) Both statements are correct
  - (d) Both Statements are incorrect
4. Which of the following is not an example of Analytical Procedures having consideration of comparisons of the entity’s financial information:
- (a) Comparable information for prior periods.
  - (b) Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
  - (c) Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.
  - (d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.
5. Statement I : A firm whereof majority of partners practising in India are qualified for appointment may be appointed by its firm name to be auditor of a company.
- Statement II : Where a firm including a limited liability partnership is appointed as an auditor of a company, all the partners shall be authorised to act and sign on behalf of the firm.
- (a) Only Statement I is correct
  - (b) Only Statement II is correct
  - (c) Both statements are correct
  - (d) Both Statements are incorrect

#### **PART II B – DESCRIPTIVE QUESTIONS**

1. State with reason (in short) whether the following statements are true or false:
- (i) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding hundred crore rupees or more shall constitute an Audit Committee.

- (ii) According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a general resolution of the company.
- (iii) As per sub-section (5) of the section 140, the Tribunal cannot direct the company to change its auditors.
- (iv) SA 210 does not require the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.
- (v) Government audit does not serve as a mechanism or process for public accounting of government funds.
- (vi) An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 180 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.
- (vii) An Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent.
- (viii) In the planning stage, analytical procedures would not in any way assist the auditor.
- (ix) Statistical sampling has narrower application where a population to be tested consists of a large number of similar items.
- (x) Risk assessment procedures are not performed to obtain an understanding of the entity and its environment.

#### **Chapter 1- Nature, Objective and Scope of Audit**

- 2. (a) The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.
- (b) Explain the objectives of an Audit as per SA 200.
- 3. (a) There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.
- (b) In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

#### **Chapter 2- Audit Strategy, Audit Planning and Audit Programme**

- 4. (a) Plans should be further developed and revised as necessary during the course of the audit. Explain.
- (b) Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall

audit strategy assists the auditor to determine such matters as for example - the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters. Explain the other three such matters.

5. (a) Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples.
- (b) Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.

Analyse and explain with the help of example of evidence in respect of Sales.

### **Chapter 3- Audit Documentation and Audit Evidence**

6. (a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. 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. Explain stating clearly objectives of the auditor regarding written representation.
- (b) 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. Explain the auditor's obligation in the above situation.
7. (a) The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.
- (b) When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.
8. (a) Define the following :
  - (i) Positive confirmation request

- (ii) Negative confirmation request
- (iii) Non-response
- (iv) Exception
- (b) Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

#### **Chapter 4- Risk Assessment and Internal Control**

- 9. (a) When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain
- (b) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples.
- 10. (a) Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.
- (b) It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Explain with the help of example in respect of the procedure for sales.

#### **Chapter 5- Fraud and Responsibilities of the Auditor in this Regard.**

- 11. Auditor of A Ltd while conducting audit in the course of the performance of his duties as auditor, believes with reasons that "an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed". Analyse and also explain the manner of reporting the matter to the Central Government.
- 12. Discrepancies in the accounting records, including transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy is one of the example of circumstances that indicate the possibility of fraud. Explain at least four other such examples relating to discrepancies in the accounting records.

#### **Chapter 6- Audit in an Automated Environment**

- 13. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform check completeness of data and population that is used in either test of controls or substantive audit tests. Explain in detail stating all the relevant points.
- 14. Explain some of the commonly used methods for testing in an automated environment.



**Chapter 7- Audit Sampling**

15. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. Explain
16. Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example.

**Chapter 8 - Analytical Procedures**

17. Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances.
18. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context.

**Chapter 9 - Audit of Items of Financial Statements**

19. Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit.
20. What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory.

**Chapter 10 - The Company Audit**

21. ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report.
22. 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 identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard.
23. The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor ?

**Chapter 11 - Audit Report**

24. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Explain and analyse the indicators of lack of neutrality with examples, wherever required.
25. 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 identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section.

**Chapter 12- Bank Audit**

26. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense.
27. In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also. Analyse and Explain.

**Chapter 13- Audit of Different Types of Entities**

28. (a) As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account. Explain
- (b) Explain the powers and duties of auditors under the Multi-State Co-operative Societies Act, 2002.

**SUGGESTED ANSWERS / HINTS****ANSWERS - MULTIPLE CHOICE QUESTIONS- Integrated Case Scenario-1**

1. (b)
2. (c)
3. (a)
4. (d)

5. (c)

**ANSWERS - MULTIPLE CHOICE QUESTIONS- Integrated Case Scenario-2**

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

**General MCQ's**

- 1 (c)  
2 (d)  
3 (b)  
4 (d)  
5 (a)

**DESCRIPTIVE ANSWERS**

1. (i) **Incorrect:** all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more shall constitute an Audit Committee.
- (ii) **Incorrect:** According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014.
- (iii) **Incorrect:** As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.
- (iv) **Incorrect:** SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.
- (v) **Incorrect:** Government audit serves as a mechanism or process for public accounting of government funds. It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
- (vi) **Incorrect:** An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where

the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

- (vii) **Incorrect:** The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.

Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.

- (viii) **Incorrect:** In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

- (ix) **Incorrect:** Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

- (x) **Incorrect:** Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

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

#### **Analysis of the Definition**

1. Audit is Independent examination of Financial information.
2. 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.
3. The objective of the audit is to express an opinion on the financial statements.

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- (i) the accounts have been drawn up with reference to entries in the books of account;
  - (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
  - (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
  - (iv) the information conveyed by the statements is clear and unambiguous;
  - (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
  - (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.
- (b) As per SA-200 “Overall Objectives of the Independent Auditor”, in conducting an audit of financial statements, the overall objectives of the auditor are:
- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
  - (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.
3. (a) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor’s ability to obtain audit evidence. For example:
- 1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
  - 2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
  - 3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- (b) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor’s ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
- Fraud, particularly fraud involving senior management or collusion.

- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

4. (a) **Plans should be further developed and revised as necessary during the course of the audit.**

SA-300, "Planning an Audit of Financial Statements" further expounds this principle. According to it, **planning is not a discrete phase of an audit, but rather a continual and iterative process** that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

(b) **Overall audit strategy** sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

**The process of establishing the overall audit strategy assists the auditor** to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

1. The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
2. The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
3. When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates; and
4. How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (**for example, on-site or off-site**), and whether to complete engagement quality control reviews.

5. (a) **Examples are :**

- ◆ The competitive environment, including demand, capacity, product and price competition as well as cyclical or seasonal activity.

- ◆ Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those entities.
  - ◆ Technological developments, such as those related to the entity's products, energy supply and cost.
  - ◆ The effect of regulation on entity operations.
- (b) Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques. What is best evidence for testing the accuracy of any assertion is a matter of expert knowledge and experience. This is the primary task before the auditor when he draws up the audit programme. Transactions are varied in nature and impact; procedures to be prescribed depend on prior knowledge of what evidence is reasonably available in respect of each transaction.

**Example**

Sales are evidenced by:

- (i) invoices raised by the client;
- (ii) price list;
- (iii) forwarding notes to client;
- (iv) inventory-issue records;
- (v) sales managers' advice to the inventory section;
- (vi) acknowledgements of the receipt of goods by the customers; and
- (vii) collection of money against sales by the client.

6. (a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. 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.

Written representations are requested from those responsible for the preparation and presentation of the financial statements.

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 objectives of the auditor regarding written representation**

The objectives of the auditor are:

**(a) To obtain written representations**

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

**(b) To support other evidence**

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

**(c) To respond appropriately**

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

- (b)** 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:

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

- 7. (a)** Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.

**Example**

- ◆ Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- ◆ Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.



- ◆ Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.
- (b) 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.
8. (a) **Positive confirmation request** – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
- Negative confirmation request** – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
- Non-response** – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
- Exception** – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.
- (b) **Matters relevant in planning attendance at physical inventory counting include, for example:**
- (a) Nature of inventory.
  - (b) Stages of completion of work in progress.
  - (c) The risks of material misstatement related to inventory.
  - (d) The nature of the internal control related to inventory.
  - (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
  - (f) The timing of physical inventory counting.
  - (g) Whether the entity maintains a perpetual inventory system.
  - (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which

locations attendance is appropriate

(i) Whether the assistance of an auditor's expert is needed.

9. (a) **Control risk assessment when control deficiencies are identified:** When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements.

When control deficiencies are identified and auditor identifies and tests more than one control for each relevant assertion, he evaluates control risk considering all of the controls he has tested. If auditor determines that they support a 'rely on controls' risk assessment, or if compensating controls are identified, tested and evaluated to be effective, he may conclude that the 'rely on controls' is still appropriate. Otherwise we change our control risk assessment to 'not rely on controls.'

When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls have been identified that mitigate the risk related to the assertion. If the deficiency relates to one WCGW (what can go wrong) out of several WCGW's, he can 'rely on controls' but performs additional substantive procedures to adequately address the risks related to the deficiency.

- (b) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:
- ◆ Assessing risks of material misstatement of the financial statements;
  - ◆ Determining materiality in accordance with SA 320;
  - ◆ Considering the appropriateness of the selection and application of accounting policies;
  - ◆ Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
  - ◆ Developing expectations for use when performing analytical procedures;
  - ◆ Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.

**10. (a) Objectives of Internal Control**

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

**Objectives of Internal Control are :**

- (i) transactions are executed in accordance with managements general or specific authorization;
  - (ii) all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
  - (iii) assets are safeguarded from unauthorised access, use or disposition; and
  - (iv) the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.
- (b) It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of transaction at each stage through which it flows.

**For example, the procedure for sales requires the following:**

1. Before acceptance of any order the position of inventory of the relevant article should be known to ascertain whether the order can be executed in time.
2. An advice under the authorisation of the sales manager should be sent to the party placing the order, internal reference number, and the acceptance of the order. This advice should be prepared on a standardised form and copy thereof should be forwarded to inventory section to enable it to prepare for the execution of the order in time.
3. The credit period allowed to the party should be the normal credit period. For any special credit period a special authorisation of the sales manager would be necessary.

4. The rate at which the order has been accepted and other terms about transport, insurance, etc., should be clearly specified.
5. Before deciding upon the credit period, a reference should be made to the credit section to know the creditworthiness of the party and particularly whether the party has honoured its commitments in the past.

**11. Reporting to the Central Government:** As per sub-section (12) of section 143 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 of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ **1 crore or above**, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

**The manner of reporting the matter to the Central Government is as follows:**

- (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
- (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;
- (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

**12. Discrepancies in the accounting records, including:**

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

**13. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:**

- ◆ Check completeness of data and population that is used in either test of controls or substantive audit tests.
- ◆ Selection of audit samples – random sampling, systematic sampling.
- ◆ Re-computation of balances – reconstruction of trial balance from transaction data.
- ◆ Reperformance of mathematical calculations – depreciation, bank interest calculation.
- ◆ Analysis of journal entries as required by SA 240.
- ◆ Fraud investigation.
- ◆ Evaluating impact of control deficiencies.

**14. When testing in an automated environment, some of the more common methods are as follows:**

- ◆ Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
- ◆ Observe how a user processes transactions under different scenarios.
- ◆ Inspect the configuration defined in an application.

**15. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.**

For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

16. **Block Sampling:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

**Example**

Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

17. **Trend analysis** – A commonly used technique is the comparison of current data with the prior period **balance** or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.
18. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:
- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
  - (ii) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
  - (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
  - (iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

19. Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS).

A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures.

In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

- completeness;
- cut-off;
- existence/ occurrence;
- valuation/ measurement;
- rights and obligations; and
- presentation and disclosure

of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

**Example**

If Company X's balance sheet shows building with carrying amount of ₹ 50 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of ₹ 50 lakh (Completeness assertion).

20. **Meaning of Valuation Assertion**– Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

**Example of Inventory explaining the valuation assertion is given hereunder:**

Inventory has been recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted

average etc.) has been used to value inventory as at the period-end.

21. Sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

22. **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:

- (a) identify division of audit areas and common audit areas;
- (b) ascertain the reporting objectives of the engagement;
- (c) consider and communicate among all joint auditors the factors that are significant
- (d) in directing the engagement team's efforts;
- (e) consider the results of preliminary engagement activities, or similar engagements performed earlier.
- (f) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

23. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report. It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹ 1 crore, however, reporting under CARO, 2016 is required.

24. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial



statements to be materially misstated. Indicators of a lack of neutrality include the following:

- (i) The selective correction of misstatements brought to management's attention during the audit.

**Example**

- ◆ Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
- ◆ The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives.

- (ii) Possible management bias in the making of accounting estimates.

- 25.** 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.
- 26.** In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.
- The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.
  - The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing

each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.

- The auditor should, on a test check basis, verify the calculation of interest and ensure that:
  - (a) Interest has been provided on all deposits upto the date of the balance sheet;
  - (b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
  - (c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
  - (d) Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.

The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. The auditor should re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc from the term sheet, deal ticket, agreements, etc and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

## **27. Reversal of Income:**

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).

Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any

communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.

28. (a) As per sub-section (3) & (4) of section 73 of Multi- state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account, which are laid before the Multi-State co-operative society in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said account give the information required by this act in the manner so required, and give a true and fair view:

- (a) In the case of the balance-sheet, of the state of the Multi-State co-operative society's affairs as at the end of its financial year; and
- (b) In the case of the profit and loss account, of the profit or loss for its financial year. The auditor's report shall also state:
  - (i) Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.
  - (ii) Whether, in his opinion, proper books of account have been kept by the Multi- State co-operative society so far as appears from his examination of these books and proper returns adequate for the purpose of his audit have been received from branches or offices of the Multi-State co-operative society not visited by him.
  - (iii) Whether the report on the accounts of any branch office audited by a person other than the Multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
  - (iv) Whether the Multi-State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

- (b) Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi- State co-operative society such information

and explanation as the auditor may think necessary for the performance of his duties as an auditor.

As per section 73(2), the auditor shall make following inquiries:

- (a) Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State co-operative society or its members,
- (b) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,
- (c) Whether personal expenses have been charged to revenue account, and
- (d) Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.