THEORETICAL QUESTIONS from INTER CA AUDIT MODULE

Chapter 1- Nature Objective and Scope of Audit

Q1. Explain Clearly Meaning of Auditing. How would you as an auditor perform the audit

"An audit is independent examination of fi nancial 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."
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.
Q2. The independent Audit of an entity's financial statements is a vital service to investors, trade payables and other participants in economic exchange. Explain

Advantages of Audit

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below:
(a) **It safeguards the financial interest of persons who are not associated** with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
(b) **It acts as a moral check on the employees** from committing defalcations or embezzlement.
(c) Audited statements of account are **helpful in settling liability for taxes**, negotiating loans and for determining the purchase consideration for a business.
(d) These are **also useful for settling trade disputes** for higher wages or bonus as well as claims in respect of damage suffered by property, by fi re or some other calamity.
(e) An audit can also **help in the detection of wastages and losses** to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
(f) **Audit ascertains whether the necessary books of account and allied records have been properly kept** and helps the client in making good deficiencies or inadequacies in this respect.

(g) As an appraisal function**, audit reviews the existence and operations of various controls in the organisations** and reports weaknesses, inadequacies, etc., in them.
(h) Audited accounts are of great help in **the settlement of accounts at the time of admission or death of partner.**
(i) **Government may require audited and certified statement** before it gives assistance or issues a license for a particular trade.

Q3. State the objectives of audit according to SA 200.

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.

Q4. The code of ethics for professional accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats.

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifi es fi ve types of threats. These are:
1. **Self-interest threats,** which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement.
2. Self-review threats, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.
3. Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.
4. Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.
5. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because

of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

Chapter 2- Audit Strategy, Planning and Programming

1. "Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy" Explain.

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.
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.

2. "Planning is not a discrete phase of an audit, but rather a continual and iterative process". Discuss.

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. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:
1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

3. "The nature, timing and extent of the direction and supervision of engagement

team members and review of their work vary depending on many factors." Explain.

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work.
The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:
1. The size and complexity of the entity.
2. The area of the audit i.e. the materiality of the information being audited by team members
3. The assessed risks of material misstatement. Example: An increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.
4. The capabilities and competence of the individual team members performing the audit work.

4. "The utility of the audit programme can be retained and enhanced only by keeping the programme and also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed" Discuss stating clearly the advantages of an audit programme.
The advantages of an audit programme are:
(a) It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
(b) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
(c) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
(d) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger is signifi cantly less and the audit can proceed systematically.
(e) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
(f) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
(g) It serves as a guide for audits to be carried out in the succeeding year.
(h) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

The disadvantages are:
(a) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
(b) The programme often tends to become rigid and inflexible following set grooves;

the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
(c) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
(d) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

5. "Determining materiality involves the exercise of professional judgment". Discuss stating the factors that may affect the identification of an appropriate benchmark. Also give examples.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:
-The elements of the financial statements e.g. Assets, liabilities, equity, revenue, expenses;
-Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused e.g. For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates; The entity's ownership structure and the way it is financed e.g. If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings);
-The relative volatility of the benchmark.

Chapter 3 Audit Documentation and Audit Evidence

1 Define audit documentation. Also give some examples.

SA 230 on "Audit Documentation", audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.)

Audit Documentation include:

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of signifi cant matters.
- Letters of confi rmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning signifi cant matters.

The auditor may include copies of the entity's records (**for example,** signifi cant and specifi c contracts and agreements) as part of audit documentation. Audit documentation is not a substitute for the entity's accounting records.

2 "Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain.

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-

- the significant matters identified during the audit and
- 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.

3 "Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal". Discuss.

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.

4 Discuss the objective of Auditor with respect to Opening balances – in conducting an initial audit engagement.

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

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

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

5 Define Risk of material misstatement. Explain its components also.

Risk of material misstatement: may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows

(a) Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

(b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.

6 "When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences" Explain.

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

(a) The test of controls that have been performed provide an appropriate basis for reliance on the controls;

(b) Additional test of controls are necessary; or

(c) The potential risks of misstatement need to be addressed using substantive procedures.

Chapter 4- Risk Assessment and Internal Control

1. "The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting" Explain

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

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

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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.

2. "Risk of material misstatement consists of two components" Explain clearly defining risk of material misstatement.
Same as Chapter 3 Q5 of this document.

3. "The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement"" Explain (Same as previous question)

4. "The auditor shall obtain an understanding of the control environment" Explain stating what is included in control environment.

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.

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:

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

(b) 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.

(c) Participation by those charged with governance– Attributes of those charged with governance such as:

- Their independence from management.
- 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.
- Their experience and stature.

Chapter 5

1. What do you understand by the term fraud? Provide its meaning as given under SA 240

Refer Chapter 5 Q1

2. Briefly explain self- revealing errors with some examples

Self-Revealing Errors: These are such errors the existence of which becomes apparent in the process of compilation of accounts. A few illustrations of such errors are given hereunder, showing how they become apparent.

(i)	Omission to post a part of a journal entry to the ledger.	Trial balance is thrown out of agreement.
(ii)	Wrong totaling of the Purchase Register.	Control Account (*e.g.*, the Sundry Trade payables Account) balances and the aggregate of the balances in the personal ledger will disagree.
(iii)	A failure to record in the cash book amounts paid into or withdrawn from the bank	Bank reconciliation statement will show up error.
(iv)	A mistake in recording amount received from X in the account of Y.	Statements of account of parties will reveal mistake.

3. There are many ways for cash defalcation, one of which is by suppressing cash receipts. List out few techniques of how the receipts are suppressed.

Refer Chapter 5 Q2

4. Fraud Risk Factors are the events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Further the nature of the industry or the entity's operations also provides opportunities to engage in fraudulent financial reporting. List out some of the cases from where these opportunities may arise.

Refer Chapter 5 Q3

5. You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit. As a Statutory Auditor, how would you deal?

Refer Chapter 5 Q9

6. Fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

In view of the above-mentioned circumstances of management fraud, explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from such Management Fraud.

Refer chapter 5 Q5

7. Intelligent Ltd. entered into an agreement with Mr. Intellectual on 15th March, 2017, whereby it agreed to pay him ` 2 lakhs per month as retainership fee for consultation in IT department. However, no amount was actually paid and ` 24 lakhs was provided in the Statement of Profit and Loss for the year ending on March 31st, 2017. Management of the company uttered that need-based consultation was obtained throughout the year. However, on investigation, no documentary or other evidence of receipt of such service was found. As the auditor of Innocent Ltd., what would be your approach?

Would your approach be different if the amount involved is ` 1 crore or above?
As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
In the given case, Intelligent Ltd. has entered into an agreement with Mr. Intellectual, at year-end, for consultation in IT department. It also charged yearly fee of ` 24 lakhs in the Statement of Profit and Loss, however, no documentary or other evidence of receipt of such service was found, on investigation**.** It is clear that company has passed fictitious journal entries, near year-end, to manipulate the operating results.
Accordingly, the auditor would adopt the approach which will be based on the result of misstatement on the basis of such fictitious journal entry, i.e. if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; or the auditor may consider for appropriateness of withdrawal from such engagement, where withdrawal from the engagement is legally permitted.
In addition, the auditor is required to report according to section 143(12) of the Companies Act, 2013. As per Section 143(12), if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter. If the offence of fraud involved is of ` 1crore or above, he shall report the matter to the Central Government.

Chapter 6
1. Briefly mention three reasons why IT should be considered relevant to an audit of financial statements.
The auditor should consider relevance of IT in an audit of financial statements for the following reasons:
(a) Since auditors rely on the reports and information generated by IT systems, there could be risks in the IT systems that could have an impact on audit.
(b) Standards on auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.
(c) By relying on automated controls and using data analytics in an audit, it is possible to increase the effectiveness and efficiency of the audit process.
2. Describe how risks in IT systems, if not mitigated, could have an impact on audit.
When risks in IT systems are not mitigated the audit impact could be as follows:
(i) The auditor may not be able rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.
(ii) The auditor has to perform additional audit work by spending more time and efforts.
(iii) The auditor may have to issue a modified opinion, if necessary.
3. What are the different testing methods used when auditing in an automated environment. Which is the most effective and efficient method of testing?
When auditing in an automated environment, the following testing methods are used:

(a) Inquiry
(b) Observation
(c) Inspection
(d) Re-performance

A combination of inquiry and inspection is generally the most effective and efficient testing method. However, determining the most effective and efficient testing method is a matter of professional judgement and depends on the several factors including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed.

Chapter 7

1. What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling".

According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

Methods of Sampling:

Refer Q3.

2. With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

Refer chapter 7 Q6.

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

Refer Chapter 7 Q4.

4. Write short notes on the following:

(a) Advantages of Statistical sampling in Auditing.

Refer Chapter 7 Q2.

(b) Stratified sampling

Refer Chapter 7 Q3

Chapter 8

1. Define Analytical Procedures.

Refer Chapter 8 Q1

2. What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures".

Refer Chapter 8 Q6

3. While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement?

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

Test of Details: The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size.

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

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fi xed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedure to provide evidence to support the reasonableness of recorded amounts.

Chapter 9 <u>(all other questions covered in JKSC Question bank of chapter 9)</u>

1. How will you vouch and/or verify the following:

- **(a) Goods sent out on Sale or Return Basis.**
- **(b) Borrowing from Banks.**

2. How will you vouch/verify the following:

- **(a) Goods sent on consignment.**
- **(b) Foreign travel expenses.**
- **(c) Receipt of capital subsidy.**
- **(d) Provision for income tax.**

3. How will you vouch and/or verify payment of taxes?

4. How would you vouch/verify the following:

- **(a) Advertisement Expenses.**
- **(b) Sale of Scrap.**

Chapter 10 (all questions covered in JKSC textbook)

1. An auditor purchased goods worth ` 501,500 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers. Comment.

2. (a) Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2015-2016. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd. Discuss.

(b) Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.

3. Under what circumstances the retiring Auditor cannot be reappointed?

4. Discuss the following:

(a) Ceiling on number of audits in a company to be accepted by an auditor.

(b) Filling of a casual vacancy of auditor in respect of a company audit.

(c) In Joint Audit, "Each Joint Auditor is responsible only for the work allocated to him".

Chapter 11

1. "The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework." Explain.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account:

(a) whether sufficient appropriate audit evidence has been obtained;

(b) whether uncorrected misstatements are material, individually or in aggregate;

(c) The evaluations.

2. "The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments." Discuss stating clearly qualitative aspects of the entity's accounting practices.

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Qualitative Aspects of the Entity's Accounting Practices:

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. 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.
    (ii) Possible management bias in the making of accounting estimates.
4. SA 540 addresses possible management bias in making accounting estimates.

3. Discuss the factors affecting the decision of the auditor regarding which type of modified opinion is appropriate.

Refer Chapter 11- Q2

4. Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report".

As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is **to express clearly an appropriately modified opinion** on the financial statements that is necessary when:

(a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the fi nancial statements as a whole are free from material misstatement.

Chapter 12

1. The functioning of banking industry in India is regulated by the Reserve Bank of the Central Bank of our country. Explain.

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. RBI is responsible for development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions) as well as for determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.

Important functions of RBI are issuance of currency; regulation of currency issue; acting as banker to the central and state governments; and acting as banker to commercial and other types of banks including term-lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks. No bank can commence the business of banking or open new branches without obtaining licence from RBI. The RBI also has the power to inspect any bank.

The provisions of the Reserve Bank of India Act, 1934, also affect the functioning of banks. The Act gives wide powers to the RBI to give directions to banks which also have considerable effect on the functioning of banks.

2. "The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain.

The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion provides:

- An opportunity for more experienced engagement team members, including the audit engagement partner, to share their insights based on their knowledge of the bank and its environment.
- An opportunity for engagement team members to exchange information about the bank's business risks.
- An understanding amongst the engagement team members about eff ect of the results of the risk assessment procedures on other aspects of the audit, including decisions about the nature, timing, and extent of further audit procedures. The discussion between the members of the engagement team and the audit engagement partner should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

The engagement team discussion ordinarily includes a discussion of the following matters:

- Errors that may be more likely to occur;
- Errors which have been identified in prior years;
- Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- Need to maintain professional skepticism throughout the audit engagement;

• Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

3. Write a short note on reversal of income under bank audit.

Refer Chapter 12- Q12

Chapter 13

1. You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?

Covered in Chapter 13 JKSC textbook

2. The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital?

Covered in Chapter 13 JKSC textbook

3. Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only ` 500 per month from a student for his lodging/boarding.

1. **General**

(i) Study the constitution under which the charitable institution has been set up whether under the Society Registration Act, as a trust or as a company limited by guarantee. Verify whether it is managed as contemplated by the law and rules and regulations made thereunder.

(ii) Examine the internal control structure particularly with reference to admission to hostel, expenses incurred on different kinds of activities.

(iii) Verify the broad nature of expenses likely to be incurred with reference to the previous year's annual audited accounts.

2. Verification of the receipts

(i) Check the amounts received on account of, monthly rentals, etc., and receipts issued for the same.

(ii) Ascertain that there is adequate internal control over the issue of official receipts, custody of unused receipt books, printing of receipt books, etc.

(iii) Cross - tally the rent received along with the number of students (from the student register) staying in the hostel during the year.

3. Verification of expenses

(i) Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.

(ii) Verify whether the expenses incurred are in conformity with the budgets prepared internally or fi led with the relevant authorities.

4. Verify investments made from surplus funds as well as existing investments by physically verifying the same and that they are in the name of the institution and that there is no charge/pledge against the same.

5. Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass, cutlery, kitchen utensils, liner, etc. are adequately depreciated.

4. Explain in detail the duties of Comptroller and Auditor General of India

Refer Chapter 13

5. An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for

relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations

Receipt of Donations:

(i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.

(ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.

(iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.

(iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.

(v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.

(vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

(i) **Mode of Sending Remittance:** All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.

(ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.**.**

(iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.

(iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.

(v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

(vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.