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SUBJECT- AUDIT

Test Code - CIM 8368 M

BRANCH - () (Date :)

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ANSWER-1

ANSWER-A

The auditor shall evaluate-

(a) The **results of the sample**; and

(b) Whether the use of audit sampling has provided a **reasonable basis for conclusions** about the population that has been tested.

For tests of controls, an **unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement**, unless further audit evidence substantiating the initial assessment is obtained. For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.

In the case of tests of details, the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the **sample does not provide a reasonable basis for conclusions** about the population that has been tested. The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement. Also, **if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size,** the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement. Considering the results of other audit procedures helps the auditor to assess the risk that actual misstatement in the population exceeds tolerable misstatement, and the risk may be reduced if additional audit evidence is obtained.

In case the auditor concludes that **audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may request management to investigate misstatements that have been identified** and the potential for further misstatements and to make any necessary adjustments; or tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

(5 MARKS)

ANSWER-B

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

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

(5 MARKS)

ANSWER-2

ANSWER-A

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

The essential audit reporting differences between the approaches are:

(a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas

(b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Definition of Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

Audit Procedures regarding comparative information

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

(a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

(b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

(6 MARKS)

ANSWER-B

<u>Risk Factors while applying Sampling Techniques</u>: As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that **<u>controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does.</u>** The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the **controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not.** This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

(4 MARKS)

ANSWER-3

ANSWER-A

Techniques available as substantive analytical procedures: The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

1. **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.

2. **Ratio analysis** — Ratio analysis is **useful for analysing asset and liability accounts as well as revenue and expense accounts**. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

   For example, Financial ratios may include:

   1. Trade receivables or inventory turnover
   2. Freight expense as a percentage of sales revenue

3. **Reasonableness tests** — Unlike trend analysis, this **analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration** (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts.

4. **Structural modelling**— A modelling tool **constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances** (e.g., linear regression).

(6 MARKS)

ANSWER-B

Communicating key audit matters in the auditor's report is not:

(i) A **substitute for disclosures in the financial statements** that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;

(ii) A **substitute for the auditor expressing a modified opinion** when required by the circumstances of a specific audit engagement in accordance with SA705(Revised);

(iii) A **substitute for reporting in accordance with SA 570** when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or

(iv) A **separate opinion on individual matters**.

(4*1 = 4 MARKS)

ANSWER-4

ANSWER-A

Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

(a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;[because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.]and

(b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall **include a description of when the use of the going concern basis of accounting is appropriate**.

(5 MARKS)

ANSWER-B

Audit sampling enables the auditor to **obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in form or assist in forming a conclusion** concerning the population from which the sample is drawn. Audit sampling can be applied using either non – statistical or statistical sampling approaches.

Approaches to Sampling

Statistical Sampling

Non – Statistical Sampling

<u>Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results</u>, including measurement of sampling risk characteristics. A sampling approach that does not have above characteristics is considered **non – statistical sampling.**

An approach to sampling that has the random selection of the sample items; and

the use of probability theory to evaluate sample results,

the use of probability theory including measurement of sampling risk characteristics.

Characteristics of Statistical sampling approach

The decision whether to use a statistical or non – statistical sampling approach is a matter for the auditor's judgment, however, sample size is not a valid criterion to distinguish between statistical and non – statistical approaches.

<u>Sample must be representative</u>.

Whatever may be the approach non – statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

(5 MARKS)

ANSWER-5

(10*1 = 10 MARKS)

1. **A**
2. **D**
3. **A**
4. **A**
5. **A**
6. **C**
7. **B**
8. **D**
9. **A**
10. **B**