IPCC – November 2017

AUDIT

Test Code –8059

Branch (MULTIPLE) (Date : 16.07.2017)

(50 Marks)

Note: All questions are compulsory.

Question 1(6 marks)

This is a case of external confirmation. covered by SA 505 “External Confirmation". The identities of creditors are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation. it might be a case that an income oft 5 lakhs had been hidden in previous year/s. **(2 marks)**

The statutory auditor should examine the validity of the credit balance as appeared in the 'company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members. **(4 marks)**

Question 2(8 marks)

As per SA 700, “Forming an Opinion and Reporting on Financial Statements”, the auditor may modify the opinion in the auditor’s report in the following circumstances: **(4 marks)**

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

(ii) if the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor’s report in accordance with SA 705.

Types of Modification to the Auditor’s Opinion:

As per SA 705, “Modification to the Opinion in the Independent Auditor’s Report”, modified opinion may be defined as a qualified opinion, an adverse opinion or a disclaimer of opinion.

Types of modifications possible to the said report are below mentioned: **(4 marks)**

(1) Qualified Opinion:

The auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(2) Adverse Opinion:

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(3) Disclaimer of Opinion:

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive

Question 3(8 marks)

Audit Working Papers: Working papers are papers prepared and obtained by the auditor and retained by him, in connection with the performance of his audit. Working papers are the property of the auditor. As per SA 230 "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).	1
Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.	
In case of recurring audits, auditors generally prepare two types of audit files. **(1) Permanent Audit file: It includes –**	3.5
(i) Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.	
(ii) Extracts or copies of important legal documents, agreements and minutes relevant to the audit.	
(iii) A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.	
(iv) Copies of audited financial statements for previous years.	
(v) Analysis of significant ratios and trends.	
(vi) Copies of management letters issued by the auditor, if any.	
(vii) Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.	
(viii) Notes regarding significant accounting policies.	
(ix) Significant audit observations of earlier years.	
(2) Current Audit file: The current file normally includes:	3.5
(i) Correspondence relating to acceptance of annual reappointment.	
(ii) Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.	
(iii) Evidence of the planning process of the audit and audit programme.	
(iv) Analysis of transactions and balances.	
(v) A record of the nature, timing and extent of auditing procedures performed and the results of such procedures.	
(vi) Evidence that the work performed by assistants was supervised and reviewed.	
(vii) Copies of communications with other auditors, experts and other third parties.	
(viii) Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.	
(ix) Letters of representation or confirmation received from the client.	
(x) Conclusions reached by the auditor concerning significant aspects of the audit.	
(xi) Copies of the financial information being reported on and the related audit reports.	

Question 4(8 marks)

SA-320 on "Materiality in Planning and Performing an Audit" states that the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.	1

According to it, misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements	0.5
Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.	0.5
The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered. It stresses that the assessment of what is material is a matter of professional judgement.	0.5
The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.	1
Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when: (a) Identifying and assessing the risks of material misstatement; (b) Determining the nature, timing and extent of further audit procedures; and (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.	2
After the auditor has assessed the inherent and control risks, he should consider the level of detection risk that he is prepared to accept and, based upon his judgment, select appropriate substantive audit procedures. If the auditor does not perform any substantive procedures, detection risk, that is, the risk that the auditor will fail to detect a misstatement, will be high.	0.5
The auditor reduces detection risk by performing substantive procedures - the more extensive the procedures performed, the lower the detection risk. The nature and timing of substantive procedures will also affect the detection risk, for example, confirmation with third parties will lead to lower detection risk than reliance on internal data, as will procedures carried out closer to year-end.	1
The auditor's assessment of audit risk may change during the course of an audit. For example, in planning the audit, the auditor may believe that he has low inherent and control risk based on his assessment of the probability of errors occurring and on his review and testing of the system of internal control.	0.5
After performing audit procedures, however, the auditor may conclude that his earlier assessment was too low. In this case, he will have to carry out additional audit procedures in order to reduce the level of detection risk and achieve audit risk at the level originally planned.	0.5

Question 5(6 marks)

Disclaimer of Opinion:	
As per SA 500 "Audit Evidence", the auditor must collect sufficient and appropriate audit evidence, on the basis of which he draws his conclusion to form an opinion, on the financial statements. But, if the auditor fails to obtain sufficient information to form an overall opinion on the matter contained in the financial statements, he issues a disclaimer of opinion.	2
The reasons due to which the auditor is not able to collect the audit evidence are: (i) Scope of audit is restricted; (ii) The auditor may not have access to the books of accounts, e.g.- (1) Books of A/c's of the company seized by IT authorities. (2) Sometimes, inventory verifications at locations outside the city bound the scope of duties of the auditor.	2

In such a case, the auditor must state in his audit report that- "He is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion".	2

Question 6(8 marks)

Services not to be rendered by the Auditor :	
Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditro. An auditor appointed under this Act shall provide to the company only such other services as are appointed by the Board of the Directors or the Audit Committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or tis holding company or subsidiary company), namely -	1.5
i) accounting and book keeping services	0.5
ii) internal audit	0.5
iii) cdesign and implementation of any financial information system	0.5
iv) acturial services	0.5
v) investment advisory setvices	0.5
vi) investment banking services	0.5
vii) management services	0.5
viii) rendering of ousourced financial services	0.5
ix) and other kind of service as prescribed	
Further, section 141(3)(i) of the Companies Act, 2013 also disqualifies a person for the appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.	1
In the given case, CA Prem was appointed as an auditor of ABC Ltd. He was offered additional services of investment banking, rendering of outsourced financial services and management services which was also approved by the Board of Diirectors. The auditor is advised not to accept the services as these services are specifically covered in the services not to be rendered by him as an auditor as per section 144 of the Companies Act, 2013.	1.5

Question 6(6 marks)

i) Correct - As per section 139(10) of the Companies Act, 2013, where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.	2
ii) Incorrect - As per section 2(12) of the Companies Act, 2013, "Book and paper" and "Book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.	2

iii) Correct- As per section 129(2) of the Companies Act, 2013, at every general meeting of a company, it shall be the duty of Board of Directors of the company to lay before the company the financial statements for the financial year.	2

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