

INTER CA
MAY '19
REVISION NOTES
AUDIT

PART - I

AUDITING AND ASSURANCE**Scheme of Revision:**

ALL IMPORTANT CONCEPTS OF ALL TOPICS WILL BE REVISED IN THE LECTURE and AFTER the REVISION IS DONE STUDENT SHOULD ATLEAST READ THIS QUESTION ANSWERS WHICH ARE A SUMMARISED VERSION OF WHAT IS GIVEN IN THE MODULE.

(READ THESE NOTES ONLY AFTER VIEWING THE LECTURE ON jkshahclasses.com/revision or YOUTUBE SUBSCRIBE JK SHAH CLASSES CHANNEL)

(Compiler of Theory questions from module)

CHAPTER 1 NATURE SCOPE AND OBJECTIVES OF AUDIT

Q.no	Reference	Question	Answer
1	ICAI Module Question Bank	Explain clearly meaning of Auditing. How would you as an auditor perform the audit	<p>"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."</p> <p>We need to verify:</p> <ul style="list-style-type: none"> (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;
2	ICAI Module Question bank	"The independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange." Explain	<p>Advantages:</p> <ul style="list-style-type: none"> (a) It safeguards the financial interest of persons who are not associated (b) It acts as a moral check on the employees (c) helpful in settling liability for taxes (d) also useful for settling trade disputes
3	ICAI Module Question Bank	State the objectives of Audit according to SA 200	<p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p> <ul style="list-style-type: none"> (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.
4	ICAI Module Question Bank	"The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats." Explain	<ul style="list-style-type: none"> a) Self-interest threats: b) Self-review threats: c) Advocacy threats: d) Familiarity threats: e) Intimidation threats:
5	ICAI Module	Inherent Limitations of Auditing	<p>It means unavoidable limitation which makes audit a reasonable assurance and not absolute assurance.</p> <p>Limitations arise from:</p> <ul style="list-style-type: none"> 1) Nature of financial reporting 2) Nature of Audit procedures 3) Timelines 4) Cost benefit analysis

6	ICAI Module	Scope of audit and Principal Aspects to be covered	Scope means coverage and it depends upon a) Applicable Laws b) The ICAI pronouncements c) Terms of engagement Principal aspects to be covered: Examine accounting system, internal control, books of accounts, balance sheet, profit and loss, accounting standards, regulatory requirements and forming opinion through audit report.
7	ICAI Module SA 210	Contents of letter of engagement (LOE)	LOE is written by auditor and addressed to the management. Contents are: a) Objective and Scope of audit b) Management's Responsibility c) Auditor's Responsibility d) AFRF e) Form and content of audit report
8	ICAI Module & SA 210	Changes in the terms of engagement	Accept only if there are valid reasons to do so.
9	ICAI Module & SA 220	Elements of Quality control	Engagement partner has to take the leadership responsibility for quality of audit engagement.

CHAPTER 2 AUDIT STRATEGY PLANNING AND PROGRAMMING

Q.no	Reference	Question	Answer
1	ICAI Module	"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.	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 develop an audit plan that shall include a description of (a) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment". (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks". (c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs
2	ICAI Module	"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 matters such as: <ol style="list-style-type: none"> 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	ICAI Module	“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	Factors affecting DSR: <ol style="list-style-type: none"> 1. The size and complexity of the entity. 2. The area of the audit. 3. The assessed risks of material misstatement. 4. The capabilities and competence of the individual team members performing the audit work
4	ICAI Module	“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: <ol style="list-style-type: none"> (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 unorganised. (e) The assistants, by putting their signature on programme, accept the responsibility. (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.
5	ICAI Module	“Determining materiality involves the exercise of professional judgment”. Discuss stating the factors that may affect the identification of an appropriate benchmark. Also give examples	Factors affecting selection of benchmark: <ol style="list-style-type: none"> 1) The elements of the financial statements 2) Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused 3) 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 4) The entity’s ownership structure and the way it is financed 5) The relative volatility of the benchmark.

CHAPTER 3 AUDIT DOCUMENTATION AND AUDIT EVIDENCE

Q.no	Reference	Question	Answer
1	ICAI Module	The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of Kapur Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter. How Would you deal with this situation?	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. Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company.
2	ICAI Module	Paramount Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of Paramount Exports Ltd. Considers that inventory held with job workers is material to the financial statements. Suggest the audit procedures in the given case.	When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (b) Perform inspection or other audit procedures appropriate in the circumstances
3	ICAI Module	Pride India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims resulting to risk of material misstatements. Suggest the auditor with reference to SAs	The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including: (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel; (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and (c) Reviewing legal expense accounts. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel
4	ICAI Module	While conducting the audit of Jay Kay Ltd, the auditor K of KLM and Associates, Chartered	If management refuses to allow the auditor to send a confirmation request, the auditor shall: (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity

		Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables but the management refused the auditor to send confirmation request. How would the auditor proceed?	and reasonableness; (b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures. The auditor also shall determine the implications for the auditor's opinion in accordance with SA 705.
5	ICAI Module	When we find in the balance sheet, an item under current assets reading as "cash in hand - ₹ 8,000" the obvious assertions that would strike the mind are?	the obvious assertions that would strike the mind are the following: (i) The firm concerned had ₹ 8,000 in hand in valid notes and coins on the balance sheet day; (ii) That the cash was free and available for expenditure to the firm; and (iii) That the books of account show a cash balance of identical amount at the end of the day on which the balance sheet is drawn up
6	ICAI Module	Define audit documentation. Also give some examples	Audit documentation may be recorded on paper or on electronic or other media Example: ☐ Audit programmes. ☐ Analyses. ☐ Issues memoranda. ☐ Summaries of significant matters. ☐ Letters of confirmation and representation. ☐ Checklists. ☐ Correspondence (including e-mail) concerning significant matters. The auditor may include copies of the entity's records.
7	ICAI Module	"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.
8	ICAI Module	"Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their	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

		own about any of the matters with which they deal". Discuss	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.
9	ICAI Module	Discuss the objective of Auditor with respect to Opening balances – in conducting an initial audit engagement	Initial audit engagement: An engagement in which either: (i) The financial statements for the prior period were not audited; or (ii) The financial statements for the prior period were audited by a predecessor auditor Objective: (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
10	ICAI Module	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 at the assertion level (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. <u>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</u>
11	ICAI Module	"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

Q.no	Reference	Question	Answer
1	ICAI Module	<p>XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc.</p> <p>There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis.</p> <p>Discuss the types of inherent, control and detection risks as perceived by the auditor.</p>	<p>Inherent Risk: Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.</p> <p>Control Risk: There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still collusion among employees may be there and risk to auditor would again be that inventory records would be inaccurate.</p> <p>Detection Risk: Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also employ sampling techniques to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated</p>
2	ICAI Module	The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed	Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The auditor should proceed accordingly
3	ICAI Module	Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment.	While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area
4	ICAI Module	Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard	The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit
5	ICAI Module	"The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over	(i) Monitoring of controls Defined: Monitoring of controls is a process to assess the effectiveness of internal control performance over time.

		financial reporting” Explain	<p>(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.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p>
6	ICAI Module	“Risk of material misstatement consists of two components” Explain clearly defining risk of material misstatement	Q10 Chap 3
7	ICAI Module	“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	Q10 Chap 3
8	ICAI Module	“The auditor shall obtain an understanding of the control environment” Explain stating what is included in control environment.	<p>The control environment includes: (i) the governance and management functions and (ii) the attitudes, awareness, and actions of those charged with governance and management .</p> <p>(iii) the control environment sets the tone of an organization, influencing the control consciousness of its people.</p> <p>Elements of the Control Environment:</p> <p>(a) Communication and enforcement of integrity and ethical values</p> <p>(b) Commitment to competence</p> <p>(c) Participation by those charged with governance</p> <p>(d) Management’s philosophy and operating style</p> <p>(e) Organisational structure</p> <p>(f) Human resource policies and practices</p>