

Chapter 1 - Nature, Objective and Scope of Audit

Meaning of Auditing

Q1.	<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.” Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. (MTP1, Nov 2019, 4 Marks)</p> <p style="text-align: center;">OR</p> <p>The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing. (RTP, May 2020, NA) (MTP1, Nov 2021, 4 marks)</p>
	<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>Analysis of the definition:</p> <ul style="list-style-type: none"> ● Audit is an independent examination of financial information. ● Audit applies to various entities, including non-profits (e.g., NGOs, trusts), regardless of size or legal form (e.g., sole proprietorships, partnerships, LLPs, private/public companies, societies, trusts). ● The purpose of the audit is to express an opinion on the financial statements. <p>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:</p> <ol style="list-style-type: none"> 1. the accounts have been drawn up with reference to entries in the books of account; 2. the entries in the books of account are adequately supported by sufficient and appropriate evidence; 3. 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; 4. the information conveyed by the statements is clear and unambiguous; 5. the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and 6. the statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

Objectives of Audit

Q2.	<p>Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide a picture of healthy financial performance having robust turnover, low debt and good profits. On the above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct? (ICAI Study Material- Test Your Understanding)</p> <ul style="list-style-type: none"> ● An audit does not provide assurance to investors in shares regarding safety of his money. Share prices of securities are affected by a range of factors. ● An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. <p>Conclusion: Lalji Bhai is not correct.</p>
Q3.	<p>CA N is the auditor of SR Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements or not. In your opinion, whether CA N has complied with objectives of audit considering the applicability of relevant SA? (SA, May 2022, 3 marks)</p> <p style="text-align: center;">OR</p> <p>CA Jatin is the auditor of JP Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements. Explain w.r.t SA 200. (MTP2, May 2023, 3 marks)</p> <p style="text-align: center;">OR</p>

	<p>Explain the overall objective of the auditor as contained in SA 200. (RTP, May 2019, NA) (RTP, May 2020, NA)</p> <p style="text-align: center;">OR</p> <p>Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2023-24, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives (RTP, Nov 2023, NA)</p> <p>Overall Objectives of the Independent Auditor:</p> <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"> ● To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and ● To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. <p>In the given case, the auditor expressed his opinion on the financial statements of the company without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that the auditor did not comply with the objective of audit as stated in SA 200</p>
Q4.	<p>M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotive markets. GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements. Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing. (RTP, May 2024, NA)</p> <p>In conducting audit of financial statements, objectives of auditor in accordance with SA 200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are: -</p> <ol style="list-style-type: none"> a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. <p>An analysis of above brings out following points clearly: -</p> <ul style="list-style-type: none"> ● Auditor's objective is to obtain a reasonable assurance whether financial statements as a whole are free from material misstatement whether due to fraud or error. Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance. Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On the basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance. ● Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on financial statements as a whole, in totality. ● Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. ● The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing. <p>Therefore, perception of both assistants is not proper. Auditor of financial statements does not seek to provide guarantee that financial statements are free from material misstatements caused by frauds or errors. He obtains reasonable assurance.</p>

Test Checking and Judgment

Q5.	<p>"Professional judgment is essential to the proper conduct of an audit." Discuss. (MTP1, Nov 2020, 3 Marks) (SA, Nov 2018, 5 Marks)</p>
	<p>Meaning of Professional Judgment : The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.</p> <p>Relevant SA : SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"</p> <p>The auditor shall exercise professional judgment in planning and performing an audit of financial statements. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:</p> <ul style="list-style-type: none"> ● Materiality and audit risk. ● The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence. ● Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor. ● The evaluation of management's judgments in applying the entity's applicable financial reporting framework. ● The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Scope of Audit

Q6.	<p>Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit? (ICAI Study Material- Test Your Understanding)</p>
	<p>Scope of Audit</p> <p>The following points are included in scope of audit of financial statements: -</p> <ol style="list-style-type: none"> 1. Coverage of all aspects of entity : Audit of FSs should be organized adequately to cover all aspects of the entity relevant to the FSs being audited. 2. Reliability and sufficiency of financial information : The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and provide sufficient basis for preparation of financial statements. 3. Proper disclosure of financial information: The auditor must ensure FSs adequately disclose relevant information and comply with statutory requirements, verifying that they accurately summarize recorded transactions and considering management's judgments in their preparation. <p>Conclusion: Proper disclosure of financial information is well within scope of audit.</p>
Q7.	<p>A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report? (ICAI Study Material- Test Your Understanding)</p>
	<ul style="list-style-type: none"> ● 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

	<ul style="list-style-type: none"> An audit is not an official investigation into alleged wrongdoing. In the given case, appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. <p>Conclusion: Services rendered by CA are in the nature of investigation and therefore his report will not be in the nature of audit report.</p>
Q8.	<p>“Choosing appropriate accounting policies in relation to accounting issues is the responsibility of management”. Do you agree? Discuss the duty of the auditor, if any, in relation to accounting policies. (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> Choosing appropriate accounting policies is the responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management The auditor evaluates management's judgments in FS preparation, including the selection and consistent application of accounting policies, such as depreciation methods for fixed assets and inventory valuation, ensuring proper choice and period-to-period consistency.
Q9.	<p>An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss. (RTP, May 2023, NA)</p> <ul style="list-style-type: none"> Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes on the character of investigation. The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. Therefore, audit is never started with a preconceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in the normal course of examination of accounts. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that the auditor has given some findings of serious concern. Such findings may prompt for calling an investigation
Q10.	<p>The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. (MTP1, May 2024, 3 marks)</p> <ul style="list-style-type: none"> The auditor should decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard. It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements. The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories. The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.
Q11.	<p>The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word “audit” in proposed assignment. Comment. Also, discuss how audit is different from investigation. (MTP1, Sep 2024, 4 Marks) (Similar to Q9)</p> <ul style="list-style-type: none"> Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation. The objective of audit, on the other hand, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. The scope of audit is general and broad whereas scope of investigation is specific and narrow.

- In the given situation, management of company suspects that some of its employees may be involved in making fraudulent payments on account of dummy workers at its different plants in the country. Such an **assignment is in the nature of "investigation"**. Therefore, Mr. P is right in objecting the use of word "audit" in the proposed assignment.

Benefits of Audit

- Q12. RAG is a proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making a total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 5 crores from Canara Bank. In the year 2023-24, the proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore the firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited.

(MTP1, May 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks)

OR

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. Explain. **(RTP, Nov 2018, NA)**

Advantages of audit of Financial statements:

- Audited accounts provide **high quality information**. It gives **confidence to users** that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.
- In case of companies, shareholders may or may not be involved in daily affairs of the company. The FSs are prepared by management consisting of directors. As shareholders are owners of the company, they need an **independent mechanism** so that financial information is **qualitative** and **reliable**. Hence, their interest is **safeguarded** by an audit.
- An audit acts as a **moral check** on **employees** from committing frauds for the fear of being discovered by audit.
- Audited FSs are helpful to **government** authorities for determining tax liabilities.
- Audited FSs can be relied upon by **lenders**, bankers for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
- An audit may also **detect fraud** or **error** or both.
- An audit **reviews** the **existence** and **operations** of various **controls** operating in any entity. Hence, it is useful at pointing out deficiencies.

Inherent Limitations of Audit

- Q13. Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of the firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to the GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of an audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected a true and fair view of the state of affairs of the firm. However, later on, it was discovered that the purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with the accountant through the banking channel.

The partners of firm blame auditors for futile audit exercise. Are partners of firms correct in their view point? Imagine any probable reason for such a situation. **(ICAI Study Material- Test Your Understanding)**

- The auditor is **not expected** to, and **cannot, reduce** audit **risk** to **zero** and **cannot** therefore **obtain absolute assurance** that the financial statements are free from material misstatement due to fraud or error. This is because there are **inherent limitations** of an audit.
- Circumstances given in the question is an example of **failure of internal controls** of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls.

	<p>Conclusion: The view of the partners is not correct. This is an inherent limitation of audit.</p>
Q14.	<p>An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (ICAI Study Material - Test Your Knowledge) (MTP2, Nov 2023, 3 marks)</p> <p style="text-align: center;">OR</p> <p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples. (RTP, May 2020, NA) (MTP1, Nov 2020, 3 Marks) (RTP, Nov 2021, NA) (RTP, Nov 2023, NA)</p> <p>The Nature of Audit Procedures</p> <ul style="list-style-type: none"> ● An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence. ● Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence. ● The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. ● It is quite possible that the entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.
Q15.	<p>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain. (RTP, Nov 2018, NA)</p> <p style="text-align: center;">OR</p> <p>JK Ltd. was having a 'Pager' manufacturing plant and looking at the demand it was of the view that the company will grow continuously in future. But, with the introduction of mobile phones in the market, the plant was shut down completely. The shareholders of the company were of the view that auditor failed to perform their duty and have not informed to them about the company's inability to continue its business, otherwise they might not have suffered the loss. List down the factors giving rise to the inherent limitations due to which auditor cannot provide a guarantee that the financial statements are free from material misstatement due to fraud or error. (SA, May 2024, 3 Marks)</p> <p>The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from:</p> <ol style="list-style-type: none"> 1. The Nature of Financial Reporting: Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors 2. The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example, <ul style="list-style-type: none"> ● an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of a practical limitation on an auditor's ability to obtain audit evidence. ● Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence. Further, fraud may involve sophisticated and carefully organized schemes 3. Not in nature of investigation: An audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors 4. Timeliness of Financial Reporting and the Balance between Benefit and Cost: The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.

	<p>5. Future events: Future events or conditions may affect an entity adversely. Adverse events may seriously affect an entity's ability to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.</p>
Q16.	<p>There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation. (RTP, Nov 2022, NA)</p> <p>The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example,</p> <ul style="list-style-type: none"> ● An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence. ● Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence. ● The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. ● It is quite possible that the entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions. <p>Difference between audit and investigation</p> <ul style="list-style-type: none"> ● An audit is not an official investigation into alleged wrongdoing. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation. ● Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation. ● The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. ● The scope of audit is general and broad whereas scope of investigation is specific and narrow
Q17.	<p>The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations. (MTP1, May 2024, 3 marks)</p> <p>Example of practical limitation on ability of auditor to obtain audit evidence An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.</p> <p>Example of legal limitation on ability of auditor to obtain audit evidence Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.</p>
Q18.	<p>Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain (MTP2, May 2024, 3 marks)</p> <ul style="list-style-type: none"> ● Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. ● One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations. ● Therefore, nature of financial reporting itself is one of causes inherent limitations of audit.

Interdisciplinary Nature of Auditing relationship with Diverse Subjects

Q19.	<p>Both accounting and auditing are closely related with each other. Explain (RTP, Nov 2020, NA)</p> <ul style="list-style-type: none"> Both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. Auditing begins when accounting ends. It requires that the auditor must have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements.
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Assurance Engagement

Q20.	<p>The management of Exotic Tours and Travels Limited requests its auditor Raja & Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures. Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case? (ICAI Study Material- Test Your Understanding)</p> <p>In the given case, Raja & Co. can provide a review report. Review is a limited assurance engagement and it provides assurance which is lower than that provided by audit. It is due to the fact that review involves fewer procedures as compared to audit.</p> <p>Therefore, Raja & Co can provide a report as requested by the management of the company. Such a report would be in the nature of “review”.</p> <p>Raja & Co is required to obtain sufficient appropriate evidence based on limited procedures performed.</p>
Q21.	<p>Assurance engagements are not restricted to audit of financial statements alone. Discuss. (ICAI Study Material - Test Your Knowledge)</p> <ul style="list-style-type: none"> “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. Scope of Assurance engagements is not restricted to audit of financial statements only, it also extends to examination of prospective financial information and examination of internal controls. Example of assurance engagement <ul style="list-style-type: none"> Audit of financial statements - Reasonable assurance engagement Review of financial statements - Limited assurance engagement Examination of Prospective financial information - Provides assurance regarding reasonability of assumptions forming basis of projections and related matters Report on controls operating at an organization - Provides assurance regarding design and operation of controls
Q22.	<p>An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement (ICAI Study Material - Test Your Knowledge)</p> <p>A three party relationship involving a practitioner, a responsible party, and intended users</p> <ul style="list-style-type: none"> Practitioner: A practitioner is a person who provides assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information. Responsible party: A responsible party is the party responsible for preparation of subject matter. Intended users: Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.
Q23.	<p>A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. (ICAI Study Material - Test Your Knowledge)</p>

	<ul style="list-style-type: none"> “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. Reasonable assurance is a high level of assurance but it is not absolute assurance In the given case, a Chartered Accountant is specifically asked to check accounts whether fraud exists. It is not a reasonable assurance engagement. It is in the nature of investigation.
Q24.	<p>KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement? (MTP2, May 2024, 3 Marks)</p> <p>As given above, the engagement involves gathering of sufficient appropriate evidence on the basis of which limited conclusion can be drawn up. It is a limited assurance engagement like review. Other two features of such type of engagement are: -</p> <ol style="list-style-type: none"> It provides lower level of assurance than reasonable assurance engagement. It performs fewer procedures than reasonable assurance engagement.
Q25.	<p>Kriti, a CA student, has joined articles in a reputed audit firm. She considers audit engagement to be an “assurance engagement”. Her understanding is that audit engagement is the only kind of assurance engagement in which a practitioner gives a written assurance report in appropriate form. However, her friend Somaya, does not agree with her. She is of the view that assurance engagements are not restricted to audit alone. Besides, Somaya also thinks that assurance engagements can also relate to matters other than historical financial information. Whose view appears to be correct? State with reasons. (RTP, Sep 2024, NA)</p> <ul style="list-style-type: none"> Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements, engagements providing assurance involving prospective financial information, engagements providing assurance on internal controls in an entity. Assurance engagements provide assurance to users. The difference is of degree. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit. There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving prospective financial information and providing assurance on internal controls in an entity. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management’s assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions, and it is properly presented, and all material assumptions are adequately disclosed. In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas is Somaya of the view that assurance engagements are not restricted to audit alone. <p>Conclusion: Thus, view of Somaya is correct.</p>
Q26.	<p>“Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. In this context, give three examples of assurance engagements highlighting difference in nature of assurance provided by such engagements. (MTP2, Sep 2024, 5 marks)</p> <p>Three examples of assurance engagements are as under :-</p> <ol style="list-style-type: none"> Audit of financial statements - An audit of financial statements provides reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Review of financial statements - Review provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.

- iii) **Examination of prospective financial information** - In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's **assumptions** on which the prospective financial information is based are **not unreasonable**, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and **all material assumptions** are adequately **disclosed**. Such type of assurance engagement provides a **moderate** assurance.

Qualities of Auditor

Q27.	Explain qualities of an Auditor. (RTP, May 2019, NA) (MTP1, May 2021, 4 Marks) (MTP1, Nov 2021, 4 Marks)
	<p>Qualities of an Auditor:</p> <ul style="list-style-type: none"> ● Tact, caution, firmness, good temper, integrity, discretion, industry, judgment, patience, clear headedness and reliability are some of qualities which an auditor should have. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor. ● He must have the highest degree of integrity backed by adequate independence. ● The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education. ● Knowledge of an expert. He is called upon constantly to critically review FSs and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. ● An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.

Quality Control and Engagement Standards

Q28.	<p>CA. P Babu is conducting an audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing. Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing? (ICAI Study Material- Test Your Understanding)</p>
	<ul style="list-style-type: none"> ● It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants. ● However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, professional accountant is required to <ul style="list-style-type: none"> ○ Document how alternative procedures performed achieve the purpose of the required procedure. ○ Reason for departure has to be documented ○ Report should draw attention to such departures <p>Conclusion: Hence, CA. P Babu is required to follow the above procedure.</p>
Q29.	<p>Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples. (RTP, May 2022, NA) (RTP, May 2024, NA)</p>
	<p>Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.</p> <p>"Historical financial information" means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.</p> <p>"Audit" and "Review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a</p>

limited assurance engagement, and its **objective** is a **reduction** in assurance engagement **risk** to a **level** that is **acceptable** in the **circumstances** of the engagement,

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements. Some examples of Standards on Auditing are :

- **SA 200** Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- **SA 230** Audit Documentation
- **SA 315** Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- **SA 500** Audit Evidence
- **SA 700** Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- **SRE 2400** (Revised) Engagements to Review Historical Financial Statements
- **SRE 2410** Review of Interim Financial Information Performed by the Independent Auditor of the Entity

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