SA 240: The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements

Q1. My Décor Limited, **presently engaged in manufacturing of fabrics, wants to set up a new plant for manufacturing** of special kind of fabric providing an altogether different texture and feel. This kind of fabric has become a hit with retail customers. The company needs to set up plant for manufacturing the above kind of fabric **involving huge capital outlays** to stay competitive in the market.
You are auditor of the company and find that company's revenue has increased in financial year 2022-23 to 1000 crore from ` 750 crore in last year. By the time, **you started the audit, there was no change in plant capacity** and **information regarding need to set up new plant has become known to you during inquiry** of company's personnel.
Discuss, **how you should proceed** to deal with above situation, as auditor of the company, **paying special attention to risk of material misstatement** due to fraudulent financial reporting? **(SM)**

Answer

The given situation highlights need for the company to set up new plant for manufacturing of special kind of fabric to stay competitive in the market. Setting up of such plant involves huge capital outlays which could entail financing arrangements. **Therefore, excessive pressure exists** for management to be involved in fraudulent financial reporting. In such a situation, **management may be tempted to inflate its revenues to show rosy picture. It is a fraud risk factor and needs to be evaluated by the auditor.**
The revenues of company have jumped from ` 750 crore in last year to ` 1000 crore in year 2022-23 without any change in plant capacity. The auditor may consider above said fraud risk factor for assessing risk of material misstatement due to fraud.
In case of auditor assessing risk of material misstatement due to fraudulent financial reporting, audit procedures to address such risk like **performing substantive analytical procedures** relating to revenue, **use of computer assisted audit techniques** to identify unusual revenue transactions and **testing controls** pertaining to revenue transactions need to be performed.

Q2. CA. Ridhima, **internal auditor** of Track Store Limited, has **pointed out following deficiencies** in internal control of the company, in her reports: -
[i] Receivables are not reconciled at stipulated intervals.
[ii]Customers are provided a credit limit based upon their track record. However, no review of customer credit limits is undertaken at required intervals.

The **statutory auditor** of the company **finds that no action has been** taken by the company on the said deficiencies pointed out in reports of internal auditor.
What does above situation allude to statutory auditor of company?

Answer

Management failing to remedy known significant deficiencies in internal control on a timely basis **is a fraud risk factor for misstatements arising from fraudulent financial reporting**.

When management does not correct significant deficiencies in internal control on a timely basis**, it reflects an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act.**

Failure to rectify known control deficiencies pertaining to reconciliation of receivables and review of customer credit limits has the potential to fraud. Lack of timely reconciliation of receivables may lead to intentional misstatements. Further, non-reviewing customer limit may lead to grant of credit beyond creditworthiness of customers. It may result in intentional tying up of company's funds with risky customers due to collusion.
The above situation is a **fraud risk factor for fraudulent financial reporting.**

Q3. Arihant Limited was engaged in the business of **owning and managing hotels** and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22. While planning the audit, **audit team decided that the risk of improper revenue recognition** from hotel business **should not be treated as a fraud risk.** This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. **While testing** the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the **conclusion that there is no risk of fraud in revenue recognition**. During the course of substantive testing, it was identified that the ***management did not account for revenue received from corporate hotel bookings amounting to Rs. 35 crore***. These amounts were **partially received** in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings. In the light of above scenario, kindly guide the statutory auditors with respect to their **responsibility relating to fraud in an audit of a financial statement. (RTP NOV 2022)**

Answer

As per **SA 240**, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and **SA 315**, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall **identify and assess** the **risks of material misstatement** due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the **auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate** which types of revenue, revenue transactions or assertions **give rise to such risks.**

In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and 330," The Auditor's Responses to Assessed Risks" the auditor shall **determine overall responses to address the assessed risks of material misstatement** due to fraud at the financial statement level and assertion level. The **presumption that there are risks of fraud in revenue recognition may be rebutted**. For example, the auditor may conclude that there is no ROMM due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.
However, **when there is a complex revenue structure or when there is lack of controls on revenue recognition**, then there is a high probability of fraud risk in revenue recognition.

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.

In the current scenario, the company was **earning** revenue **from multiple streams**. Also, it was identified that the **controls are not properly designed** to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management **did not account for revenue from corporate hotel bookings amounting to Rs. 35 crore**. These amounts were **partially received** in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should **consider the complexity and nature of the revenue for determining the fraud risks in revenue recognition.** Also, there were **no adequate controls** addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the **audit team should have recognised fraud risk by identifying the deficiencies of internal control** over the revenue recognition process and should have **treated the risk of improper revenue recognition as a significant risk**.

Also, as per **Section 143(12)**, the auditor is required to report all the frauds identified during the course of the audit involving amounts above Rs. 1 crore within the prescribed time frame to the Central Government.

Q4. In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the **fraudulent financial reporting may be accomplished** and also **discuss the techniques of committing fraud** by management overriding controls. **(PYQ Nov 2020)**

Answer

In the given case, management of Quick Ltd has made intentional misstatements to deceive the users in order to meet market expectations. Auditor is suspecting such intentional behavior of the management and in such situations, SA 240 discusses how fraudulent financial reporting may be accomplished and also discusses techniques of committing fraud by management overriding controls.

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"
Fraudulent financial reporting may be accomplished by the following:

a) **Manipulation, falsification (including forgery), or alteration** of accounting records or supporting documentation from which the financial statements are prepared.

b) **Misrepresentation in or intentional omission from,** the financial statements of events, transactions or other significant information.
c) **Intentional misapplication** of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. **Fraud can be committed by management overriding controls using such techniques as:**

a) **Recording fictitious journal entries**, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
b) **Inappropriately adjusting assumptions and changing judgments** used to estimate account balances.

c) Omitting, advancing or delaying recognition in the financial statements **of events and transactions** that have occurred during the reporting period.

d) **Concealing, or not disclosing, facts** that could affect the amounts recorded in the financial statements.

e) Engaging in **complex transactions** that are structured to misrepresent the financial position or financial performance of the entity.

f) **Altering records and terms** related to significant and unusual transactions.

Q5. M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.
Guide CA Kumar with respect to **Risk factors related to misstatements arising from misappropriation of assets** with reference to relevant Standard on Auditing. **(PYQ - Nov 2021)**

Answer

Guidance to CA Kumar with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:

As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements", misappropriation of assets involves the theft of entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Misappropriation of assets can be accomplished in a variety of ways including stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

Risk factors that relate to misstatements arising from misappropriation of assets are also **classified according to the three conditions** generally present **when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization**
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Incentives/Pressures

- **Personal financial obligations** may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- **Adverse relationships** between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets.
- **For example**, adverse relationships may be created by the following:

(i) Known or anticipated future employee **layoffs**.
(ii) Recent or anticipated **changes to employee compensation** or benefit plans.
(iii) Promotions, compensation, or other rewards **inconsistent with expectations.**

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

1) **Large amounts of cash on hand** or processed.

2) **Inventory** items that are small in size, of high value, or in high demand.
3) **Easily convertible assets**, such as bearer bonds, diamonds, or computer chips.
4) **Fixed assets** which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets.
For example, misappropriation of assets may occur because there is the following:

1) Inadequate segregation of duties or independent checks.
2) **Inadequate oversight** of senior management expenditures, such as travel and other reimbursements.
3) **Inadequate management oversight** of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
4) Inadequate record keeping with respect to assets.
5) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
6) Lack of complete and timely reconciliations of assets.
7) Lack of mandatory vacations for employees performing key control functions.

Attitudes/Rationalizations

1) **Disregard** for the need for monitoring or reducing risks related to misappropriations of assets.
2) **Disregard** for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
3) **Behaviour indicating displeasure or dissatisfaction** with the entity or its treatment of the employee.
4) **Changes in behaviour or lifestyle** that may indicate assets have been misappropriated.
5) **Tolerance of petty theft.**

Q6. Explain briefly **duties and responsibilities of an auditor** in case of material misstatement resulting from **Management Fraud**. **(PYQ)**

Answer

Duties & Responsibilities of an Auditor in case of Material Misstatement resulting from Management Fraud:
Misstatement in the financial statements can arise from fraud or error. The term **fraud refers to an 'Intentional Act'** by one or more individuals among management, TCWG. The auditor is concerned with fraudulent acts that cause a MM in FS.

As per **SA 240** on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", **fraud can be committed by management overriding controls using such techniques** as engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud".

The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.
Further, an auditor conducting an audit in accordance with SAs is responsible for **obtaining reasonable assurance** that the financial statements taken as a whole are free from material misstatement, whether

caused by fraud or error. Owing to the **inherent limitations** of an audit, there is an **unavoidable risk** that **some material misstatements** of the financial statements **may not be detected**, even though the audit is properly planned and performed in accordance with the SAs.

The risk of the auditor not detecting a MM **resulting from management fraud is greater** than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.
Auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance, hence in an audit, the **auditor does not guarantee that material misstatements will be detected.**

Refer: Section 143(12) + Clause (x) of Paragraph 3 of CARO, 2016

Q7. Managing Director of the Co. has committed a **"Teeming and Lading" Fraud.** Amount involved has been however subsequently after the year end deposited in the co. As a Statutory Auditor, **how would you deal**? **(MTP - 2018)**

Answer

Fraud Committed by Managing Director: Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is **required to perform his responsibilities** as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements".

First of all, as per SA 240, the auditor needs to **perform procedures** whether the financial statements are materially misstated. **Because an instance of fraud cannot be considered as an isolated occurrence** and it becomes important for the **auditor to perform audit procedures and revise the audit risk assessment.**

Secondly, the auditor **needs to consider the impact of fraud on financial statements** and **its disclosure in the audit report**.

Thirdly, **auditor should communicate the matter to the Chairman and Board of Directors.**

Finally, in view of the fact that the **fraud has been committed at the highest level of management**, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management.

Refer: 143(12) of the Companies Act, 2013 + Clause (x) of Paragraph 3 of CARO, 2020

Q8. M/s Innocent Limited has **entered into a transaction on 25th February, 2018**, **near year-end**, whereby it has agreed to pay Rs. 5 lakhs per month to Mr. Yuvraj as annual retainer-ship fee for "engineering consultation". **No amount was actually paid, but Rs. 60 lakhs is provided in books of account as on March 31, 2018.** Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Innocent Limited, what would be your approach? **(PYQ-Old)**

Answer

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", **fraud can be committed by management overriding controls using such techniques as Recording fictitious**

journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. Keeping in view the above, it is clear that Company has passed fictitious journal entries near year end to manipulate the operating results. Also, Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable.

Accordingly, the auditor would adopt the following approach. **If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall**:

A) Determine the **professional and legal responsibilities** applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons **who made the audit appointment** or, in some cases, **to regulatory authorities;**

B) Consider whether it is **appropriate to withdraw from the engagement**, where withdrawal from the engagement is **legally permitted**; and

C) If the auditor withdraws:

Discuss with appropriate level of management and TCWG, auditor's withdrawal from the engagement and the reasons for the withdrawal; and
Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal

Refer 143(12) of the Companies Act, 2013 + Clause (x) of Paragraph 3 of CARO, 2020

Q9. Is it appropriate for **auditor to make inquiries of management** regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it? Discuss. **(Nov'16)**

Answer

Appropriateness of making inquiries of management regarding assessment of fraud: SA 240 "Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements" requires the auditor to make inquiries of management regarding:

(a) Management's assessment of **ROMM due to fraud**;
(b) Management's process for **identifying & responding to the risks of fraud** in the entity, including any specific risks of fraud;
(c) Management's communication, if any, **to TCWG**; and
(d) Management's communication, if any, **to employees** regarding its views on business practices and ethical behaviour.

Management is responsible for the entity's internal control and for the preparation of financial statements.

Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and controls in place to prevent and detect it.

The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent.

The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

Q10. In the course of audit of K Ltd., its auditor Mr. 'N' observed that there was a **special audit conducted** at the **instance of the management on a possible suspicion of a fraud** and **requested for a copy of the report** to enable him to report on the fraud aspects. Despite many reminders it was not provided. In absence of the special audit report, Mr. 'N' insisted that he be provided **with at least a written representation** in respect of fraud on/by the company. For this request also, **management remained silent**. **Please guide Mr. 'N'.**

Answer

Auditor's Responsibilities Relating to Fraud: As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor is responsible for obtaining **reasonable assurance** that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA **580 "Written Representations**", if **management modifies or does not provide the requested written representations,** it may **alert auditor to the possibility that one or more significant issues may exist**.

In the instant case, the auditor observed that there was a special audit conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for special audit report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall **discuss the matter with management**; **re- evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations** (oral or written) and audit evidence in general; and **take appropriate actions**, including determining the possible effect on the opinion in the auditor's report.

Refer - Section 143(12) of the Companies Act, 2013 + Clause (x) of Paragraph 3 of CARO, 2020.
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If, as a result of a misstatement resulting from fraud or suspected fraud, auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:
Explain **---> Withdrawal Circumstances.**

SA – 250 Consideration of Laws and Regulations in an Audit of Financial Statements

Q11. FAS Insurance Brokers Limited is a leading **online insurance intermediary**. During the year, Director General of GST Intelligence **(DGGI) has issued notice** to the company for allegedly **creating fictitious invoices** for "marketing and sales services" amounting to ` 50 crores in favour of non-life insurance companies. The **premises** of company **were also searched** during the year by DGGI officials. The **matter was also informed to IRDAI** by DGGI for **violation of norms and regulations** in this regard.
Does above situation has any bearing on your responsibilities as statutory auditor of the company? Outline briefly in context of **possible non-compliance with laws by the company. (SM)**

Answer

When auditor becomes aware of the existence of or has information about investigations by government departments and regulatory organizations, it may be an **indication of non- compliance with laws and regulations.**

In the instant case, notice has been served upon the company by DGGI for allegedly **creating fictitious invoices** in guise of providing "marketing and sales services" for ` 50 crores. Issuing an invoice without supply of services is a serious offence under GST laws and it could involve penalties and imprisonment. Such suspected non-compliance may have a direct effect on financial statements.

The matter has also been informed to regulator i.e. IRDAI. Violation of IRDAI regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

If the auditor **becomes aware of information** concerning **an instance of non-compliance or suspected non-compliance with laws and regulations**, auditor shall obtain: -

(a)An **understanding** of nature of the act and circumstances in which it has occurred and

(b)Further information to evaluate **possible effect** on the financial statements.

- If auditor **suspects** there may be non-compliance, auditor shall discuss matter with management and, where appropriate, TCWG.
- If management or, as appropriate, TCWG **do not provide sufficient information** that supports that the entity is in compliance with laws and regulations and, in his **judgment**, effect of the suspected non-compliance **may be material** to financial statements, auditor shall consider need to **obtain legal advice**.
- If **sufficient information** about suspected non-compliance cannot be obtained, auditor shall **evaluate the effect of the lack of sufficient appropriate audit evidence** on the auditor's opinion.
- Also, evaluate **implications of non compliance** in relation to other aspects of the audit, including auditors risk assessment and reliability of WR, and take appropriate actions.

Q12. PQ Limited, a listed entity, is in the business of manufacturing of specialty chemicals. The company has appointed CA Jazz as CFO of the company. CA Jazz is concerned about compliance with the provisions of laws and regulations that determine the reported amounts and disclosure in financial statements of PQ Limited. Accordingly, **CA Jazz wants to implement such policies and procedures that can assist him in the prevention and detection of non-compliance with laws and regulations**. Help CA Jazz by **citing examples of such policies and procedures. (PYQ Nov 2020)**

Answer

The following are **examples of the types of policies and procedures** PQ Ltd. may **implement to assist in the prevention and detection of non-compliance** with laws and regulations:

1) **Monitoring** legal requirements and **ensuring that** operating procedures are designed to meet these requirements.
2) **Instituting** & **operating** appropriate systems of **internal control**.
3) Developing, publicizing and following a **code of conduct**.
4) **Ensuring employees** are properly trained and understand the **code of conduct**
5) **Engaging legal advisors** to assist in monitoring legal requirements.
6) **Maintaining a register** of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.
7) Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.

Q13. As an Auditor of TRP Ltd., you are **suspicious that there might be non-compliance with laws and regulations** to which the Company is subject to. **Indicate the possible areas or aspects** where you may have to look out for forming an opinion as to whether your suspicion has some basis to further inquire. **(PYQ Nov 2021)**

OR

You are appointed as an auditor of Moksh Ltd., a company engaged in export of agricultural equipment. During the course of audit, your audit team informed you regarding non-deduction of TDS on huge payments made to legal counsel of Moksh Ltd. You want to alert your team on the possibility of non-compliance with Laws and Regulations by Moksh Ltd. Help your audit team in identifying any other **indications of non- compliance with Laws and Regulations** particularly related to payments made by the company. **(MTP - May 2023)**

Answer

Indications of Non-Compliance with Laws and Regulations: When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of noncompliance with laws and regulations, possible areas or aspects to look out for forming an opinion are:

1) **Investigations** by regulatory organisations and government departments or payment of fines or penalties.
2) **Payments** for unspecified services or loans to consultants, related parties, employees or government employees.
3) **Sales commissions or agent's fees** that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
4) Purchasing at prices **significantly above or below market price**.
5) Unusual payments towards **legal and retainership fees**.
6) Unusual transactions with companies **registered in tax havens**.
7) **Payments** for goods or services made other than to the country from **which the goods or services originated.**
8) Payments **without proper exchange control documentation**.
9) **Adverse media comment.**

Q14. XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31 -3-18 for audit. The audit assistant observes and brings to your notice that the company's records show following dues:
Income Tax relating to Assessment Year 2014-15 Rs. 125 lacs - Appeal is pending before Hon'ble ITAT since 30-9-16.
Customs duty Rs. 85 lakhs - Demand notice received on 15-9-17 but **no action has been taken to pay or appeal.** Comment. **(MTP - 2018)**

OR

During the course of audit of CT Ltd. for the financial year 2017-18, it is noticed that Rs. 3.00 lakhs of employee contribution and Rs. 7.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that Rs. 5.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2018. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor. (MTP - 2018)

Answer

Non-Compliance of Laws and Regulations: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", **it is responsibility of management, with the oversight of those charged with governance,** to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

Auditor is responsible for **obtaining reasonable assurance** that financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the **auditor concludes that the non-compliance has a material effect** on the financial statements, and has not been adequately reflected in the financial statements, he shall **express a qualified or adverse opinion on the financial statements.**

Further, auditor is required to report on certain matters specified in Para 3 of CARO, 2020 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause **(vii)(b) of Para 3 of CARO, 2016**, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis.

Therefore, as per **AS 29 "Provisions, Contingent Liabilities and Contingent Assets"**, partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

Q15. State **reporting responsibility of an auditor** in the context of non-compliance of Law and Regulation in an audit of Financial Statement.

Answer

According to SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", the reporting responsibilities of an Auditor may be divided into the following categories-

A) Reporting Non-Compliance to Those Charged with Governance: Unless all of those charged with governance are involved in management of the entity, and there are are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall **communicate with those charged with governance** matters involving non-compliance with laws and regulations that come to auditor's attention during course of audit, other than when the matters are clearly inconsequential.

If, in the auditor's judgment, the non-compliance referred above is **believed to be intentional and material**, auditor shall communicate matter to those charged with governance **as soon as practicable**.

If the auditor **suspects that management or those charged with governance are involved** in non-compliance, he shall communicate the matter to **next higher level of authority** at the entity, if it exists, such as an audit committee or supervisory board.

Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

B) Reporting Non-Compliance in the Auditor's Report on the Financial Statements:

If the auditor concludes that the non-compliance has a **material effect** on the financial statements, and has **not been adequately reflected in the financial statements**, auditor shall, in accordance with SA 705 **express a qualified or adverse opinion on the financial statements.**

If the **auditor is precluded by management or those charged with governance** from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to financial statements has, or is likely to have, occurred, the auditor shall **express a qualified opinion or disclaim an opinion** on the financial statements on the basis of a limitation on the scope of the audit in accordance with SA 705.

If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with SA 705.

C) Reporting Non-Compliance to Regulatory and Enforcement Authorities: If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

Q16. What are **roles and responsibilities of the statutory auditors** in relation to compliance with the laws and regulations by the entity?

Answer

As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", as part of obtaining an understanding of entity and its environment the auditor shall obtain a general understanding of:

1) The **legal and regulatory framework applicable** to the entity and the industry or sector in which the entity operates; and

2) How the **entity is complying** with that framework.

Auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.

Auditor shall perform following audit procedures **to help identify instances of non-compliance with other laws and regulations** that may have a material effect on the FS:

(i) **Inquiring** of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and

(ii) **Inspecting correspondence**, if any, with the relevant licensing or regulatory authorities.

During the audit, the auditor **shall remain alert** to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. The auditor shall request management and, where appropriate, those charged with governance to provide **written representations** that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

Thus, the auditor is responsible for **obtaining reasonable assurance** that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

Q17. You are auditor of a social media company. Of late, government has tightened noose around companies operating in this segment by bringing in a maze of regulatory legislations to protect interests of users. **How you can proceed to verify that company is compliant with new regulatory requirements?** Besides, what does above situation underscore to you as an auditor?

Answer

It **needs** to be **verified** that the company has put in place systems and procedures to meet with new regulatory requirements. The same can be **verified by** examining policies and procedures developed by company in this regard like devising appropriate system of internal control, sensitizing employees regarding new rules, engaging legal advisors etc.

Further, **financial stability of the company may be threatened** due to new regulatory requirements. The **management may be under pressure**. It is also a ***fraud risk factor and may need to be evaluated by auditor.***

Q18. Discuss **why the potential effects of inherent limitations of an auditor's ability to detect MM** described in SA 200 **are far greater in respect of non-compliance with laws and regulations?**

Answer

In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following: -

1) There are many laws and regulations, **relating principally to the operating aspects of an entity** that typically <u>do not affect the financial statements</u> and <u>are not captured by the entity's information systems</u> relevant to financial reporting.
2) Non-compliance may involve conduct **designed to conceal it,** such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
3) Whether an act constitutes non-compliance is **ultimately a matter for legal determination by a court of law.**

Q19. CA Anand is the engagement partner for the audit assignment of NHT Ltd. engaged in manufacture of Iron and Steel bars. The company has its plants in the state of Sikkim.
While verifying the wages record of the company, CA Anand found that **maximum of the labour employed** in the plants of the company was **child labour**. He questioned the management of the company about the same to which the management replied that **looking into the compliance of such law is outside his scope of financial audit**. Give your comments with respect to such situation. (SA 250) (RTP)

Answer

As per SA 250 "Considerations of Laws and Regulations in an Audit of Financial Statements", **auditor is not responsible for preventing non-compliance** and **can't be expected to detect non-compliance with all laws and regulations**. The auditor is responsible for obtaining **reasonable assurance** that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

For the compliance with provisions of those laws and regulations generally recognised to **have a direct effect** on the determination of material amounts and disclosures in FS	For other laws and regulations that **do not have a direct effect** on the determination of the amounts and disclosures in FS but compliance with which may be fundamental to the operating aspects of the business,
Auditor's responsibility is to obtain SAAE about compliance with the provisions of those laws and regulations.	**Auditor's responsibility is limited to undertaking specified audit procedures** t<u>o help identify non-compliance with those laws and regulations that may have a material effect on FS.</u>

In the instant case, maximum of the labour employed in the plants of the company was child labour. When CA Anand questioned the management of the company about the same, the management replied that looking into the compliance of such law is outside his scope of financial audit. **Such reply by the management is not acceptable** as such situation may have a material effect on the financial statements. Therefore, CA Anand should ensure as to whether any penal provisions will be there for non- compliance of such law and also whether the same has been duly disclosed by the company.

If CA Anand concludes that **such non- compliance has a material effect on the financial statements and the same has not been adequately reflected in the financial statements** by the company, he shall ***express an adverse or a qualified opinion on the financial statements.***

SA 260 Communication with TCWG

Q20. "The auditors should communicate audit matters of governance interest **arising from the audit** of financial statements with those charged with the governance of an entity". Briefly **state the matters to be included in such Communication. (PM)**

Answer

As per SA 260 "Communication with those Charged with Governance", the auditor shall communicate with those charged with governance, **responsibilities of the auditor in relation to the financial statement audit, including that:**

(a) Auditor is responsible for forming and expressing an opinion on financial statements that have been prepared by management with the oversight of TCWG; and
(b) Audit of financial statements does not relieve management or TCWG of their responsibilities.

The auditor **shall communicate with TCWG** the following:

(a) **Auditor's views** about **significant qualitative aspects** of the entity's accounting practices, **including accounting policies, accounting estimates and financial statement disclosures.**
When applicable, auditor shall explain to those charged with governance **why the auditor considers a significant accounting practice,** that is acceptable under the applicable financial reporting framework, **not to be most appropriate** to the particular circumstances of the entity;

(b) **Significant difficulties**, if any, encountered during the audit;

(c) **Unless all of TCWG are involved in managing the entity**:

- **Significant matters**, if any, arising from the audit that were discussed, or subject to correspondence with management; and

- **WR** the auditor is requesting;

d) **Other matters**, if any, arising from the audit that, in auditor's professional judgment, are significant to the oversight of the financial reporting process.

Q21. M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a MNC dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management.
Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as **significant difficulties** as per SA 260.

Answer

As per SA 260, "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as:

1) **Significant delays** by management, **unavailability of entity personnel**, or an **unwillingness by management** to provide information necessary for the auditor to perform the auditor's procedures.
2) **An unreasonably brief time** within which to complete the audit.
3) Extensive unexpected effort required to **obtain sufficient appropriate audit evidence.**
4) **Unavailability** of expected information.
5) **Restrictions imposed** on the auditor by management.
6) **Management's unwillingness** to make or extend its assessment of the entity's ability to continue as a **going concern** when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.as per SA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report.

Q22. SA 260 requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance. **Explain in detail why it is important to communicate key audit matters to those charged with governance.**

OR

Q. CA. Vallabh Sundar is auditor of a leading private sector bank. "IT Systems and controls" is under his consideration to be reported as "Key audit matter" in audit report of the bank due to high level of automation and complexity of the IT architecture and its impact on the financial reporting system.
At what time he should communicate such identified "Key audit matter"? What are relevant considerations in this regard and their usefulness?

Answer

SA 260 requires the auditor to communicate with TCWG on a **timely basis**. The **appropriate timing for communications** about key audit matters will vary with the circumstances of the engagement.

However, auditor may **communicate preliminary views about key audit matters** when discussing planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may **help to alleviate the practical challenges** of attempting to have a robust two-way dialogue about key audit matters at the time financial statements are being finalized for issuance.

Communication with those charged with governance enables them to be made aware of key audit matters that the auditor intends to communicate in auditor's report, and **provides them with an opportunity to obtain further clarification where necessary**.

Auditor may consider it useful to **provide TCWG with a draft of the auditor's report to facilitate this discussion.**

Communication with TCWG recognizes their important role in overseeing the financial reporting process, and **provides the opportunity** for TCWG to understand the basis for auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report.

It also enables TCWG **to consider whether new or enhanced disclosures may be useful** in light of the fact that these matters will be communicated in the auditor's report.

Q23. CA. Shelly Goel is offered appointment as auditor of RUTE Limited, a **listed company**. The audit committee of the company wants her to justify **independence** in relation to company through proper communication. Although she has ensured that there are no threats to her independence, she feels requirement of audit committee to be beyond its purview. What is your opinion in this regard? **(SM)**

Answer

As required in SA 260, in the case of listed entities, the auditor shall communicate with those charged with governance: - **(Communication of Auditor's Independence in case of listed entities)**

a) A **statement** that engagement team and others in the firm as appropriate, firm and, when applicable, network firms have complied **with relevant ethical requirements regarding independence** and

b) **All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence.** This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor and

c) **Related safeguards** that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

Further, as per the Companies Act, 2013 requires audit committee to review and monitor auditor's independence. Therefore, audit committee requiring auditor to justify her independence is well within its purview.

SA – 299 Responsibility of Joint Auditors

Q24. Four audit firms viz. GPR & Co., MKS & Co., CY & Associates and DES & Associates have been appointed for **conducting statutory audit of KNB Bank,** a public sector bank in accordance with regulatory guidelines. The professional work was divided by audit firms on the basis of zones of bank. However, **work relating to "IT Systems and controls" was not allocated** by them due to its very nature.
While planning for the **above common work area,** it was **decided** to test IT general controls, application controls and IT dependent manual controls. Planned key audit procedures relating to this common area also included testing design and operating effectiveness of controls over "computer operations including back-up, batch-processing and data centre security".
The **actual audit procedures** pertaining to **"testing controls over batch processing" were performed by team of DES & Associates.** In case work in relation to **above audit procedures is not performed professionally by DES & Associates, discuss where responsibility for such lapses would lie in line with SA 299? (SM)**

Answer

In respect of **common areas**, the **joint auditors are only responsible** <u>for appropriateness of nature, timing and extent of planned audit procedures agreed among them.</u> The responsibility of individual execution lies with concerned joint auditor.
In the instant case, audit procedures relating to testing design and operating effectiveness of controls over computer operations including back-up, batch-processing and data center security **have been planned jointly as it is a common area.**
However, **audit procedures relating to testing** controls over batch processing **were actually performed by team of DES & Associates** <u>although these were planned jointly</u>. **In case of any lapses** in performing such procedures, **DES & Associates would be responsible.**

Q25. A, B and C are joint auditors of a company. B is of the opinion that there are material misstatements in financial statements of a company which, if accounted for, would turn profit reflected in financial statements for ` 25 crore to a loss of ` 5 crore. He, therefore, wants an adverse opinion to be expressed in audit report. However, A and B do not concur with his views and are inclined to accept management's version. **Is B required to go by majority opinion of 2-1? (SM)**

Answer

Where the **joint auditors are in disagreement** with regard to the opinion or any matters to be covered by the audit report, they shall **express their opinion in a separate audit report**.

A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. Therefore, **B is not required to go by majority opinion of 2-1.**

In such circumstances, the audit report issued by the **joint auditors shall make a reference to the separate audit report** issued by the other joint auditor. Further, **separate audit report shall also make reference to the audit report** issued by other joint auditors. **Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706.**

Q26. Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019.
In the course of audit, it has been observed that there is a **major understatement in the value of inventory**. The **inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors.**
Comment on the above situation with regard to responsibilities among joint auditors. (PYQ May 2019)

Answer

Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Joint Audit of Financial Statements", where joint auditors are appointed, they should, by **mutual discussion, divide the audit work among themselves**.
Division of the work would usually be in terms of audit identifiable units or specified area.
In some cases due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The **division of the work among joint auditors as well as the areas of work to be covered** by all of them should be **adequately documented and preferably communicated to the entity.**

In respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate audit of the work performed by him.

On the other hand all the **joint auditors are jointly and severally responsible** –

a) audit work which is **not divided** among the joint auditors and is carried out by all joint auditors
b) **decisions taken by all the joint auditors** under audit planning in respect of **common audit areas** concerning NTE of audit procedures to be performed by each of them.
c) matters which are **brought to the notice** of the joint auditors by any one of them and on which there is an **agreement** among the joint auditors
d) examining that **FS comply** with **requirements of the relevant statutes**
e) **presentation and disclosure** of FS as required by the applicable FRF.
f) ensuring that **audit report complies** with the requirements of the relevant statutes, applicable SA and other relevant pronouncements issued by ICAI.

The joint auditors shall also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, **in respect of audit work divided among the joint auditors**, **each joint auditor shall be responsible only for the work allocated to such joint auditor** including proper execution of the audit procedures.

In the instant case. Dice Ltd. appointed two CA Firms MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates.

In view of SA 299 **MN & Associate will be held responsible** for the same as inventory valuation work was looked after by MN & Associates only. Further, **there is violation of SA 299 as the division of work has not been documented.**

Q27. KRP Ltd., at its annual general meeting, appointed **Mr. X, Mr. Y and Mr. Z as joint auditors** to conduct auditing for the financial year 2018-19. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. **Due to difference of opinion**, all the **joint auditors consulted their respective Actuaries**. Subsequently, **major difference was found in the actuary reports**. However, Mr. X agreed to Mr. Y's actuary report, though, **Mr. Z did not. Mr. X** contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

(a) You are required to briefly **explain the responsibilities of auditors when they are jointly and severally responsible** in respect of audit conducted by them and also guide Mr. Z in such situation.

(b) Explain the **responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty. (OLD)**

Answer

(a) **Difference of Opinion Among Joint Auditors:** SA 299 on, "Joint Audit of Financial Statements" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, **each joint auditor is responsible only for the work allocated** to him, whether or not he has made a separate report on the work performed by him. On the other hand, the **joint auditors are jointly and severally responsible** in respect of the audit conducted by them as under:

a) audit work which is **not divided** among the joint auditors and <u>is carried out by all</u> joint auditors
b) **decisions taken by all the joint auditors** under audit planning in respect of **common audit areas** concerning NTE of audit procedures to be performed by each of them.
c) <u>matters</u> which are **brought to the notice** of the joint auditors by any one of them and on which there is an **agreement** among the joint auditors
d) examining that **FS comply** with **requirements of the relevant statutes**
e) **presentation and disclosure** of FS as required by the applicable FRF.
f) ensuring that **audit report complies** with the requirements of the <u>relevant statutes,</u> applicable <u>SA</u> and other relevant <u>pronouncements</u> issued by ICAI.
g) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
h) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;
i) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are required to issue **common audit report**, however, where the joint auditors are in **disagreement** with regard to the opinion or any matters to be covered by the audit report, they **shall express their opinion in a separate audit report**. A joint auditor is **not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement.

In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a **reference** to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors.
Such reference shall be made under the heading "Other Matter Paragraph" as per Revised SA **706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs** in the Independent Auditor's Report".

In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditor) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.

Hence, as per SA 299, **Mr. Z is suggested to express his own opinion through a separate report** whereas **Mr. X and Mr. Y may provide their joint report for the same.**

(b) **Using the work of an Auditor's Expert**: **As per SA 620 "Using the Work of an Auditor's Expert",** the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the **auditor has sole responsibility for the audit opinion** expressed, and that **responsibility is not reduced by the auditor's use of the work of an auditor's expert**.

The auditor shall **evaluate the adequacy of the auditor's expert's work** for the auditor's purposes, including the **relevance and reasonableness** of that expert's findings or conclusions, and **their consistency** with other audit evidence as per SA 500.

Further, in view of SA 620, if the **expert's work involves use of significant assumptions and methods,** then the **relevance and reasonableness** of **those assumptions and methods** must be ensured by the auditor and if the expert's work involves the **use of source data** that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas **Mr. Z will not be held liable for the same due to separate opinion expressed by him.**

Q28. NMN & Co LLP and ABC & Associates LLP are the joint statutory auditors of BHS Ltd. BHS Ltd. is a listed company and has been in existence for the last 50 years. Since beginning this company was audited by MQS & Associates but due to audit rotation, the company had to bring in new auditors. Considering the size of the company, **two auditors were appointed as joint auditors**. Since the company is new to these auditors and the concept of joint auditors to whom audit work has been divided, management had a discussion and understood that each joint auditor is responsible only for the work allocated to him, **whether or not he has prepared a separate report on the work performed by him. Advise. (old)**

Answer

SA 299 "Joint Audit of Financial Statements" deals with the professional responsibilities which the auditors undertake in accepting appointments as joint auditors. The joint auditors are required to issue **common audit report,** however, where the joint auditors are in **disagreement** with **regard to the opinion or any matters** to be covered by the audit report, they shall **express their opinion in a separate audit report.**

A joint auditor is **not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in **separate audit report in case of disagreement**. In such circumstances, the audit report(s) issued by the joint auditor(s) shall **make a reference** to the **separate audit report(s)** issued by the other joint auditor(s). Further, **separate audit report shall also make reference** to the audit report issued by other joint auditors. Such reference shall be made under the heading **"Other Matter Paragraph" as per SA 706**, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

Each joint auditor is entitled to assume that:

- **Other joint auditors have carried out their part of the audit work** and the work has actually been **performed in accordance with the Standards on Auditing** issued by the Institute of Chartered Accountants of India. It is **not necessary for a joint auditor to review the work performed by other joint auditors** or perform any tests in order to ascertain whether the work has actually been performed in such a manner.

- The **other joint auditors** have **brought to said joint auditor's notice any departure from applicable financial reporting framework or significant observations** that are relevant to their responsibilities noticed in the course of the audit.

Where financial statements of a division/branch are audited by one of the joint auditors, the other joint auditors are entitled to proceed on the basis that such financial statements comply with all the legal and regulatory requirements and present a true and fair view of the state of affairs and of the results of operations of the division/branch concerned.

Before finalizing their audit report, the joint auditors shall **discuss and communicate with each other their respective conclusions that would form the content of the audit report.**

Q29. Excellent Bank Ltd. is a Public Limited Company. The said Bank has various branches all over India. The Bank appoints 3 Joint Auditors for the financial year ending 31.03.20XX. All the 3 Joint Auditors divide the work with mutual consent. **Verification of Consolidation, however, remained undivided**. All branches and zones were divided amongst the 3 Joint Auditors. During audit of zones, **CA. Z,** one of the joint auditors **expressed a concern about internal control** in one of the large. corporate branches situated in his zone. The **irregularity was not reported in the final accounts** as the other 2 Joint Auditors were not in favour of reporting and **decision of not reporting** the same was taken on the **basis of majority.** Subsequently, **fraud was detected in the said branch** which was audited by CA. Z. The Bank seeks your advice about the **responsibility of the 3 Joint Auditors** in the above situation. **(PYQ Nov 2019)**

Answer

Responsibility and Co-ordination among Joint Auditors: As per SA 299, "Responsibility and coordination of joint Auditors" where joint auditors are appointed, they should, by **mutual discussion, divide the audit work**

among themselves. The division of the work would usually be in terms of audit identifiable units or specified area.

In respect of the audit work divided among the joint auditors, **each joint auditor is responsible only for the work allocated to him**, whether or not he has prepared a separate audit of the work performed by him. On the other hand all the **joint auditors are jointly and severally responsible for the audit work which is not divided** among the joint auditors and is carried out jointly **and matters which are brought to the notice of the joint auditors by any one of them** and on which there is an agreement among the joint auditors.

In the instant case, Excellent Bank Ltd. Appoints 3 joint auditor for the financial year ending 31.03.20XX. All the joint auditors divided the work with mutual consent. The only work which remained undivided was verification of Consolidation. In accordance with SA 299, all the joint auditors are responsible for the same.

Further, during audit of zone, CA Z, one of the joint auditors expressed a concern about internal control in one of the large corporate branches situated in his zone, however, this irregularity was not reported as 2 of the joint auditors (i.e. majority of the joint auditors) were not in favour of the same. Later on, fraud has been detected in the same branch which was audited by CA. Z.

As per SA 299, Before finalizing their audit report, the **joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report.** Further, a joint auditor is **not bound by the views of the majority** of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in **separate audit report in case of disagreement.**

But in the present scenario, CA. Z brought this matter in the notice of the other 2 joint auditors and the decision for not reporting was taken on majority basis and no separate opinion was expressed through separate audit report pointing out irregularity.

Thus, **all the 3 joint auditors will be held responsible** for the fraud detected in the branch audited by CA. Z as per SA 299.

SA 402 Audit Considerations Relating to an Entity Using a Service Organization

Q30. G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of JIO Ltd. as to **how he can obtain an understanding of how JIO Ltd. uses the services of the outsourced agency in its operations.**

OR

In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions and process related data. **As an auditor, what would be your considerations regarding the nature and extent of activities undertaken by service organisation** so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk. Discuss with reference to relevant Standard on Auditing. **(PYQ Nov 21)**

Answer

As per **SA 402 on "Audit Considerations Relating to an Entity Using a Service Organisation"**, when obtaining an understanding of the user entity in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

(a) **Nature of the services** provided by SO and significance of those services to user entity, including the effect thereof on the user entity's IC.

(b) **Nature and materiality** of the transactions processed or accounts or financial reporting processes affected by SO.

(c) **Degree of interaction** between activities of SO and those of the user entity.

(d) **Nature of the relationship** between user entity and SO, including the relevant contractual terms for activities undertaken by SO.

Q31. ENN Limited is availing the services of APP Private Limited for its payroll operations. Payroll cost accounts for 65% of total cost for ENN Limited. APP Limited has provided the type 2 report as specified under SA 402 for its description, design and operating effectiveness of control.

APP Private Limited has also outsourced a material part of payroll operation M/s SMP & Associates in such a way that M/s SMP & Associates is sub-service organization to ENN Limited. The Type 2 report which was provided by APP Private Limited was based on carve-out method as specified under SA 402.

CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence asked his assistant to remove such reference and modify report accordingly.
Comment **whether CA Raman is correct in removing the reference** of the work done by service auditor? **(RTP - Nov 2020)**

Answer

Reporting by the User Auditor: As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", the user auditor shall **modify the opinion** in the user auditor's report in accordance with SA

705, "Modifications to the Opinion in the Independent Auditor's Report", if the user auditor is **unable to obtain sufficient appropriate audit evidence** regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements.
The user auditor **shall not refer** to the work of a service auditor in the user auditor's report **containing an unmodified opinion** unless required by law or regulation to do so.

If such reference is required by law or regulation, the user auditor's report shall **indicate** that the **reference does not diminish** the user auditor's responsibility for the audit opinion.

Thus, in view of above, contention of CA. Raman in removing reference of the work done by service auditor is in order as in case of unmodified audit report, user auditor cannot refer to the work done by service auditor.

Q32. When a sub-service organization performs services for a service organization, **there are two alternative methods** of presenting the description of controls. The service organization determines which method will be used. **As a user auditor what information would you obtain about controls at a sub-service organization?**

Answer

Controls at a Sub-Service Organisation: In accordance with SA 402 "Audit Considerations relating to an Entity Using a Service Organisation",

- User entity may use a SO that in turn uses a sub service organisation (SSO) to provide some of the services provided to a user entity that are part of the user entity's IS relevant to financial reporting.
- SSO may be a separate entity from SO or may be related to SO.
- A user auditor may need to **consider controls at the SSO.**
- In situations where **one or more SSO are used**, **interaction** between the activities of user entity and those of SO is expanded to include the interaction between the user entity, the SO and the SSOs.
- **Degree of this interaction**, as well as **nature and materiality** of the transactions processed by SO and SSOs are the most important factors for user auditor to consider in determining the significance of SO and SSO's controls to the user entity's controls.
- Further, user auditor shall determine whether a **sufficient understanding of the nature and significance** of the services provided by SO and their effect on user entity's IC relevant to the audit has been obtained to provide a basis for the identification and assessment of ROMM.
- If user auditor **is unable to obtain a sufficient** understanding from the user entity, user auditor shall obtain that understanding by application of following **two methods of presenting description of IC** i.e. **(i) Type 1 report; or (ii) Type 2 report.**
- If a SO uses SSO, service auditor's report may either include or exclude the SSO relevant control objectives and related controls in SO description of its system and in the scope of the service auditor's engagement.
- 2 methods of reporting are known as **inclusive method** and **carve-out method**.
- In either method, SO includes in its description of controls a description of the functions and nature of the processing performed by the SSO.
- If the Type 1 or Type 2 report excludes the control at a SSO and services provided by SSO are relevant to the audit of the user entity's FS, user auditor is required to apply the requirements of the SA 402 in respect of SSO.

- Nature and extent of work to be performed by user auditor regarding the services provided by a SSO depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

Q33. Durafone Mobile Co. Ltd. have pan India presence and market leader in mobile operation. It has **outsourced all its revenue operation** including accounting functions to Set Solutions (P) Ltd. As an Auditor of the mobile company, **enumerate the factors to be taken into consideration related to its financial reporting. (PYQ - 2018)**

Answer

Factors to be considered by Auditor related to Financial reporting of Service organisation: As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", services provided by a service organisation are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting.

Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:

a)	**Classes of transactions** in user entity's operations that are significant to the user entity's FS.
b)	**Procedures**, within both information technology <u>(IT) and manual systems</u>, by which **user entity's transactions** are initiated, recorded, processed, corrected as necessary, <u>transferred</u> to the general ledger and <u>reported</u> in the FS.
c)	**Related accounting records**, either in electronic or manual form, supporting information and specific accounts in user entity's FS that are used to initiate, record, process and report the user entity's transactions
d)	**How user entity's information system captures** events and conditions, other than transactions, that are significant to FS.
e)	**Financial reporting process** used to <u>prepare the user entity's FS</u>, including significant accounting estimates and disclosures and
f)	**Controls surrounding journal entries**, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments

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Q34. How does an auditor report on the description, design and operating effectiveness of controls at a service organization? (PYQ - OLD)

Answer

Report on the Description, Design and Operating Effectiveness of Controls at a Service Organization: As per SA 402 "Audit Considerations Relating to an Entity using a Service Organisation", a report on the description, design and operating effectiveness of controls at a service organization shall comprise-

(i) A **description**, prepared by management of service organisation, of service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and

(ii) A **report** by the service auditor with the objective of conveying reasonable assurance that includes:

a) Service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and

b) A description of the service auditor's tests of the controls and the results thereof.

SA 200 – Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

Q35. M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020- 2021. The Company implemented internal controls for prevention and early detection of any fraudulent activity. Auditors carried out test of controls and found out no major observations. After the completion of audit, audit report was submitted by the auditors and audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit and auditors were asked to make submission as to why audit failed to identify such fraud. **Auditors submitted that because of inherent limitations of audit**, it is **not possible to get persuasive evidence of certain matters like fraud.** Do you think auditor made correct statement? Also **discuss certain subject matters or assertions where it is difficult to detect material misstatements** due to potential effects of inherent limitations. **(July 2021)**

Answer

Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations –

As per **SA 200** - "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" and as per **SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected,** even though the audit is properly planned and performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than-persuasive audit evidence.

Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

In view of above, it can be **concluded that auditors did not give correct statement.**

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant.

Such assertions or subject matters include:
1) **Fraud**, particularly fraud involving senior management or collusion.
2) The existence and completeness of **related party relationships and transactions.**

3) The **occurrence of non-compliance with laws and regulations.**
4) Future events or conditions that may cause an entity to **cease** to continue as a **going concern**.

Q36. Yupee (P) Ltd. got incorporated on 15th May 2021 and Mr. Harsh, the director of Yupee (P) Ltd. proposed to Kamal & Co. on 24th May 2021, for being appointed as its statutory auditor. Mr. Kamal, the sole proprietor of Kamal & Co., after checking the compliance with all the statutory requirements, accepted the said offer and issued an audit engagement letter vide email to Yupee (P) Ltd.
Mr. Harsh found all terms of audit engagement to be proper but in the paragraph relating to auditor's responsibly in the engagement letter, as produced below:- "We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement."

Certain queries raised in his mind that **what does reasonable assurance meant**? **Which Standard on Auditing requires the auditor to obtain such reasonable assurance? Is it possible to give absolute assurance on such financial statements?**
Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above. **(MTP 22)**

Answer

As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is required:- "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." **Reasonable assurance is a high level of assurance and is less than absolute assurance.** It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

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**, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

The **inherent limitations of an audit arise from:**

- The **nature of financial reporting;**
- The **nature of audit procedures; and**
- The **need for the audit to be conducted within a reasonable period of time and at a reasonable cost**.

SA 210 – Agreeing to the terms of audit engagement

Q37. Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The **company** has **mentioned in** the **audit terms that they will not be able to provide internal audit reports** to Mr. Ram during the course of audit. Further, company also imposed some limitation on scope of Mr. Ram. What are the **preconditions Mr. Ram should ensure before accepting/ refusing the proposal?** Also advise, whether Mr. Ram should accept the proposed audit engagement? (**RTP Nov 2019)**

Answer

As per **SA 210 "Agreeing the Terms of Audit Engagements"**, In order to establish whether preconditions for an audit are present, auditor shall:

a) Determine whether **FRF** to be applied in the preparation of FS **is acceptable**; and
b) Obtain the **agreement of Mgt**. that it acknowledges and understands its responsibility:
   - For **preparation of FS** in accordance with the applicable FRF, including where relevant their fair presentation;
   - **For such IC** as Mgt. determines is necessary to enable the preparation of FS that are free from MM, whether due to fraud or error; and
   - To **provide auditor with**:

Access to all info. of which Mgt. is aware that is relevant to the preparation of the FS such as records, documentation & other matters;	**Additional info.** that the auditor may request from Mgt. for the purpose of the audit; and	**Unrestricted access** to persons within the entity from whom auditor determines it necessary to obtain audit evidence.

Further, **if management or those charged with governance impose a limitation on the scope** of the auditor's work in the terms of a proposed audit engagement **such that the auditor believes the limitation will result in the auditor disclaiming an opinion** on the financial statements, the auditor **shall not accept such a limited engagement** as an audit engagement, unless required by law or regulation to do so.

In addition if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

In the instant case, **Mr. Ram should not accept the appointment as statutory auditor** of XYZ Private Limited due to limitation imposed on his scope of work.

Q38. AKJ Ltd. is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of Chartered Accountants as their statutory auditors. The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required. Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, **what should be included in terms of agreed audit engagement letter**? **(MTP-Apr-19)**

OR

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them. But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The **engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited (RTP Nov'2020)**

Answer:

Agreement on Audit Engagement Terms: As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. Subject to prescribed details under Law or Regulations, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

(i) The **objective and scope** of the audit of the financial statements;

(ii) The **responsibilities** of the **auditor**;

(iii) The **responsibilities** of **management**;

(iv) **Identification of the applicable financial reporting framework** for the preparation of the financial statements; and

(v) **Reference to the expected form and content of any reports** to be issued by the auditor and a **statement** that there may be **circumstances** in which a **report may differ from its expected form and content.**

In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors. However, engagement letter issued by MEA Ltd. **does not specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management.**

Q39. R&Co., a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the **circumstances that may warrant the revision in terms of engagement.**

Answer-

As per SA210 on "Agreeing the Terms of Audit Engagements", the auditor may decide not to send a new audit engagement letter or other written agreement each period.

However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

1) Any **indication** that the **entity misunderstands** the <u>objective and scope</u> of the audit.
2) Any **revised or special terms** of the audit engagement.

3) A **recent change of senior management**.
4) A **significant change** in **ownership**.
5) A **significant change** in nature or size of the entity's business.
6) A **change in legal or regulatory requirements**.
7) A **change in the financial reporting framework** adopted in the Preparation of the financial statements.
8) A **change in other reporting requirements**.

SA 230 Audit Documentation

Q40. Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What **factors would influence the amount of working papers** required to be maintained for the purpose of his audit? **(RTP May 2020)**

Answer

Factors Influencing the amount of Working Papers:
As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

1) The **size and complexity** of the entity.
2) The **nature of the audit procedures to be performed.**
3) The **identified risks of material misstatement.**
4) The **significance of the audit evidence obtained.**
5) The **nature and extent of exceptions identified.**
6) The **audit methodology and tools used.**
7) **Timely preparation of Audit Documentation.**
8) The n**eed to document a conclusion** or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.

Q41. You are the team leader of 10 members for an audit of a Multinational Company. All the team members are concerned about audit documentation in order to provide evidence that the audit complies with SAs. Hence, the **team members wish to document every matter** concerned. In your **opinion** it is **neither necessary nor practicable for the auditor to document every matter** considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. **Illustrate by giving examples with reference to relevant Standard on Auditing. (MAY 2022)**

Answer:

SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

1) the **existence of an adequately documented audit plan** demonstrates that the auditor has planned the audit.

2) the **existence of a signed engagement letter** in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
3) An auditor's **report** containing an appropriately **qualified opinion** demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
4) In relation to **requirements that apply generally throughout the audit**, there may be a **number of ways in which compliance** with them may be demonstrated within the audit file:

- For example, there may be **no single way in which the auditor's professional skepticism is documented.** But the **audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism** in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.

- Similarly, that the **engagement partner has taken responsibility for the direction, supervision and performance of the audit** in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may **include documentation of the engagement partner's timely involvement** in aspects of the audit, such as participation in the team discussion required by **SA 315**, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".