## SA 300 Planning an Audit of Financial Statements

**Q1.** XWL Limited was engaged in dealing in commodity futures trading based in Surat. CA P, based at Delhi, was auditor of the company. The **auditor did not even once visit office** of the company and **failed to understand the nature of business** of the company. All the papers and account books were received on emails and audit was concluded.

There **were also included in his working papers checklists which had a requirement of test checking of cost of raw material consumed** & cost of stores and spares. **There was nothing in his working papers showing understanding of nature of business of company**. What does it reflect upon planning of audit by CA P? **(SM)**

**Answer**

**SA 300** requires the auditor to **plan the audit** in such a manner that it is performed effectively.
It also **requires auditor to establish overall audit strategy** including identifying the characteristics of the engagement, facilitating him to define its scope and planning of nature, timing and extent of audit procedures required to be performed to achieve the objective of audit.

SA 300 further requires the auditor to **document** the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

In the given situation, auditor didn't even once visit the company and failed to understand about business of the company. Therefore, he has **flouted requirement of SA 300** to plan the audit in such a manner that it is performed effectively. The auditor has to plan the audit commensurate to the nature and complexity of the business of the entity and identify and assess the risk of material misstatement.

Further, **working papers** of auditor also do not show his understanding of nature of business which is again a blatant violation of requirement of SA 300 which requires the auditor to document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to such plans.

**Inclusion of a checklist in working papers having requirement of test checking** of cost of raw material consumed & cost of stores and spares shows that it was a general checklist and specifics of business were never understood and audit was not planned to be conducted in an effective manner in accordance with requirements of SA 300.

---

**Q.2** CA. Pradyuman is **planning for audit of a listed company** headquartered in NOIDA. While doing this exercise, he **has made a list of various procedures** intended to be performed by him during the course of audit. He has further made up his mind to **decide about sample size** at time of performing various planned procedures. Is above approach proper? **(SM)**

**Answer**

**SA 300** states that **audit plan shall include description about nature, timing and extent of audit** procedures. The **extent of audit procedures** also includes deciding about sample sizes to be tested for performing audit procedures. Therefore, the **said approach is not proper**. Various procedures planned to be undertaken should also include considerations relating to sample sizes to be tested.

---

**Q3.** CA. Nikita is conducting audit of a leading society engaged in promoting awareness regarding usefulness of internet among the disadvantaged sections of society through easily understandable means and methods. The society is also registered under FCRA, 2010 for receipt of foreign contributions. During the course of audit, **she embarked upon extensive procedures relating to verification of receipt of foreign contributions** to rule out "round-tripping" in **comparison to procedures originally thought of**. She is documenting various procedures performed by her including relevant audit findings.

However, **she doesn't not feel need for putting into writing about how she planned the whole exercise**. Does she require refreshening of her knowledge? **(SM)**

**Answer**

**SA 300** requires auditor to **document audit plan and significant changes** made during the audit engagement to the audit plan. It also requires auditor to **document reasons for such changes.**

The **documentation** of the audit plan is a **record of the planned nature, timing and extent of risk assessment procedures** and **further audit procedures** at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

Further, **changes to audit plan** along **with reasons** thereof due to embarking upon extensive procedures related to verification of foreign contributions in comparison to what was originally envisaged **need to be documented.**

**Failure to document audit plan** could entail risk of not conducting audit according to professional standards in a qualitative manner.

---

**Q4.** A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what **factors shall be considered in the development of overall audit plan? (SM)**

**Answer**

**Development of an overall plan –**
Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

1) **Terms of his engagement** and any statutory responsibilities.
2) **Nature and timing of reports** or other communications.
3) **Applicable Legal or Statutory requirements.**
4) **Accounting policies** adopted by the clients and changes, if any, in those policies.
5) The **effects of new accounting and auditing pronouncement** on the audit.

6) **Identification of significant audit areas.**
7) **Setting of materiality levels** for the audit purpose.
8) Degree of reliance to be placed on the accounting system and internal control.
9) Possible rotation of emphasis on specific audit areas.
10) Nature and extent of audit evidence to be obtained.
11) Work of the internal auditors and the extent of reliance on their work, if any in the audit.
12) Involvement of other auditors in audit of subsidiaries or branches of client and involvement of experts.
13) Allocation of works to be undertaken between joint auditors & the procedures for its control and review.
14) Establishing and coordinating staffing requirements.
15) Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.

---

**Q5.** As an auditor of garment manufacturing company for the last 5 years, you have observed that new venture of online shopping has been added by the company during current year.
What **factors** would be **considered by you in formulating the audit strategy** of the company? **(SM/PYQ)**

**Answer**

**Formulation of Audit Strategy:**
While formulating the audit strategy for a company, following factors may be considered -

**General Factors:**

1) **Determination of Characteristics of Audit:** Identify the characteristics of the engagement that defines its scope.
2) **Reporting Objectives:** Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.
3) **Team's Efforts:** Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
4) **Considering result of preliminary engagement activities:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.
5) **Nature, timing and Extent of Resources**: Ascertain the nature, timing and extent of resources necessary to perform the engagement.

**Specific Factors for Online Shopping:**

The auditor shall also **obtain an understanding of the information system** including the related business processes due to new venture of online shopping in the following areas:
1) The **classes of transactions** in the entity's operations that are **significant to the financial statements;**
2) The **procedures**, within both information technology (IT) and manual systems, **by which those transactions are initiated, recorded, processed, corrected as necessary**, transferred to the general ledger and reported in the financial statements;

3) The **related accounting records, supporting information and specific accounts in the financial statements** that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
4) **How the information system captures events and conditions**, other than transactions, **that are significant to the financial statements;**
5) **Controls surrounding journal entries,** including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

---

**Q6.** Cineplex, a **movie theatre complex**, is the foremost theatre located in Delhi. **Along with the sale of tickets over the counter and online booking,** the major proportion of **income is from the cafe, shops, pubs** etc. located in the complex. Its **other income includes advertisements** exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for **parking** of vehicles is also provided in the basement of the premises.

Cineplex appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an **audit programme initially in respect of its revenue and expenditure** considering the above mentioned facts along with other relevant points relating to such complex. **(SM)**

**Answer**

**Audit Programme of Movie Theatre Complex:**

1) Peruse the **Memorandum of Association** and **Articles of Association** of the entity.
2) Ensure the **object clause permits** the entity to engage in this **type** of business.
3) In the case of **income from sale of tickets:**
    a) **Verify** the **control system** as to **how it is ensured that the collections** on sale of tickets of various shows **are properly and accurately accounted.**
    b) Verify the **system relating to online booking** of various shows and the **system of realization of money.**
    c) **Check that there is overall system of reconciliation** of collections with the number of seats available for different shows in a day.
4) **Verify** the **internal control system** and **its effectiveness** relating to the income from café, shops, pubs, game zone etc., located within the multiplex.
5) **Verify the system of control exercised relating to the income receivable from advertisements** exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
6) **Verify system of collection from the parking areas** in respect of the vehicles parked by customers.
7) **Verify the system of payment of salaries and other benefits to the employees** and ensure that statutory requirements are complied with.
8) **Verify payments effected in respect of maintenance of the building** and ensure the same is in order.
9) **Verify** the **insurance premium paid** and **ensure** it covers the entire assets.
10) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement, any payment of advance made to the distributor is also adjusted against the amount due.

---

**Q7.** You have been appointed as auditor of Bahubali Ltd. for the first time. Enumerate the **factors** to be **considered while establishing an overall audit strategy and its benefits.**

**Answer**

**Factors while establishing Overall Audit Strategy: Overall audit strategy would involve:**

1) **Determination of Characteristics of Audit:** Identify the characteristics of the engagement that defines its scope.
2) **Reporting Objectives:** Ascertain the **reporting objectives** of the engagement to plan the timing of the audit and the nature of the communications required.
3) **Team's Efforts:** Consider the **factors** that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.
4) **Considering result of preliminary engagement activities:** Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner **for the entity is relevant**.
5) **Nature, timing and Extent of Resources**: Ascertain the nature, timing and extent of resources necessary to perform the engagement.

**Benefits of Overall Audit Strategy:**

1) **Employment of Qualitative Resources**: The resources to deploy for **specific audit areas**, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters like review of valuation, hedging transactions.
2) **Allocation of Quantity of Resources:** The amount of resources to **allocate to specific audit areas,** such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the allocation of audit budgeted hours to high risk areas.
3) **Timing of Deployment of Resources:** When these resources are to be deployed, such as whether at an interim audit stage or at or close to key cut-off dates.
4) **Management of Resources:** How such resources shall be managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

---

**Q8.** **"Planning is not a discrete phase of an audit but rather a continual and iterative process." Analyse explaining the matters to be considered while planning an audit.**

**Answer**

**Planning is not a discrete phase of an audit but rather a continual and iterative process.** It often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes consideration of the timing of certain activities and audit procedures.

For example, **planning includes the need to consider such matters as:**

1) The **analytical procedures to be applied** as risk assessment procedures.

2) **Obtaining a general understanding** of the **legal and regulatory framework applicable** to the entity and how the entity is complying with that framework.
3) The **determination** of **materiality.**
4) The **involvement** of **experts.**
5) The **performance** of other **risk assessment procedures.**

---

**Q9.** Write a short note on **Contents of an audit plan.**

**Answer**

**Contents of an Audit Plan:** The auditor shall develop an audit plan that shall include a description of

(i) **Risk Assessment Procedures: -** The **nature, timing and extent of planned risk assessment procedures**, as determined under SA **315** "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
(ii) **Further Audit Procedures:** - The **nature, timing and extent** of planned further audit procedures at the assertion level, as determined under **SA 330** "The Auditor's Responses to Assessed Risks".
(iii) **Other Audit Planned procedures: -** Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The **audit plan is more detailed** than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

**For example,** planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

---

**Q10. Write a short note on Relationship between the overall audit strategy and the audit plan.**

**Answer**

Relationship between the Overall Audit Strategy and the Audit Plan:

- Audit strategy is prepared **before audit plan**.
- Audit plan is **more detailed** than the overall audit strategy.
- Audit strategy and audit plan **are inter-related** because change in one would result into change in the other.
- Audit strategy provides the **guidelines** for developing the audit plan. It establishes the scope and conduct of the audit procedures and thereby, works as basis for developing a detailed audit plan.
- **Detailed audit plan** would include the NTE of the audit procedures so as to obtain SAAE.

The overall audit strategy & Audit plan should take into consideration the element of materiality and its relationship with Risks & procedures to be adopted. It is summarized as under:-

| | | |
|---|---|---|
| High Materiality | Detailed Procedures | High Risks |
| Low Materiality | Test Checks | Low Risks |

**Q11.** BSA & Company, Chartered Accountants are duly appointed auditors of ASB LTD engaged in manufacturing of various FMCG products and having its manufacturing facilities spread across India. Senior partner CA B has called meeting of audit staff to plan the audit for current year and at the meeting he addresses as under:

"SA 200 "Overall Objectives of Independent Auditor and Conduct of an Audit in accordance with Standards on Auditing", states that to achieve overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning & performing the audit. Without a careful plan, overall objective of audit may not be achieved. Audit planning is necessary to conduct effective audit in efficient & timely manner"

In view of above, you are required to analyse and **explain the benefits of Planning in an Audit of Financial Statements.**

**OR**

Planning an audit involves establishing the overall audit strategy for the engagement arid developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. **Briefly discuss the usefulness of careful and adequate audit planning.**

**Answer**

**SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing"** states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner.

**Benefits/Advantages of Planning in an Audit of Financial Statements**

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways described hereunder-

1) **Attention to Important Areas -** Planning would help the auditor to devote appropriate attention to important areas of the audit.
2) **Timely resolution of Potential Problems** - It would also help the auditor identify and resolve potential problems on a timely basis.
3) **Proper Organisation and Management of Audit Engagement -** Adequate planning would help the auditor in properly organizing and managing the audit engagement so that it is performed in an effective and efficient manner.
4) **Proper Selection of Engagement Team** - Planning would assist the auditor in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

5) **Direction and Supervision of Engagement Team** - It would further facilitate the direction and supervision of engagement team members and the review of their work.
6) **Easy Coordination -** Also, planning would be helpful to the auditor in coordination of work done by auditors of components and experts.

---

**Q12.** Mr. S & Mr. J are a senior and junior articled assistant respectively, in a renowned audit firm. Both were assigned statutory audit of a manufacturing company. Mr. S instructed his junior to draft an audit plan by taking reference from a similar client (a partnership firm) who was engaged in the same business. Mr. J was confused as to how that reference could suit in this case, since the nature and extent of planning would vary for both clients. After few days, the audit work commenced. During the course of the audit, certain events took place, which made Mr. J to rethink about the audit plan initially designed. He approached Mr. S and enquired about **when would an audit plan require a change.** Comment about both the situations face by Mr. J in the above situation

**Answer**

**SA 200** "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing" states that in order to achieve the overall objectives of the audit, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved.

The audit planning is necessary to conduct an effective audit, in an efficient and timely manner. **So far as the nature of planning is concerned, it would vary according to-**

1) **Size and Complexity of the Auditee -** If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.
2) **Past Experience & Expertise** - The key engagement team members' previous experience & expertise also contributes towards variation in planning activities.
3) **Change in Circumstances** - Another factor contributing towards variation in planning activities is change in circumstances.

**Changes to Audit Planning:** The auditor should update and change the overall audit strategy and audit plan as necessary during the course of the audit. The auditor may **need to modify the overall audit strategy and audit plan due to the factors such as**

(i) **result of unexpected events,**
(ii) **changes in conditions, or**
(iii) **the audit evidence obtained from the results of audit procedures.**

Further, the auditor would also have to **modify the nature, timing & extent of further audit procedures,** based on the revised considerations of assessed risks. This may be the case when information coming to the auditor differs significantly from the information when he planned the audit process.

In addition to the above, there may be possibilities of change in law, notifications, government policies, which warrants updation of overall audit strategy and audit plan.

---

**Q13. "The auditor shall document (i) The overall audit strategy; (ii) The audit plan; and (iii) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes." Explain.**

**Answer**

Auditor shall **document**:

1) The **overall audit strategy;**
2) The **audit plan**; and
3) Any **significant changes** made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes as under:

a) **Record of Key Decisions:** The **documentation of the overall audit strategy is a record of the key decisions** considered necessary to properly plan the audit and to communicate significant matters to the engagement team. For example, the auditor may **summarize the overall audit strategy in the form of a memorandum that contains key decisions** regarding the overall scope, timing and conduct of the audit.

b) **Record of Nature, Timing and Extent of Risk Assessment Procedures:** The **documentation of the audit plan** is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

c) **Record of reasons for Change in Audit Plans:** A **record of the significant changes** to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, **explains why the significant changes were made**, and the **overall strategy and audit plan finally adopted for the audit**. It also reflects the appropriate response to the significant changes occurring during the audit

---

**Q14. Key phases in the audit execution stage** are Execution Planning, Risk and Control Evaluation, Testing and Reporting. Explain. (RTP-N18)

**Answer**

1) **Execution Planning:**

- **Prior to commencement** of an audit engagement, it is **important to lay down the roadmap for audit execution** to ensure timely and quality audit results.
- The auditors **need to plan their work** in order to carry out the audit in an effective, efficient and timely manner.
- A **detailed audit program** is prepared laying down the audit objectives, scope and audit approach.
- The **manpower requirement**, **audit team qualifications**, and the **time element**, etc. **are some of the important considerations during execution planning.**

2) **Risk and Control Evaluation:**

For each segment of audit, **auditors should conduct a detailed risk and control assessment** i.e. **list the risks that must be reviewed** in that segment, **capture for each risk the controls that exist** or those that are needed to protect against the risk and show for each control, the work steps required to test the effectiveness of the controls.

While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.

**3) Testing:**

Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, the auditors should **test the operating effectiveness of the controls** to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls

**4) Reporting:**

**SA 700**, "**Forming an Opinion and Reporting on Financial Statements**" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity.

The auditor should **review and assess the conclusions drawn from the audit evidence obtained** as the basis for the expression of an opinion on the financial statements.

This **review and assessment involves** considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit.

It is also necessary to **consider whether the financial statements comply with the relevant statutory requirements** such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc.

The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole. A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur. A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

**5) Other Important Considerations:** In addition to above, **there are certain other consideration** which auditor is required to take care while executing the audit **such as using the work of other auditor, using the work of an auditor's expert etc.**

---

**Q15.** Discuss a few **circumstances where the audit programme would have to be suitably altered** by the auditor.

**Answer**

At each subsequent engagement, **Programme should be reviewed** &, **if necessary, modified on account of**:

1) **experience gained during the previous audits**;
2) **important changes taken place in business** specially in the system of IC, accounting procedures or in the structure of management or of the scope of business; and
3) **evaluation of IC made** for the current year.

**Circumstances where audit programme would have to be suitably altered**

1) If audit procedures were designed for a certain volume of turnover and **subsequently the volume have substantially increased**. Also, when there have been **significant changes in the accounting organisation, procedures and personnel** subsequent to the audit procedures.
2) Where during the course of an audit, it has been discovered that **internal control procedures were not as effective as assumed** at the time the audit programme was framed.
3) Where there has been an **extraordinary increase** in the amount of book debts or that in the value of stocks as compared to that in the previous year.
4) When a **suspicion has aroused** during the course of audit or information has been received that **assets of the company have been misappropriated.**

---

**Q16.** XY Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to **enquire into causes of abnormal wastage of raw materials. Draw out an audit plan**.
Wastage percentage are
July 2017 - 2.5%
Aug 2017 - 2.7%
Sep 2017 - 2.4%
Oct 2017 - 8.1%

**Answer**

**Audit Plan to locate the Abnormal Wastage of Raw Material:** To locate the reasons for the abnormal wastage, the auditor should first of all assess the general requirements as under:

1) **Procure a list of raw materials**, showing the names and detailed characteristics of each raw material.
2) Obtain the **standard consumption figures**, and **ascertain the basis according to which normal wastage figures have been worked out**. Examine the **break-up of a normal wastage** into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.
3) **Examine** the **various records maintained** for recording separately the various lots purchased and identification of each lot with actual material consumption and **for ascertaining actual wastage figures therein.**
4) **Obtain reports of Preventive Maintenance Programme of machinery** to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrap work.
5) Assess whether **personnel employed are properly trained and working efficiently**.
6) **See whether quality control techniques** have been **consistent** or **have undergone any change**.
7) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.
8) Examine whether the **basis adopted for calculating wastage** for September is the **same as was adopted for the other three months.**
9) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

## SA 450 Evaluation of Misstatements Identified during the Audits

**Q17.** In audit plan for TELCO Ltd, as the audit partner you want to highlight the sources of misstatements arising from other than fraud to your audit team and caution them. Identify the **sources of misstatements**. **(RTP-M22)**

**Answer**

According to SA 450 "Evaluation of Misstatements identified during the Audit", the following are the sources of misstatements arising from other than fraud -

(i) **inaccuracy** in gathering or processing data from which the financial statements are prepared;
(ii) **omission** of an amount or disclosure;
(iii) **incorrect accounting estimate** arising from overlooking, or clear misinterpretation of facts; and
(iv) **Judgments of management** concerning accounting estimates that the auditor **considers unreasonable** or the selection and application of accounting policies that the auditor **considers inappropriate.**

---

**Q18.** The auditor of XY & Co Ltd has intimated the management that certain misstatements identified during the course of audit need to be corrected as an auditor, discuss the impact of such misstatements in case the management does not carry out the said corrections. (PYQ-N17)

**OR**

Discuss the **impact of uncorrected misstatements identified during the audit** and the **auditor's response** to the same.

**Answer**

**Reassess Materiality:**
Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate.

**Whether Uncorrected Misstatements is Material?**
In accordance with SA 450 "Evaluation of Misstatements identified during the Audit", the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider-

1) The **size and nature of the misstatements**, both in relation to particular classes of transactions, account balances or disclosures and the FS as a whole, and the particular circumstances of their occurrence; and
2) The **effect of uncorrected misstatements** related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

**Communicate to TWCG (Request to correct):**
The auditor shall communicate this with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.
The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

**If management refuse:**

If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should **report accordingly**.

**Written Representation If Immaterial**

**As per management**, if effect of such uncorrected misstatement is immaterial then the auditor shall request for a **written representation** from management and, where appropriate, those charged with governance that whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

## SA 520 Analytical Procedures

**Q19.** What are the **considerations to be kept in mind while performing analytical procedures** on data prepared by the client?

**Answer**

As per "SA 520 Analytical Procedure", when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:

(1) Determine **suitability** of **particular substantive analytical procedures** for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
(2) Evaluate **reliability of data** from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
(3) **Develop an expectation of recorded amounts or ratios** and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
(4) **Determine amount of any difference of recorded amounts from expected values** that is acceptable without further investigation and if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, **auditor shall investigate such differences** by:
    - **Inquiring** of management and obtaining appropriate audit evidence relevant to management's responses; and
    - **Performing other audit procedures** as necessary in the circumstances.

---

**Q20.** The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, what are the **relevant criteria which determine whether the data is reliable** for the purposes of designing substantive analytical procedures?

**Answer**

SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained.

Accordingly, the following are relevant criteria when determining whether data is reliable for purposes of designing substantive analytical procedures-

(1) **Source** of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;

(2) **Comparability** of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;

(3) **Nature** and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and

(4) **Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

---

**Q21.** In audit of DEF Limited, the Auditor had made use of certain analytical procedures with regard to certain key data in the Statement of Profit and Loss. The results obtained showed inconsistencies with other relevant information. State the **course of action that the Auditor should take to ensure that the risk of material misstatement would be contained to a low level fixed as per materiality level. (PYQ-N18)**

**Answer**

**Investigating Results of Analytical Procedures**: As per SA 520, "Analytical Procedures", if analytical procedures performed in accordance with this SA **identify fluctuations or relationships** that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall **investigate such differences** by:

(i) **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses**; and

(ii) **Performing other audit procedures as necessary in the circumstances.**

Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

---

**Q22.** You have been appointed as an auditor of M/s Excellent Hotels Ltd. As a senior partner, you want to use **analytical procedures in respect of room rentals as well as payroll expenses. Discuss. (PYQ-M19)**

**Answer**

**As per SA 520 on "Analytical Procedures"**, in some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

**Analytical Procedures in case of Payroll cost**

Where an entity **has a known number of employees** at fixed rates of pay throughout the period, it may be possible for the auditor to **use this data to estimate the total payroll costs** for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.

**Analytical Procedures in case of Room Rental Income of Hotel-**

Different types of analytical procedures provide different levels of assurance. Analytical procedures involving the **prediction of total rental income** in case of Hotel taking the room tariff rates, the number of rooms and vacancy rates into consideration, **can provide persuasive evidence** and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.

## SA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

**Q23.** While auditing Z Ltd., you observe certain material **financial statement assertions have been based on estimates** made by the management. As the auditor **how do you minimize the risk of material misstatements**? **(SM) (PYQ-M18)**

**OR**

**Q.** CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s Delist Limited is a listed entity at National Stock Exchange and the financial statements are to be drawn up in compliance with Ind AS. M/s Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active and open market. CA Harry is **concerned with identification and assessment of the risks of material misstatement for accounting estimates**. Guide him with regard to the estimation making process adopted by management with reference to the relevant Standard on Auditing. **(PYQ-M22)**

**OR**

**Q.** While auditing REAL Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements? **(MTP)**

**Answer**

As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates:

a) **Requirements of applicable FRF** relevant to accounting estimates, including related disclosures.
b) **How Mgt. identifies** those transactions, events & conditions that may give rise to **need for accounting estimates** to be recognised or disclosed in F.S.
   In obtaining this understanding, he **shall make inquiries of Mgt.** about changes in circumstances that may give rise to new, or need to revise existing, accounting estimates.
c) **How Mgt. makes accounting estimates**, & understanding of data on which they are based including:
   - **Method used** in making A/E;
   - **Relevant controls**;
   - Whether **Mgt. has used an expert**;
   - **Assumptions** underlying A/E;
   - Whether there has been or ought to have been a **change from prior period in methods** for making A/E, and if so, why; and
   - Whether and, if so, **how Mgt. has assessed effect of estimation uncertainty**.

---

**Q24.** A private company is engaged in the business of real estate. The **auditor of the company requested the information from the management to review the outcome of accounting estimates** (like estimated costs considered for percentage completion etc ) included in the prior period financial statements and their subsequent re-estimation for the purpose of the current period.

The **management has refused** the **information** to the auditor **saying that the review of prior period information should not be done by the auditor**. Please advise. **(TYK)(RTP-M19)**

**Answer**

- **As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, Auditor shall **review outcome of A/c estimates included in prior period F.S.**, or **their subsequent re- estimation** for purpose of current period.
- **Nature & extent of auditor's review** takes account of nature of accounting estimates & **whether info. obtained from review** would be **relevant to identifying & assessing ROMM** of A/E made in current period F.S.
- **Outcome** of A/E **will often differ** from A/E **recognised in prior period F.S**.
- **By performing RAP** to identify & understand reasons for such differences, obtain:
  1) **Info. regarding effectiveness of Mgt.'s prior period estimation process,** from which auditor can judge the likely effectiveness of Mgt.'s current process.
  2) **Audit evidence** that is **pertinent to re-estimation,** in current period, of prior period A/E.
  3) **Audit evidence** of matters, such as **estimation uncertainty**, that may be required to be disclosed in F.S.
- It may **assist auditor in current period in identifying conditions or circumstances** that increases susceptibility of A/E to possible Mgt. bias.
- Auditor's **professional skepticism** assists in identifying such circumstances or conditions and in determining NTE of further audit procedures.
- However, **Review is not intended** to **call into question judgments made** **in prior periods** that were based on info. available at that time.

In the given case, the management is **not correct** in refusing the relevant information to the auditor.

---

**Q25.** Statutory auditor of O Ltd **requested the management for a written representation** in respect of obsolescence of inventory and warranty obligations recognized by the company in its financial statements. The **management denied the representation** on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report. Please comment. (MTP 4 Marks, Mar 19)

**OR**

Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. **Mr. L wants to obtain written representation** from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing. **(PYQ-M19)**

**Answer**

**Written Representations**: **As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**, the auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

**SA 580, "Written Representations"** discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

1) **About appropriateness of measurement processes**, including related assumptions & models, used by Mgt. in determining A/E.
2) That **assumptions appropriately reflect** Mgt.'s intent & ability to carry out specific courses of action on behalf of entity.
3) That **disclosure related to A/E** are complete & appropriate.
4) That **no subsequent event requires adjustment** to A/E & disclosures.

For those accounting estimates not recognised or disclosed in the financial statements, written representations may also include representations about:

- The appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.
- The appropriateness of the basis used by management to overcome the presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework, for those accounting estimates not measured or disclosed at fair value.

Thus, **management's contention** on the ground that during the course of audit, all the required procedures were performed by the auditor and after obtaining sufficient appropriate audit evidence, auditor has issued a clean report, for not providing written representation is **not correct**. The management should provide written representations to the auditor.

Further as per **SA 580** Written Representation, **if management does not provide one or more of the requested written representations**, the auditor shall

a) **Discuss the matter with management;**
b) **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
c) **Take appropriate actions**, including determining the possible effect on the opinion in the auditor's report in accordance with SA **705**.

---

**Q26.** During the Audit of Data Solutions Ltd., a listed company, your audit manager observed that several estimates are made by the Company. He seeks your guidance to know **areas of accounting estimates that may give rise to lower level of risk of material misstatement**. Guide him with examples. **(PYQ-N19)**

**Answer**

As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

**(1)** Accounting estimates arising in entities that engage in business activities that **are not complex.**
**(2)** Accounting estimates that are **frequently made and updated** because **they relate to routine transactions.**
**(3)** Accounting estimates derived from **data that is readily available**, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.

**(4)** Fair value accounting estimates where the **method of measurement** prescribed by applicable financial reporting framework is **simple** and applied easily to asset or liability requiring measurement at fair value.

**(5)** Fair value accounting estimates where the **model used** to measure the accounting estimate is well-known or generally accepted, provided that the assumptions or inputs to the model are observable.

---

**Q27.** With reference to the Standards on Auditing state the **examples of accounting estimates** that may have a high estimation uncertainty. **(PYQ)**

**Answer**

As per **SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures",** the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

**Examples** of accounting estimates that may have high estimation uncertainty include the following:

- Accounting estimates that are **highly dependent upon judgment**, for example, judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future.
- Accounting estimates that are **not calculated using recognised measurement** techniques.
- Accounting estimates where the results of the auditor's review of similar accounting estimates made in the prior period financial statements **indicate substantial difference** between the original accounting estimate and the actual outcome.
- Fair value accounting estimates for which a **highly specialised entity-developed** model is used or for which there are no observable inputs.

---

**Q28.** M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non- core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. **How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made? (PYQ-J21)**

**Answer**

In given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision.

**As an auditor evaluation would be done as under:**

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

(a) **How Mgt. has considered alternative assumptions or outcomes** & why it has rejected them, or how Mgt. has otherwise addressed estimation uncertainty in making accounting estimate.
(b) Whether **significant assumptions** used by Mgt. are **reasonable**.
(c) Where relevant to reasonableness of significant assumptions used by Mgt. or appropriate application of applicable FRF, **Mgt.'s intent to carry out specific courses of action** & its ability to do so.
(d) If, in auditor's judgment, Mgt. has **not adequately addressed effects of estimation uncertainty** on accounting estimate that give rise to significant risks, he shall **develop a range** to evaluate the reasonableness of the accounting estimate.

---

**Q29.** M/s ABC Limited is engaged in the business of construction of 4 infrastructure and housing projects. While preparing financial statements for the year ended 31.03.2023 management has made various accounting estimates and confirmed to auditor that all necessary accounting estimates have been recognized, measured and disclosed in the financial statements are in accordance with the applicable financial reporting framework. The auditor during the course of audit observed some changed circumstances giving rise to the need for an accounting estimate. Inquiries of same were sought from the management. **Can you list down some circumstances, change of which will result in inquiries from the management? [PYQ-M23]**

**Answer**

**Inquiries from management:** As per SA 540, auditor's understanding of the entity and its environment obtained during the performance of risk assessment procedures, together with other audit evidence obtained during the course of the audit, assist the auditor in identifying circumstances, or changes in circumstances, that may give rise to the need for an accounting estimate.

**Inquiries of management about changes in circumstances may include, for example, inquiries about whether:**

1) Entity has engaged in **new types of transactions** that may give rise to a/c estimates.
2) **Terms of transactions** that gave rise to A/E that have changed.
3) **Accounting policies** relating to A/c estimates have changed, as a result of changes to requirements of applicable FRF or otherwise.
4) **Regulatory or other changes outside control of Mgt**. have occurred that may require Mgt. to revise, or make new, a/c estimates.
5) **New conditions or events** have occurred that may give rise to need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to Identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

---

## SA 600 Using the Work of Another Auditor

**Q30.** CA. Sourabh is engagement partner conducting statutory audit of BBI Bank for SBT & Associates. The **bank has 1034 branches spread all over the country** which are **audited by branch auditors**. In respect of one large branch audited by a branch auditor, there **were errors in NPA classification of many advances which were not pointed out by branch auditor** in his report through memorandum of changes and NIL memorandum of changes was reported electronically.
During overall review of financial statements of bank by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection report and concurrent audit reports of above branch as part of overall review procedures. However, these reports did not point towards any irregularities in such accounts.
**Would statutory auditor of bank be liable for above lapses? What precautions have to be taken** by him while expressing opinion considering possibilities of such situations? **(SM)**

**Answer**

- SA 600 states that the principal auditor would **not be responsible** in respect of the work entrusted to the other auditors, **except** in circumstances which should have **aroused his suspicion about the reliability** of the work performed by the other auditors.
- When **principal auditor has to base his opinion on the financial information** of the entity as a whole relying upon the statements and reports of the other auditors, his report should **state clearly** the **division of responsibility** for the financial information of the entity by **indicating extent** to which the financial information of components audited by the other auditors **have been included** in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

In the given situation, nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore, he would not be responsible for work performed by branch auditor.

Further, it should be clearly stated in the report that 1034 branches of bank have been audited by branch auditors.

---

**Q31.** B is Principal Auditor of ABC Co. Ltd., with 8 branches audited by 8 Branch Auditors. B wanted to ensure that the works of Branch Auditors were adequate for the purpose of his audit. Hence he insisted on Branch Auditors to get familiar with a check list he prepared for branches and, besides, **required them to share the working papers compiled by them** for his review and return. **Is Principal Auditor within his right in asking for such sharing of working papers?** (PYQ-M18)

**Answer**

**Using the Work of Another Auditor:**
When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of

the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit.

In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor". It makes clear that in certain situations, the statute governing the entity may confer a **right on the principal auditor to visit a component and examine the books of account and other records** of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.
When using the work of another auditor, principal auditor should **ordinarily perform the following procedures:**

**(a)** **advise** the other auditor of the **use that is to be made of the other auditor's work and report** and **make sufficient arrangements for co-ordination** of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and

**(b)** **advise** the other auditor of the **significant accounting, auditing and reporting requirements** and **obtain representation as to compliance with them.**

The principal auditor might **discuss** with the other auditor the **audit procedures applied or review a written summary** of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Further, **SA 230** issued by ICAI on Audit Documentation, and "Standard on Quality Control **(SQC) 1**, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, **audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel."**

In the light of aforesaid, principal auditor **was not within his right for asking for such sharing of working papers**. It depends upon the discretion of auditor.

---

**Q32.** "There should be sufficient liaison between a principal auditor and other auditors". Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by other auditor.

**OR**

**Q.** BETA Ltd is Subsidiary company of ALPHA Ltd. PQR & Associates has been appointed as auditor of ALPHA Ltd. for the Financial Year 2019-20 and MNO & Associates has been appointed as auditor of BETA Ltd for the year 2019-20. Explain the **role of PQR & Associates and MNO & Associates as auditors of the parent company and subsidiary company respectively**. **(MTP-20)**

**Answer**

**Role of Auditor in case of Parent Company and Subsidiary Company:**
As per SA 600 "Using the Work of Another Auditor", there should be **sufficient liaison between the principal auditor** (hereinafter referred as auditor of Parent Company) and the **other auditor** (hereinafter referred as auditor of Subsidiary Company).

**Role of Principal Auditor (PQR & Associates- Auditor of Parent Company):**

(i) It is necessary to **issue written communication(s)** as a principal auditor to the other auditor.
(ii) Principal auditor should **advise** the other auditor of <u>any matters that come to his attention</u> that he thinks may have an important bearing on the other auditor's work.
(iii) When considered necessary by him, **principal auditor may require** the other auditor **to answer a detailed questionnaire** regarding matters on which the principal auditor requires information for discharging his duties.

**Role of Other Auditor (MNO & Associates- Auditor of Subsidiary Company):**

**1)** The other auditor, knowing the context in which his work is to be used by the principal auditor, should **co-ordinate** with the principal auditor. For example, by bringing to the principal auditor's immediate attention to any significant findings requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc.
**2)** He should **ensure compliance** with the relevant statutory requirements.
**3)** The other auditor **should respond** to the questionnaire sent by Principal Auditor on a timely basis

---

**Q33.** PQ Limited, a listed entity, headquartered in Mumbai and is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly and processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office and branches. Your firm is one of those firms. It was agreed that your firm will act as Principal auditor. 'What **factors will be considered by you while accepting the position of Principal auditor**? (PYQ-J21)

**Answer**

**Factors to be considered while accepting the position of Principal auditor**

**SA 600 – Using the work of Another Auditor –** While accepting the position of Principal Auditor, auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For this purpose, auditor **would consider:**

a) **Materiality** of the portion of the financial information which the principal auditor audits;
b) Principal auditor's degree of **knowledge** regarding the business of the components;
c) **Risk of material misstatements** in financial information of components audited by other auditor; and

d) Performance of **additional procedures** as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

## SA 610 Using the Work of Internal Auditors

**Q34.** CA. Amboj, a practicing chartered accountant has been appointed as an internal auditor of Textile Ltd. **He conducted the physical verification of the inventory at the year-end** and handed over the report of such verification to CA. Kishor, the statutory auditor of the Company, for his view and reporting. **Can CA. Kishor rely on such report? (SM)**

**Answer**

**Using the Work of Internal Auditor:** As per SA 610 "Using the Work of Internal Auditors", **while determining whether the work of the internal auditors can be used for the purpose of the audit**, the external auditor shall evaluate-

(1) **Extent** to which the internal audit function's organizational status and relevant policies and procedures **support the objectivity of the internal auditors;**
(2) **Level of competence** of internal audit function; and
(3) **Whether internal audit function applies a systematic and disciplined approach**, including quality control.

Further, the external auditor **shall not use the work of the internal audit function** if the external auditor determines that:

(1) The function's organizational status and relevant policies and procedures **do not adequately support the objectivity** of internal auditors;
(2) The **function lacks sufficient competence**; or
(3) The function **does not apply a systematic and disciplined approach,** including quality control.

In the instant case, CA. Kishor should ascertain the internal auditor's scope of verification, area of coverage and method of verification. He should review the report on physical verification taking into consideration these factors. If possible he should also test check few items and he can also observe the procedures performed by the internal auditors.

If **statutory auditor is satisfied about the appropriateness of the verification,** he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise. The **final responsibility to express opinion on the financial statement remains with the statutory auditor.**

**Q35.** Mr. Sheetal is appointed as a statutory auditor of Mahi Ltd. Mahi Ltd is required to appoint an internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Kunthu as its internal auditor. **External auditor** Mr. Sheetal **asked internal auditor to provide direct assistance** to him **regarding evaluating the sufficiency of tests performed and the adequacy of disclosures** in FS and other matters affecting the auditor's report. Discuss whether Mr. Sheetal, statutory auditor, can ask direct assistance from Mr. Kunthu, internal auditor as stated above in view of relevant Standard on Auditing. **(MTP - 2021)**

**Answer**

**Direct Assistance from Internal Auditor**: As per SA 610 "Using the Work of Internal Auditor", the external auditor **shall not use internal auditors to provide direct assistance** to perform procedures **that Involve making significant judgments** in the audit. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

**Significant judgments include the following:**

1) Assessing **risks of material misstatement**;
2) Evaluating **sufficiency of tests performed;**
3) Evaluating the appropriateness of management's use of the **going concern assumption;**
4) Evaluating significant **accounting estimates**; and
5) Evaluating **adequacy of disclosures** in financial statements, & other matters affecting auditor's report.

In view of above, Mr. Sheetal **cannot** ask direct assistance from internal auditors regarding evaluating the sufficiency of tests performed and the adequacy of disclosures in the financial statements and other matters affecting the auditor's report.

---

**Q36.** OPQ Ltd is in the business of software consultancy. The company has had **large balances of accounts receivables** in the past years which have been **assessed as area of high risk.** For the year ended 31 March 2018, in respect of the valuation of accounts receivable, the statutory auditor **has assigned the checking of the accuracy of the aging** of the accounts receivables **and provision** based on ageing to the internal auditor **providing direct assistance** to him. Please advise **(RTP 19)**

**Answer**

As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) **shall not use internal auditors** to provide direct assistance to perform procedures that:

1) Involve **making significant judgments** in the audit;
2) **Relate to higher assessed risks of material misstatement** where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
3) **Relate to work** with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
4) Relate to **decisions** the **external auditor makes in accordance with this SA** regarding the internal audit function and the use of its work or direct assistance.

In the given case where the valuation of accounts receivable is **assessed as an area of higher risk**, the statutory auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance. However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would **not be appropriate to assign** that latter procedure to an internal auditor providing direct assistance.

---

**Q37.** Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding **evaluating significant accounting estimates** by the management and assessing the risk of material misstatements.

(a) **Discuss whether** Mr. Anand, statutory auditor, **can ask direct assistance** from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.

(b) **Will your answer be different,** if Mr. Anand **ask direct assistance** from Mr. Bhola, internal auditor **with respect to external confirmation requests** and evaluation of the results of external confirmation procedures? **(RTP - May 2020)**

**Answer**

(a) **Direct Assistance from Internal Auditor**: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that

Involve making significant judgments in the audit. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

**Significant judgments include the following:**

(1) Assessing the **risks of material misstatement;**
(2) Evaluating the **sufficiency of tests performed;**
(3) Evaluating the appropriateness of management's use of the **going concern assumption**;
(4) Evaluating **significant accounting estimates**; and
(5) Evaluating the **adequacy of disclosures in the financial statements**, and other matters affecting the auditor's report.

In view of above, **Mr. Anand cannot ask direct assistance** from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(b) **Direct Assistance from Internal Auditor in case of External Confirmation Procedures:** SA 610 "Using the Work of Internal Auditor", provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, "External Confirmation" the **external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures*, it would not be appropriate to assign these responsibilities*** to internal auditors. However, **internal auditors may assist in assembling information necessary** for the external auditor to resolve exceptions in confirmation responses.

---

**Q38.** Smart Ltd is a manufacturing unit and you are External Auditor of the company. Internal auditors are also appointed as per the provisions of the Companies Act, 2013. As an external auditor you want to use the internal auditors to provide direct assistance for the purposes of audit.

State the **circumstances where the internal auditors cannot be used to provide direct assistance. What would you include in the audit documentation**? (PYQ - July 2021)

**Answer**

In the given case of Smart Ltd, a manufacturing unit, an external auditor shall not use internal auditors to provide direct assistance as per SA 610, Using the work of Internal Auditor, to perform procedures that:

(1) Involve **making significant judgments** in the audit;
(2) Relate to **higher assessed risks of material misstatement** where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
(3) Relate to work with which the internal auditors have been **involved** and which has already been, or will be, **reported** to management or those charged with governance by the internal audit function; or
(4) Relate to **decisions the external auditor makes in accordance with this SA** regarding the internal audit function and the use of its work or direct assistance.

Further, if the external auditor uses internal auditors to provide direct assistance on the audit, **the external auditor shall include in the audit documentation:**

(1) **Evaluation of existence & significance of threats to the objectivity** of the internal auditors, and **level of competence** of the internal auditors used to provide direct assistance;
(2) **Basis for the decision** regarding the nature and extent of the work performed by the internal auditors;

(3) **Who reviewed** the work performed and the **date** and **extent** of that review in accordance with SA 230, Audit Documentation;
(4) **Written agreements obtained from an authorized representative** of the entity and the **internal auditors**; and
(5) **Working papers prepared by the internal auditors** who provided direct assistance on the audit engagement.

---

**Q39.** Moon Ltd. of which you are the Statutory Auditor, have an internal audit being conducted by an outside agency. State the factors that weigh **considerations in opting to make use of direct assistance** of the internal auditors for the purpose of statutory audit. (PYQ-M18)

**Answer**

**Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance:** SA 610 'Using the work of Internal Auditor' Deals about the concept of direct assistance of internal auditor. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, **external auditor shall consider:**

(1) The **amount of judgment involved** in:
- (i) Planning and performing relevant audit procedures; and
- (ii) Evaluating the audit evidence gathered;

(2) The **assessed risk of material misstatement**; and
(3) The external auditor's **evaluation of the existence and significance of threats to the objectivity** and **level of competence** of the internal auditors who will be providing such assistance.

If using internal auditors to **provide direct assistance is not prohibited** by law or regulation, and the **external auditor plans to use internal auditors** to provide direct assistance on the audit, the external auditor shall **evaluate the existence and significance of threats to objectivity** and the **level of competence** of the internal auditors who will be providing such assistance.

The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

---

**Q40.** CA. Keshavraj is conducting statutory audit of a listed company "Live with Nature Limited". The company is engaged in producing environment-friendly niche products for new-born babies. There is also a well-functioning internal audit department in the company. On perusal of internal audit reports, he finds that not **only verification of inventories was attended by internal auditor at regular intervals** during the year, **workings were also made in respect of inventory valuation** as at year end.
He has also attended inventory count at end of financial year and no prima facie adverse inferences were drawn by him. However, on going through inventory reports, he **gathers that inventories are being held for considerably long period before being sold**. The internal audit reports have not taken this aspect into consideration. **Should he choose to rely upon inventory valuation work performed by internal auditor? (SM)**

**Answer**

For a particular account balance, class of transaction or disclosure, **the higher an assessed risk of material misstatement** at the assertion level, the **more judgment is often involved** in planning and performing the audit procedures and evaluating the results thereof.
In such circumstances, **external auditor will need to perform more procedures directly** and accordingly, **make less use of the work of the internal audit function** in obtaining sufficient appropriate audit evidence.

Furthermore, as explained in **SA 200, the higher the assessed risks of material misstatement, the more persuasive the audit evidence required** by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.

In the given situation, inventories are being held for considerably long period before being sold. As company is dealing in niche products for new-born babies, **there is a risk of inventory obsolescence** due to changes in customer preferences. It carries a significant risk of material misstatement and requires more judgment on part of statutory auditor in planning and performing procedures.

In such circumstances, statutory auditor **needs to perform procedures directly** like comparing net realizable value of products with costs to verify completeness of provisions, recomputing of provisions for obsolete stocks etc.

Therefore, in the given situation, **he should perform procedures directly in accordance with SA 610**.

## SA 620 Using the Work of an Auditor's Expert

**Q41.** KRP Ltd., at its annual general meeting, appointed **Mr. X, Mr. Y and Mr. Z as joint auditors** to conduct audit for the financial year 2022-23. **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 actuarial 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. Explain the **responsibility of auditors**, in case, **report made by Mr. Y's actuary, later on, was found faulty. (SM)**

**Answer**

**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 auditors 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 was found faulty. Further, Mr. Z is not in agreement 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 gross 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.**

**Q42.** X Ltd had a net worth of INR 1300 crores because of which Ind AS became applicable to them. The company had **various derivative contracts** – options, forward contracts, interest rate swaps etc. which were required to be fair valued for which company got the **fair valuation done through an external third party.** The **statutory auditors** of the company **involved an auditor's expert** to audit valuation of derivatives. Auditor and auditor's expert were new to each other i.e. they were working for the first time together but developed a good bonding during the course of the audit. The auditor **did not enter into any formal agreement with the auditor's expert**. Please advise **(SM)**

**Answer**

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In **certain situations, the need for a detailed agreement in writing is required** like -

(1) Auditor's expert will have **access to sensitive or confidential entity information**.
(2) Matter to which the auditor's expert's work relates is **highly complex.**
(3) Auditor has **not previously used work performed by that expert**.
(4) Greater the **extent of the auditor's expert's work, and its significance** in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, **auditor should have signed a formal agreement**/ engagement letter with the auditor's expert in respect of the work assigned to him.

---

**Q43.** CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the **specific procedure** which CA Dabu **should follow to evaluate the adequacy of work performed by Mr. Jay.**

**Answer**

**Evaluating the Adequacy of the Auditor's Expert's Work:** As per SA 620 on "Using the Work of an Auditor's Expert", **specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:**

- **Inquiries** of the auditor's expert.
- **Reviewing** the auditor's expert's working papers and reports.
- **Corroborative procedures**, such as:
    - Observing the auditor's expert's work;
    - Examining published data, such as statistical reports from reputable, authoritative sources;
    - Confirming relevant matters with third parties;
    - Performing detailed analytical procedures; and
    - Re-performing calculations.

• **Discussion with another expert** with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
• **Discussing** the **auditor's expert's report with management.**

Therefore, as per SA 620 on "Using 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:**

(i) The **relevance and reasonableness** of that expert's findings or conclusions, and **their consistency with other audit evidence**;
(ii) If that expert's work **involves use of significant assumptions and methods**, the relevance and reasonableness of those assumptions and methods in the circumstances; and
(iii) If that 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.

If the auditor determines that the work of the auditor's expert **is not adequate for the auditor's purposes,** he shall:

(a) **Agree** with that expert on the **nature and extent** of further work to be performed by that expert;
(b) Perform **further audit procedures** appropriate to the circumstances.

---

**Q44.** O Ltd. is in the business of manufacturing of steel. The manufacturing process requires raw material as iron ore for which large stock was maintained by the company at year end – 31 March 2019. The nature of raw material is such that its physical verification requires involvement of an expert. Management hired their expert for stock take and auditors also involved auditor's expert for the stock take.
The auditor observed that the work of the auditor's expert was not adequate for auditor's purposes and the auditor could not resolve the matter through additional audit procedures which included further work performed by both the auditor's expert and the auditor. Basis above, the **auditor concluded** that it would be **necessary to express a modified opinion** in the auditor's report because the auditor has not obtained sufficient appropriate audit evidence. However, the **auditor issued a clean report and included the name of the expert** in his report **to reduce his responsibility for the audit opinion**. Comment.

**Answer**

As per SA 620, Using the work of an Auditor's Expert, if the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence

In addition, the auditor **shall not refer to the work of an auditor's expert** in an 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 auditor shall **indicate** in the auditor's report that the reference **does not reduce the auditor's responsibility for the audit opinion.**

**If auditor makes reference** to the work of an auditor's expert in the auditor's report because

**such reference is relevant to an understanding of a modification** to the auditor's opinion, the auditor shall **indicate** in the auditor's report that such reference **does not reduce the auditor's responsibility for that opinion.**

In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a clean report. Auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of auditor's expert does not reduce his responsibility for that opinion.

---

**Q45.** While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. **What types of reports/opinions he can obtain and to what extent he can rely upon the same?**

**Answer**

As per SA 620, "Using the Work of an Auditor's Expert", during the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert.

While doing audit, Ram, the auditor can obtain the following types of reports, or options or statements of an expert for the purpose of audit evidence:

(1) **Valuation of complex financial instruments,** land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.

(2) The **actuarial calculation of liabilities** associated with insurance contracts or employee benefit plans.

(3) The **estimation of oil and gas reserves.**

(4) The **valuation of environmental liabilities**, and site clean-up costs.

(5) The **interpretation of contracts, laws and regulations.**

(6) The **analysis of complex or unusual tax compliance issues**.

When the auditor intends to use the work of an expert, he shall evaluate the adequacy of the auditor's expert's work, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; if that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and if that expert's work involves the use of source data that is significant to his work, the relevance, completeness, and accuracy of that source data.

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, he shall agree with that expert on the nature and extent of further work to be performed by that expert; or perform further audit procedures appropriate to the circumstances.

---