

**SA 210:**

---

**RTP Nov 2019 Q no. 12**

Mr. Ram Kapoor, Chartered Accountant, has been appointed as the statutory auditor by XYZ Private Limited for the audit of their financial statements for the year 2018-19. The company has mentioned in the audit terms that they will not be able to provide internal audit reports to Mr. Ram during the course of audit.

Further, company also imposed some limitation on scope of Mr. Ram.

1. What are the preconditions Mr. Ram should ensure before accepting/ refusing the proposal?
2. Also advise, whether Mr. Ram should accept the proposed audit Engagement?

**Answer:**

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

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the auditor with:

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

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

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

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

**MTP-Apr-19 Q No 5(a) 4 Marks:**

AKJ Ltd. is a small-sized 30 years old company having business of manufacturing of pipes. Company has a plant based out of Dehradun and have their corporate office in Delhi. Recently the company appointed new firm of

Chartered Accountants as their statutory auditors. The statutory auditors want to enter into an engagement letter with the company in respect of their services but the management has contended that since the statutory audit is mandated by law, engagement letter may not be required.

Auditors did not agree to this and have shared a format of engagement letter with the management for their reference before getting that signed. In this respect management would like to understand that as per SA 210 (auditing standard referred to by the auditors), if the agreed terms of the engagement shall be recorded in an engagement letter or other suitable form of written agreement, what should be included in terms of agreed audit engagement letter

**Answer**

As per SA 210 Agreeing the Terms of Audit Engagements The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- a. The objective and scope of the audit of the financial statements;
- b. The responsibilities of the auditor;
- c. The responsibilities of management;
- d. Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- e. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content

**RTP Nov'2020 Q No 13(a)**

MEA Limited is a listed company having its operation across India. MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20. After making sure that all of them are qualified to be appointed as statutory auditor, MEA Limited issued engagement letter to all of them.

But Mr. X was not clear on some points, so he requested MEA Limited to slightly change the terms of his engagement. This change will not impact the ultimate opinion on the financial statement. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor and identification of framework applicable. It also contains the reference to expected form and content of report from all three joint auditors. In your opinion what was the discrepancy in the Audit engagement letter issued by MEA Limited.

**Answer**

As per SA 210 Agreeing the Terms of Audit Engagements The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

- a. The objective and scope of the audit of the financial statements;
- b. The responsibilities of the auditor;
- c. The responsibilities of management;
- d. Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- e. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content

In the given scenario, MEA Limited appointed Mr. X, Mr. Y and Mr. Z, as its joint auditors for the year 2019-20 and issued engagement letter to all of them. The engagement letter contains the details on objective and scope of audit, responsibilities of auditor, identification of framework applicable and reference to expected form and content of report from all three joint auditors. However, engagement letter issued by MEA Ltd. does

not specify the responsibilities of management, whereas as per SA 210, it should also specify responsibilities of management

## SA 220:

---

### MTP Apr 18 Qn no.1(a) 5 Marks

Rishikumar & Co. has been appointed as an auditor of PK Ltd. for the financial year 2016 -17. CA. Kumar, one of the partners of M/s Rishikumar & Co., completed entire routine audit work by 29th May, 2017. Unfortunately, on the very next morning, while roving towards office of PK Ltd. to sign final audit report, he met with a road accident and died. CA. Rishi, another partner of M/s Rishikumar & Co., therefore, signed the accounts of PK Ltd., without reviewing the work performed by CA. Kumar. Advise, whether CA. Rishi is right in expressing an opinion on financial statements the audit of which is performed by another auditor.

Answer:

Relying on Work Performed by Another Auditor: As per SA 220 "Quality Control for an Audit of Financial Statements", an engagement partner taking over an audit during the engagement may apply the review procedures such as the

1. work has been performed in accordance with professional standards and regulatory and legal requirements;
2. significant matters have been raised for further consideration;
3. appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
4. there is a need to revise the nature, timing and extent of work performed;
5. the work performed supports the conclusions reached and is appropriately documented;
6. the evidence obtained is sufficient and appropriate to support the auditor's report;
7. and the objectives of the engagement procedures have been achieved.

Further, one of the basic principles, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information.

However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics. However, the auditor should carefully direct, supervise and review work delegated. He should obtain reasonable assurance that work performed by other auditors/experts and assistants is adequate for his purpose.

In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Kumar. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Rishi signed the report relying on the work performed by CA. Kumar. Here, CA. Rishi is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Kumar provided he further exercises adequate skill and due care and review the work performed by him as required in compliance with SA 220.

### MTP-OCT-18 Qn No 1(a) 5 Marks:

OP & Associates are the statutory auditors of BB Ltd. BB Ltd is a listed company and started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the

documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Engagement partner had completed his reviews in entirety by May 10, 2018.  
Comment.

**Answer**

Review by Engagement Partner: As per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:

- A. Determine that an engagement quality control reviewer has been appointed;
- B. Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- C. Not date the auditor's report until the completion of the engagement quality control review.

SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.

In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018. Thus, in the given case, signing of auditor's report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.

**RTP May 2019 Qn no 11(C), MTP-OCT-19 Qn No 6(c) 4 Marks:**

During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220.

**Answer**

As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:

- A. Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- B. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- C. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.

The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action. Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

## SA 230:

---

### 1. RTP May 2019 Qn no 2

Ram & Shyam Co LLP is an old firm of Chartered Accountants with Ram and Shyam as the audit partners. The firm has various statutory audit and internal audit engagements which are looked after by Ram and Shyam respectively. In the previous year ended 31 March 2018, one of the audit engagements of the firm was picked up for peer review and peer reviewer raised various observations regarding the audit documentation. Some of the information regarding audits were missing from the audit files as per the observation of the peer reviewer.

Ram & Shyam are in the process of establishing a robust mechanism for audit documentation so that the same is available for a long duration and would lead to audit efficiencies also in the future years. Ram and Shyam would like to understand the period for which audit documentation should be maintained by them as per the Standard on Auditing 230. Please advise.

- a. 10 years.
- b. 9 years.
- c. 8 years.
- d. 7 years.

### 2. RTP May 2020 Qn no 11(C)

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

#### Answer:

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

- (i) The size and complexity of the entity.
- (ii) The nature of the audit procedures to be performed.
- (iii) The identified risks of material misstatement.
- (iv) The significance of the audit evidence obtained.
- (v) The nature and extent of exceptions identified.
- (vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- (vii) The audit methodology and tools used.
- (viii) Timely preparation of Audit Documentation.

**SA 240:**

---

**Descriptive Questions 1. RTP Nov 2019 QN no 2(b)**

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

**Answer:**

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. Keeping in view the above, it is clear that Company has passed fictitious journal entries near year end to manipulate the operating results. Also Auditor's enquiry elicited a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service, is not acceptable. Accordingly, the auditor would adopt the following approach. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

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

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

(iii) If the auditor withdraws:

(1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed. The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2020, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

**MTP-OCT-19 Qn No 6(a) 5 Marks:**

Mr. Shah is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers. Mr. Shah is evaluating options for verifying the process in detecting fraud and the corrective action to be taken in such cases. As an expert, you are required to advise Mr. Shah as how inventory fraud occurs and the verification procedure to be followed for detecting the same.

**Answer:**

Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

(i) Employees may simply remove goods from the premises.

(ii) Theft of goods may be concealed by writing them off as damaged goods, etc.

(iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system. The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales.

This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer.

For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required

## Study Material

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

---

### Answer:

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

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

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

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

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ` 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ` 1 crore) within such time and in such manner as may be prescribed

The auditor is also required to report as per Clause (x) of Paragraph 3 of CARO, 2020, Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall

- (i) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (ii) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (iii) If the auditor withdraws:

(1) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(2) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal

## SA 250:

---

### 1. MTP Mar 2019 Qn no 17 (2 Marks)

KJA Ltd is in the business of consultancy services. The business of the company has been growing significantly and considering the nature of business, it becomes subject to various laws and regulations. Compliances have also increased because of this and management has found this very difficult to keep in pace with the changing regulatory requirements. The statutory auditors of the company, Shilpa & Associates, have considered compliance with laws and regulations as a significant risk for the purpose of their audit. Auditors had a audit planning meeting with the management and management has understood that it will be their responsibility including those charged with governance to ensure that the company's operations are fully compliant with the provisions of various laws and regulations. This may also have an impact on the reported amounts and disclosures in the financial statements of the company. Management is planning to ensure full compliance and may implement policies and procedures, wherever required, to assist in the prevention and detection of noncompliance with laws and regulations. Please suggest among the following which one will not be a policy/ procedure to be implemented to assist in the prevention and detection of non-compliance with laws and regulations in accordance with SA 250?

- (a) Maintaining a register of significant transactions of the company with comparison to particular industry and a record of complaints.
- (b) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- (c) Developing, publicising and following a code of conduct.
- (d) Instituting and operating appropriate systems of internal control.

### May 2018 -4(b)-4 Marks

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

### Answer

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

- Investigations by regulatory organisations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.

- Unusual payments towards legal and retainer ship fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorised transactions or improperly recorded transactions.
- Adverse media comment.

**MAY 2018 RTP Qn no. 1(d)**

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

---

**ANSWER**

Compliance with Other Laws: As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement

## SA 260:

---

### [Nov. 20 – Old Syllabus (5 Marks)]

Mr. BK, Partner in M/s. BK and Associates, as part of their audit presentation to the Audit Committee of M/s. XYZ Limited, a listed company, highlighted the following:

- Difficulties faced during the audit
- Disagreements with the management
- Management Letter Points
- Draft Management Representation letter to be provided by the Company in connection with the audit.

Some of the Audit Committee members were not happy with the above presentation and asked Mr. BK to take it back and submit directly to the Board. They believe that Audit Committee is not the forum for discussing such problems and this has to be sorted out between auditors and the management. Please comment on the above.

### Answer

Ans.: Mandatory Review Areas of Audit Committee:

- As per SA 260 “Communication with Those Charged with Governance,” statutory auditor of the Company is having an obligation to bring certain matters to the attention of TCWG, which inter alia includes aspects such as -

- (a) Difficulties faced by them during the audit
- (b) Disagreements with the management
- (c) Management Letter Points
- (d) Draft Management Representation letter to be provided by the Company in connection with the audit.

- Further, the Audit Committee is also having an obligation to mandatorily review certain areas before providing their recommendations/inputs to the board. Given below are the areas required to be mandatorily reviewed by the ACM in the case of listed companies.

- (i) Management discussion and analysis of financial condition and results of operations;
- (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
- (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
- (iv) Internal audit reports relating to internal control weaknesses;

- The auditor should further ascertain whether the Management Discussion and Analysis report includes discussion on the matters stipulated. Where certain deficiencies or adverse findings are noted by the Audit Committee, the auditor will be required to see that these have been suitably dealt with by the management in the report on corporate governance.

- In the instant case, Mr. BK, Partner in M/s BK and Associates highlighted the facts such as difficulties faced during the audit, disagreements with the management, managements letters points and draft management letters to be provided by the Company in connection with the audit.

However, some of the audit committee members were not happy and as according to them audit committee is not the forum for discussing such problems.

Conclusion: Contentions of those audit committee members regarding problems to be sorted out between auditors and the management is not in order as Audit Committee is required to mandatorily review the same in accordance with Schedule II of SEBI (LODR) Regulations, 2015.

**SA 265:**

---

**RTP May 2020 Qn no 12(b) 4 Marks,**

**MTP-OCT-18 Qn No 5(e) 4 Marks:**

**RTP Nov 18 Qn no 4**

During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

**Answers:**

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

## SA 299:

---

### 1. MTP-Apr-19 Qn No 1(a) 5 Marks:

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

#### Answer:

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

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

Each joint auditor is entitled to assume that:

- A. The other joint auditors have carried out their part of the audit work and the work has actually been performed in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.
- B. The other joint auditors have brought to said joint auditor's notice any departure from applicable financial reporting framework or significant observations that are relevant to their responsibilities noticed in the course of the audit.

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

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

### 2. May 2019 Qn no 1(b) 5 Marks

Dice Ltd. appointed two CA firms MN & Associates and PQ & Co. as joint auditors for conducting audit for the year ended 31st March, 2019. In the course of audit, it has been observed that there is a major understatement in the value of inventory. The inventory valuation work was looked after by MN & Associates but there was no documentation for the division of the work between the joint auditors.

Comment on the above situation with regard to responsibilities among joint auditors.

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

In respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate audit of the work performed by him. On the other hand all the joint auditors are jointly and severally responsible –

- (i) The audit work which is not divided among the joint auditors and is carried out by all joint auditors;
- (ii) Decisions taken by all the joint auditors under audit planning phase concerning the nature, timing and extent of the audit procedure to be performed by each of the auditor;
- (iii) Matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) Examining that the financial statements of the entity comply with the requirements of the relevant statute;
- (v) Presentation and disclosure of financial statements as required by the applicable financial reporting framework;
- (vi) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

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

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

In the instant case, Dice Ltd. appointed two CA Firms MN & Associates and PQ & Co. as joint auditor for conducting audit. As observed during the course of audit that there is a major understatement in the value of inventory and the inventory valuation work was looked after by MN & Associates. In view of SA 299 MN & Associate will be held responsible for the same as inventory valuation work was looked after by MN & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

### **Study Material**

KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2018-19. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed

to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

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

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

### Answers

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

- A. the audit work which is not divided among the joint auditors and is carried out by all joint auditors;
- B. decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors.
- C. matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- D. examining that the financial statements of the entity comply with the requirements of the relevant statutes;
- E. presentation and disclosure of the financial statements as required by the applicable financial reporting framework;
- F. ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.
- G. it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;
- H. the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors
- I. each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

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

auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s).

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

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

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

## SA 315:

---

### Nov 18 Qn no 6(a) 4 Marks

The identified risks are assessed by Auditor as to its significance on account of its likely impact, by way of material misstatement appearing in financial statements or by affecting internal control system. What may be the points of indication that may direct the Auditor to judge that the risks identified may be significant?

#### Answer:

Points of Indication that may direct the Auditor to Judge that the Risks Identified may be Significant:

As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment", as part of the risk assessment the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- Whether the risk is a risk of fraud;
- Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- The complexity of transactions;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

### 1.RTP May 2018 Qn no.4(a)

While commencing the statutory audit of Alex Co. Ltd., what would you consider as an auditor to assess risk of material misstatement and responses to such risks?

#### Answer

Considerations of Auditor for Assessing the Risk of Material Misstatement: As per SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment", the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

(i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;

(i) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

(ii) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and

(iii) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

#### **RTP May 2020 Qn no 20(d)**

Understanding and documenting automated environment.

#### **Answer:**

Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

- The applications that are being used by the company;
- Details of the IT infrastructure components for each of the application;
- The organisation structure and governance;
- The policies, procedures and processes followed;
- IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230

#### **Study Material**

SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" categorises the types of assertions used by the auditor to consider the different types of potential misstatements that may occur. Briefly explain with example.

#### **Answer:**

Assertions used by the auditor to consider different types of potential misstatements:

SA 315 "Identifying and Assessing Risk of Material Misstatements through understanding the Entity and its Environment" requires the auditor to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence.

Assertions used by auditor with respect to transactions occurred during the year are:

1. Occurrence – transactions that have been recorded have occurred during the year.
2. Completeness – transactions have been recorded completely.
3. Accuracy – transactions have been recorded accurately.
4. Cut-off – transactions have been recorded in correct accounting period.
5. Classification – transactions have been properly classified into capital and revenue.

Assertions used by auditor with respect to account balances at the period end are:

1. Existence – assets and liabilities shown in the balance sheet exists.
2. Rights and obligations – rights of the entity have been shown as assets and the obligations have been shown as liabilities.
3. Completeness – assets and liabilities have been recorded completely.

4. Valuation and allocation – assets and liabilities are included in the F.S. at appropriate amounts and any allocation adjustments are appropriately recorded.

Assertions used by auditor with respect to Presentation and Disclosure are:

1. Occurrence and Rights and obligations – disclosed transactions have occurred and belong to the entity.
2. Completeness – disclosures in the financial statements are complete.
3. Classification and understandability – financial information is appropriately presented and disclosures are clearly expressed.
4. Accuracy and Valuation – financial and other information are disclosed fairly and at appropriate amounts

### **Study Material**

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Explain.

### **Answer:**

Communication and enforcement of integrity and ethical values:

As per SA 315 “Identifying and Assessing Risk of Material Misstatements through understanding the Entity and its Environment” Communication and enforcement of integrity and ethical values are essential elements that influence the effectiveness of the design, administration and monitoring of controls.

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them.

Integrity and ethical behavior are the product of the entity’s ethical and behavioral standards, how they are communicated, and how they are reinforced in practice.

The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts.

The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example

**SA 320:**

---

**May 2018-1(c) – 5 Marks,  
MTP-Apr-19 Qn No 2(c) 5 Marks:**

Y & Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the Auditors have applied the concept of materiality for the Financial Statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard?

**Answers**

Re-evaluation of the Materiality Concept: In the instant case, Y & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re-evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company's business.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Y & Co. can re-evaluate the materiality concepts after considering the necessity of such revision.

**MTP-Aug-18 Qn No 2(d) 5 Marks:**

Mr. X was appointed as the auditor of M/s Easygo Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose.

**Answers**

SA 320 "Materiality in Planning and Performing an Audit" prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- (i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- (ii) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- (iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

(iv) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and

(v) The relative volatility of the benchmark

**Study Material.**

As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please, guide him.

**Answer**

Re-evaluation of the Materiality Concept: In the instant case, Mr. P, as an auditor of RST Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of additional information of significant contractual arrangements which draws attention to a particular aspect of the company's business.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

**SA 330:**

---

**RTP Nov 18 Qn no. 1(a), MTP-Oct-19 Qn No 2(a) 4 Marks:**

In the course of audit of ZED Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.

**Answer:**

As per SA 330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment. Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.