CHAPTER	
1	**Nature, Objective and Scope of Audit**

This Chapter Covers: Study's Chapter: 1

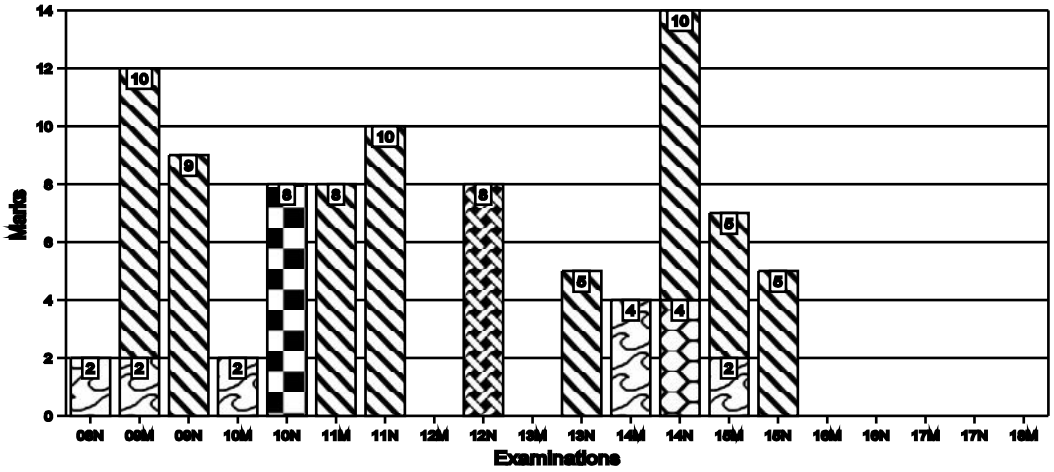
Chapter Comprises: *Meaning and Definition of Auditing ☞ Objectives of Audit ☞ Scope of Audit ☞ Types of Audit ☞ Inherent Limitations of Audit ☞ Relationship of Auditing with other disciplines ☞ Standard Setting Process ☞ Elements of a System of Quality Control ☞ Preconditions for an Audit ☞ Agreement of Audit Engagement Terms ☞ Recurring Audit.*

THE GRAPH . . . . . ***Trend Analysis***

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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TIME MANAGER								
		..... *Plan and Manage your Time*						
Time	***First In-depth learning***	***Instant Revision (in hours)***		***Periodic Revision (in hours)***				
	i.e..... ..... Day 1	Next day i.e.... ..... Day 2	After 7 days i.e. on ..... Day 8	After 30 days i.e. on ..... Day 30	After 60 days i.e. on ..... Day 60	After 90 days i.e. on ..... Day 90	Fix as per your need.	
1. Budgeted	16	4.00	3.12	2.20	1.35	1.35		
2. Actual								
3. Variance (1-2)								

QUICK LOOK		
	..... *Weightage Analysis*	
Repeatedly Asked Questions	**Common Answered Questions**	**Must Try Question**
	7.2, 9.1	3.1, 5.1, 7.3, 11.3

1 *Meaning and Definition of Auditing*

Q.1.1	**2010 - May [1] (ii)**	**Objective**

State with reasons (in short) whether the following statement is True or False:
The auditor compares entries in the books of accounts with vouchers and if two agrees, his work is done. (2 marks)

Answer:
False : The totaling of entries in the books with vouchers shows fairness of financials statements. But auditor has to determine reliability of annual statement of accounts alongwith the truth and fairness.

2 *Objective of Audit*

Q.2.1	2015 - May [2] (viii)	Objective
State with reasons (in short) whether the following statement is correct or incorrect: The basic objective of audit does not change with reference to nature, size or form of an entity. (2 marks)		

Answer:
Correct: The meaning and nature of audit does not change with the nature or size of entity, audit is examination of true and fair view of statement of any entity irrespective of its size and legal structure as defined in definition of audit.

3 *Scope of Audit*

Q.3.1	2009 - May [3]	Descriptive
In auditing, the auditor checks the specific assertions of the items appearing in the financial statements and opines about the overall assertions they signify. Explain specific assertions and overall assertions in this context. (10 marks)		

Answer:
Auditor checks specific assertions that the items of financial statements misleaded and also gives his opinion in the form of overall assertion in respect of financial statements taken as a whole.

The specific assertions are:		
1.	**Existence**	An asset or liability exists at a given date.
2.	**Rights and obligations**	An asset is a right of an entity and a liability is an obligation of the entity at a given date.
3.	**Occurrence**	A transaction or event took place which pertains to the entity.
4.	**Completeness**	There are no unrecorded assets, liabilities or transactions.
5.	**Valuation**	An assets or liability is recorded at an appropriate carrying value.
6.	**Measurement**	A transaction is recorded in the proper amount and revenue or expense is allocated to proper period.
7.	**Presentation and Disclosure**	An item is disclosed, classified and described in accordance with the acceptable accounting policies and, when applicable, legal requirements.

The overall assertion opined by the auditor about the financial statements are:

(i) The profit and loss account gives a true and fair view of the results - profit or loss for the period ended on the last date of the accounting period.

(ii) The balance sheet gives a true and fair view of the financial status or financial position of the entity as on the last date of the accounting period.

4 *Types of Audit*

Q.4.1	2011 - Nov [6] (b)	Descriptive
Discuss the types of audits required under law.		(5 marks)

Answer:
Legally audit is not compulsory for all the types of business organisation or institution. Thus it may be divided in two broad categories:
1. Statutory/Mandatory Audit
2. Voluntary/Independent Audit

1. Statutory Audit: It is an audit which is conducted under the control of law as under:

Enterprise	Governing Statute
Companies	Companies Act, 2013
Co operative Societies	Multi state Co operative Societies Act
Banking Co's	Banking Regulation Act, 1949, Banking Laws (Amendment), Act, 2012
Insurance Co's	Insurance Act & Companies Act
Electricity Co's	The Electricity Act, 2003
Public Charitable Trust	Indian Trust Act and also state enactments

2. Voluntary Audit : It is a purely optional audit and at the discretion of the governing body. Examples of enterprises of voluntary natures are individuals, private trust, partnership firm etc.

5 *Inherent Limitations of Audit*

Q.5.1	2008 - Nov [1] (xi)	Objective
State with reasons (in short) whether the following statement is True or False: "Auditor is not an Insurer". (2 marks)		

Answer:
True : SA – 200 i.e. "Overall objectives of the independent Auditor and the Conduct of an audit in accordance with standards of Auditing," states that auditor's opinion is not an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise. The auditor **does not insures** the interest of users of accounts but only states his opinion after taking all

reasonable care and skill, that the statements show a true and fair picture. The ultimate responsibility is of the management. The audit of financial statements does not relieve management of its responsibilities.

According to Companies Act 2013:

The financial statements shall give a true and fair view of the state of affairs of the company or companies as at the end of the financial year [Sec. 129(1) of 2013 Act].

The auditor's report shall state that:

to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and the profit or loss and cash flow for the year and such other matters as may be prescribed [Sec. 143(2) of the 2013 Act].

The aforesaid definition is very authoritative. It makes clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity. The definition given above is restrictive since it covers financial information aspect only. However, the scope of auditing is not restricted to financial information only, but, today it extends to variety of non-financial areas as well. That is how various expressions like marketing audit, personnel audit, efficiency audit, production audit, etc. came into existence. But here we should study only financial audit unless and until otherwise specified.

Q.5.2	2011 - May [3] (a)	Descriptive
Discuss limitations of audit.		(8 marks)

Answer:

Inherent limitations of Audit:

As per **SA-200, Overall Objectives of the Independent Auditor and the conduct of Audit in accordance with standards of auditing,** the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the

financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

The inherent limitations of an audit arise from:		
1.	**The Nature of Financial Reporting**	The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures.
2.	**Non co-operation by Management**	There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

3.	**Fraud may involve sophisticated and carefully organised schemes designed to conceal it**	Therefore, audit **procedures** used to gather audit evidence may be ineffective for detecting an **intentional** misstatement that involves, for example, collusion to falsify **documentation** which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
4.	**Timeliness of Financial Reporting and the Balance between Benefit and Cost**	The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit, Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.
5.	**Risk of failure of internal control**	Any system of internal check/control may become ineffective due to collusion among employees for doing fraud and fraud committed by top management itself.

6.	**Management's Fraud**	Risk of auditor not detecting a material misstatement resulting from management's fraud is greater than that of an employee's fraud because those charged with governance and management are often in a position that assumes their integrity and enables them to override the internal control procedures. For example- if a director of a company orders verbally the assistant not to record the sales made to particular party and to show the goods, sold as inventory, he is overriding the internally established procedure (internal control).

6 *Relationship of Auditing with other Disciplines*

Q.6.1	**2013 - Nov [1] {C} (b)**	**Descriptive**
Discuss the following: The discipline of behavioural science is closely linked with the subject of auditing. (5 marks)		

Answer:

Auditing is very much a discipline which involves review of various assertions both financial as well as non financial as regards his truthfulness. So audit can be performed in a better way only if the person also possesses a good knowledge about other disciplines.

The discipline of behavioural science is closely linked with subject of auditing. While carrying out audit activity an auditor is required to obtain information and explanations from the client's staff and he has also to interact with the client's staff in analysing the financial figures. So, the knowledge of human behaviour is very essential for an auditor. Thus knowledge of dealing with human being is indeed very essential for an auditor in order to discharge his duties.

Q.6.2	2014 - Nov [1] {C} (c)	Descriptive
Discuss the following: Indicate the factors which make it appropriate for an auditor to send a new Engagement Letter for a recurring audit. (5 marks)		

Answer:

Factors what make it appropriate for an auditor to send a new Engagement Letter for a recurring audit

Any indication that entity misunderstands the objective and scope of the audit.

Any revised or special terms of the audit engagement.

A recent change of senior management.

A significant change in ownership.

A significant change in nature or size of the Entity's business.

A change in legal or regulatory requirements.

A change in the financial reporting framework adopted in the preparation of the financial statements.

A change in other reporting requirements.

7 *Elements of a System of Quality Control*

Q.7.1	2007 - Nov [8] (b)	Short Notes
Write short note on the Quality control for audit work at firm level. (5 marks)		

Answer:

Under SA – 220, Quality Control for an audit of Financial Statement, an audit firm should implement quality control policies and procedures designed to ensure that all audits are conducted in accordance with Standard of Audit.

Following are the objectives of the quality control policies and procedure to be adopted by an audit firm:		
1.	**Professional requirements**	Personnel in the firm are to adhere to the principles of independence, integrity, objectivity, confidentiality and professional behaviour.
2.	**Skills and competence**	The firm is to be staffed by the personnel who have attained and maintained the technical standards and professional competence required to enable them to fulfill their responsibility with due care.
3.	**Assignment**	Audit work is to be assigned to personnel who have the required degree of technical, training, and proficiency required in the circumstances.
4.	**Delegation**	There should be sufficient direction, supervision and review of the work at all levels to provide reasonable assurance that the work performed keeps appropriate standards of quality.
5.	**Consultation**	Consultation with person of appropriate expertise, within or outside the firm is to be made whenever required.
6.	**Acceptance and retention of clients**	An evaluation of prospective clients and a review on an ongoing basis of existing clients is to be conducted. In making a decision to accept or retain a client, the firm's independence and ability to serve the client properly are to be considered.
7.	**Monitoring**	The continued adequacy and operational effectiveness of quality control policies and procedures are to be monitored.
8.	**Communication of quality control policies**	The firm's general quality control policies and procedures should be communicated in such a manner that provides reasonable assurance that they are understood and implemented.

Q.7.2	2008 - May [5] (b)	Descriptive
What is the importance of having the accounts audited by an independent auditor? (5 marks)		
OR	**2015 - May [1] {C} (a), RTP**	**Descriptive**
Advantages of independent audit. (5 marks)		

Answer:

Independent Audit		
1.	**Meaning**	Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.
2.	**Nature**	Independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence, which are imposed by law.
3.	**Visibility**	Independence of the auditor should not only exist, but should also appear to so exist to all reasonable persons. The relationship maintained by the auditor shall be such that no reasonable man can doubt his objectivity and integrity. There is a collective aspect of independence that is important to the accounting professional as a whole.

The advantages of an Independent Audit are :

1.	**Protection of interest**	It safeguards the financial interest of persons who are not associated with the management of the organization whether they are partners or shareholders.
2.	**Moral check**	It acts as a moral check on the employees from committing defalcations.

3.	**Tax liability**	Audited statements of account are helpful in settling liability for taxes.
4.	**Credit negotiation**	Financers and bankers use audited financial statements in evaluating the credit worthiness of individuals in negotiating loans.
5.	**Trade dispute settlement**	Audited statements are useful in settling the trade disputes for higher wages, or bonus, etc.
6.	**Control over inefficiency**	It helps in detection of wastages and losses and also helps in recommending ways to correct it.
7.	**Funds-in-trust**	It is an agency, which ensures that persons acting for others have properly accounted for the amounts collected by them.
8.	**Arbitration**	It is helpful in settling disputes by arbitration.
9.	**Appraisal**	Audit reviews the existence and operations of various controls in the organization and reports in adequacies, weaknesses, etc in them. Management can take suitable action based on the reports.
10.	**Assistance to government**	Government may require audited and certified statements before it gives assistance or issues a license for a particular trade.

Q.7.3	**RTP**	**Short Notes**
Write short note on Independence of an Auditor.		

Answer:

Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.

Independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence, which are imposed by law.

Independence of the auditor should not only exist, but should also appear to so exist to all reasonable persons. The relationship maintained by the auditor shall be such that no reasonable man can doubt his objectivity and integrity. There is a collective aspect of independence that is important to the accounting professional as a whole.

8 *Agreement of Audit Engagement Terms*

Q.8.1	2009 - Nov [4] (b)	Descriptive
Describe a set of instructions, which an auditor has to give to his client before the start of actual audit. (4 marks)		

Answer:

Set of instructions, which an auditor has to give to his client before the audit, known as letter of engagement.

Letter of Engagement:	
Meaning	A letter of engagement refers to a letter written by the auditor to his client in order to avoid any misunderstanding between them.
Purpose of the SA – 210, Agreeing the terms of Audit Engagements	Normally the objective and scope of an audit and auditor's duty and obligations are laid down in the applicable statute like Companies Act, 2013; RBI regulation for bank; or regulations and pronouncements of the Institute of Chartered Accountants of India (ICAI). In such a case to explain the terms of audit engagement by a letter by the auditor to the client is only informative. The purpose mentioned in SA - 210 is to establish standard on: 1. Agreeing with the terms of engagement with the client, and

	2. How the auditor should respond if the client requests for changes in terms of engagement.
Contents of Audit Engagement Letters	This letter should be sent before starting the audit. It should mention the following: 1. Objective of the audit of financial statements. 2. Responsibility of management regarding the following: (i) Financial statements are proposed on going concern basis. (ii) Selection of accounting policies. (iii) Consistently following the accounting policies. (iv) Maintenance of adequate accounting records. (v) Written representation by the management. (vi) Arrangement concerning the involvement of internal auditors and the other staff of the client. 3. The scope of the audit including reference to applicable laws and regulations and pronouncements of ICAI. 4. Test nature of audit, frauds & errors may remain undetected. 5. Unrestricted access to records. 6. The fact that audit process may be subjected to a peer review under the Chartered Accountants Act, 1949.
Following instructions are given by the auditor to the client before the start of audit	1. The accounts should be totaled up and trial balance and final accounts be kept ready. 2. Vouchers should be serially arranged. 3. Schedule of trade receivables and trade payables should be prepared. 4. Schedule of outstanding expenses, prepaid expenses and accrued income to be kept ready.

	5. A list of bad and doubtful debts should be prepared. 6. Schedule of investments should be prepared. 7. Certified list of goods returned to be prepared. 8. Statement of permanent capital expenditure to be prepared. 9. Schedule of deferred revenue expenditures to be prepared. 10. Names and addresses of managers and other officers should be kept ready.

9 *Recurring Audits*

Q.9.1	2011 - Nov [1] {C} (a)	Descriptive
"It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter." Explain those situations where new engagement letter is to be sent. (5 marks)		
OR	**2014 - Nov [1] {C} (c)**	**Descriptive**
Discuss the following: Indicate the factors which make it appropriate for an auditor to send a new Engagement Letter for a recurring audit. (5 marks)		

Answer:

As per SA - 210 i.e. "Agreeing the terms of audit engagement, In case of recurring audit, the auditor should consider:

1. Whether circumstances require the terms of engagement to be revised, and
2. Whether there is a need to remind the check of the existing terms of engagement.

In following circumstances the auditor may think it appropriate to send a new engagement letter to client:

1. Any indication that the client misunderstood the objective and scope of audit
2. Any revised and special terms of the engagement
3. Any recent change in board of directors, and senior managements.
4. New legal requirements, or pronouncements of the Institute of Chartered Accountants of India (ICAI)
5. Significant change in client's business.

Change in terms of engagement :

1. If a change is related to information that is incorrect or otherwise unsatisfactory the auditor should not agree to changed terms of engagement.
2. If the auditor is unable to agree to change the engagement then he should withdraw from it.

Q.9.2	2015 - Nov [1] {C}	Descriptive
Discuss the following: (c) 'P' an auditor decides not to send a new audit engagement letter to G Ltd. every year. Whether he is right in his approach? State the circumstances where sending new engagement letter, would be appropriate. (5 marks)		

Answer:

As per **SA-210, Agreeing the terms of Audit Engagements,** the auditor shall assess whether circumstances require the terms of audit engagement to be revised and whether there is a need to remind the entity of the existing terms.

It is not necessary to issue audit engagement letter each year for repetitive audit. Here 'P' an auditor decides not to send a new engagement letter to G Ltd. every year. So, the approach of the auditor is correct and appropriate.

The following are the circumstances where issue of the fresh engagement letter becomes mandatory:

(i) When it appears that the client has misunderstood the objective and scope of audit. In such case issue of engagement letter becomes necessary.

(ii) Where there has been change in management, board or ownership, so that it is felt that it is pertinent to remind them of the engagement terms again.

(iii) Where any revision by way of addition, deletion or modifications had been contemplated in the engagement letter originally issued.

(iv) Where significant changes had occurred in nature, volume of the business transactions of the client which warrant the scope and terms of engagement to be altered to be in tune with them.

(v) Where there has been necessity to modify audit approach to be in line with the pronouncements of ICAI, the Companies Act and the like.

Q.9.3	2010 - Nov [7] (c)	Practical
R & M Company, a firm of Chartered Accountants, was appointed as statutory auditors of XYZ Company Ltd. Draft an engagement letter accepting the appointment as auditors. (8 marks)		

Answer:

Engagement Letter for accepting the appointment as an Auditor : As per the SA 210, "Agreeing the Terms of Audit Engagements".

Draft of Engagement Letter :

To the Board of Directors of ABC Limited

You have requested that we audit the financial statements of ABC Company Limited, which comprise the Balance Sheet as at March 31, 2011, and the Statement of Profit & Loss, and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAS.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

Our audit will be conducted on the basis of acknowledgment provided by management or appropriate governance body.

1. For the preparation of financial statements that give a true and fair view in accordance with the Financial Reporting Standards. This includes:
   - the responsibility for the preparation of financial statements on a going concern basis.

the responsibility for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards. the responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

2. For such internal control as management determines, it is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
3. To provide us with :
   (i) Access, at all times, to all information, including the books, accounts, vouchers and other records and documentation, of the Company, whether kept at the head office of the company or elsewhere, of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
   (ii) Additional information that we may request from management for the purpose of the audit; and
   (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the Company such information and explanations as we may think necessary for the performance of our duties as auditor.

As part of our audit process, we will request from management and, where appropriate, those charged with governance, written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949 to be conducted by an Independent reviewer. The reviewer may inspect, examine or take abstract of our working papers during the course of the peer review. We look forward to full cooperation from your staff during our audit.

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.
Chartered Accountants
Firm's Registration No.
……
(Signature)
(Name of the Member)
(Partner or Proprietor)

Date :
Place :
Acknowledged on behalf of ABC Ltd. by
……..
(Signature)
Name and Designation
Date

10 *Acceptance of Change in Engagements*

Q.10.1	2009 - Nov [8] (a), RTP	Descriptive

X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.

Offer your comments in this regard. (5 marks)

Answer:

A letter of engagement refers to a letter written by the auditor to his client in order to avoid any misunderstanding between them as to the scope and objective of an audit.

Change in terms of engagement.

In the following circumstances the auditor may think it appropriate to send a new engagement letter to client.

1. Any indication that the client misunderstood the objective and scope of audit.
2. Any revised and special terms of engagement.
3. Any recent change in board of directors and senior management.
4. New legal requirements or pronouncement of ICAI.
5. Significant change in clients business

It should be kept in mind that

1. When the terms of engagement change both the auditor and the client should agree an new terms.
2. The auditor should not agree to change in terms where there is no reasonable justification for doing so.

Thus, as per the case in question, the auditor should not agree to change the terms of engagement as the auditor was unable to obtain sufficient evidence regarding receivable.

11 *Miscellaneous*

Error of Principle		
Q.11.1	**2008 - May [1] (i)**	**Objective**
State with reasons (in short) whether the following: statement is True or False: Procedural error arises as a result of transactions having been recorded in a fundamentally incorrect manner. (2 marks)		

Answer:

False : When transactions are recorded in fundamentally incorrect manner it is known as Error of Principle. For e.g. a distinction not being made between capital and revenue income or expenditure.

Procedural errors arise due to adoption of wrong accounting procedures.

Principle of Confidentiality		
Q.11.2	**2009 - May [1] (i)**	**Objective**
State with reasons (in short) whether the following statement is True or False: The principle of confidentiality precludes auditor to disclose the information about the client to third party at all circumstances without any exception. (2 marks)		

Answer:

False: The principle of confidentiality is one of the basic principles of auditing. Auditor is generally not expected to disclose the information of his client to others. He can disclose the information to others only when (a) permitted by his client, or (b) as per any statutory obligation dictated by any law.

Fundamental Accounting Assumption		
Q.11.3	**2014 - May [2] (ii), RTP**	**Objective**
State with reasons (in short) whether the following statements are correct or incorrect. (ii) Specific disclosure is required of the fundamental accounting assumptions followed in the financial statements. (2 marks)		

Answer:

(ii) **Incorrect:** As per AS - 1 Disclosure of Accounting Policies, if the company or firm does not follow the fundamental accounting assumptions viz., going concern, accrual, consistency then disclosures in the financial statements are required. If they follow the fundamental accounting assumptions then disclosures are not required.

Error of Commission		
Q.11.4	**2014 - May [2] (v)**	**Objective**
State with reasons (in short) whether the following statements are correct or incorrect. (v) 'Errors of commission' is where a transaction has been omitted either wholly or partially. (2 marks)		

(v) Incorrect: When wrong amount is entered either in the subsidiary books or in ledger accounts or when totals are wrongly made or when a wrong account is involved or when amount is posted on the wrong side, it is a case of error of commission.

Self Revealing Errors		
Q.11.5	**2014 - Nov [7] (b)**	**Short Notes**
Write short note on the Self-revealing errors and four illustrations thereof. (4 marks)		

Answer:

Self revealing errors: These are such errors the existence of which becomes apparent in the process of compilation of accounts.

A few illustrations of such errors are given hereunder, showing how they become apparent.

1.	Omission to post a part of a journal entry to the ledger.	Trial balance does not tally.
2.	Wrong totaling of the Purchase Register.	Control Account (e.g., the Sundry Creditors Account) balances and the aggregate of the balances in the personal ledger will disagree.
3.	A failure to record in the cash book amounts paid into or withdrawn from the bank.	Bank reconciliation statement will show up error.

4.	A mistake in recording amount received from X in the account of Y.	Statements of account of parties will reveal mistake.

From the above, it is clear that certain apparent errors balance almost automatically by double entry accounting procedure and by following established practices that lie within the accounting system but not being generally considered to be a part of it, like bank reconciliation or sending monthly statements of account for confirmation.

Auditing Vs Investigation		
Q.11.6	**2012 - Nov [4] (b), RTP**	**Distinguish Between**
Distinguish between Auditing and Investigation.		(8 marks)

Answer:

Both involve a systematic and critical examination of the available evidence, yet these are quite distinct from each other which is as follows:

S. No.	Basis of Difference	Auditing	Investigation
1.	**Meaning**	Auditing relates to the independent examination of financial information of any entity, when such an examination is conducted with a view to express an opinion.	Investigation relates to systematic, critical and special examination of the records of the business for a specific purpose.
2.	**Scope**	Audit covers all factual assertions in the financial statements to ascertain their truth and fairness.	Scope is limited as regards the period or area to be covered.

3.	**Object**	The object of an audit is to critically examine the financial statements and report on the truth & fairness of assertions.	Investigation aims at ascertaining certain facts such as fraud, tax liability, value of shares etc.
4.	**Coverage**	Auditing is a routine exercise for generally an accounting year.	Investigation may spread over a period longer than one year.
5.	**Purpose**	To enhance the degree of confidence of intended users in the financial statements.	To establish a fact or assessing a particular situation.
6.	**Appointment**	Auditor may be appointed by the owners or shareholders.	Investigator may be appointed by the owners or management or even third parties.
7.	**Procedure**	The audit is conducted in accordance with the Generally Accepted Auditing Procedure.	Investigation involves an extended auditing procedure.
8.	**Approach**	Auditor is skeptical and not suspicious.	Investigator starts his work with suspicion & collects evidence to either confirm or dispel that suspicion.
9.	**Evidence**	Audit evidence is persuasive.	Investigator relies on conclusive.

10.	**Extent of checking**	Test checking or sample checking is allowed.	In investigation particularly to detect frauds, test checking may not be advisable. It may be necessary to check 100%.
11.	**Report**	Auditor reports to the owners e.g. shareholders.	Investigator reports to the person on whose behalf he has undertaken the investigation.

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