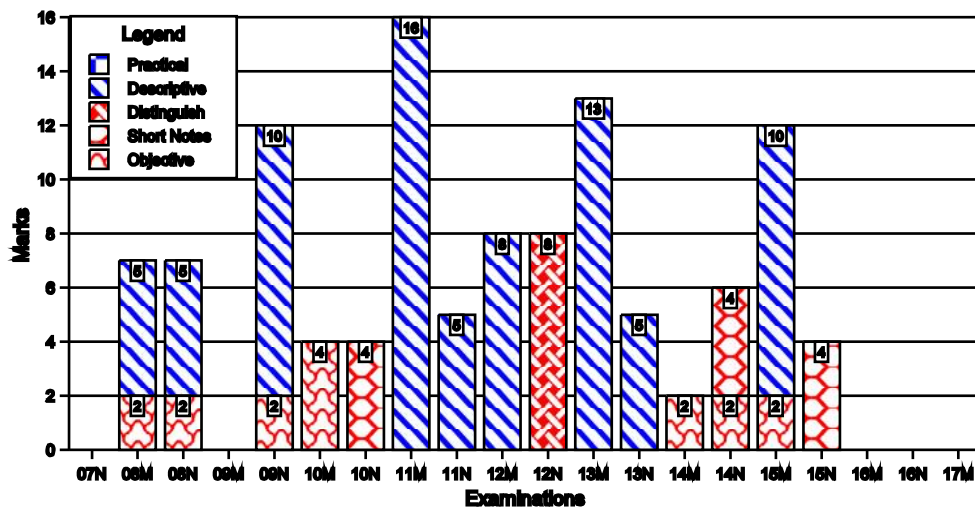


Star Rating

On the basis of Maximum marks from a chapter Nil
 On the basis of Questions included every year from a chapter Nil
 On the basis of Compulsory questions from a chapter ☆☆

| | |
|--|---------------------------|
| CHAPTER | |
| 1 | Nature of Auditing |
| THIS CHAPTER COMPRISES OF | |
| ☞ Introduction ☞ Nature and Purpose of Financial Statements ☞ Statements on Standard Auditing Practices ☞ Definition of Auditing ☞ Objective of Audit ☞ Basic principles governing Audit ☞ Scope of Audit ☞ Auditor's Engagement ☞ Inherent Limitations of Audit ☞ Audit and Investigation ☞ Types of Audit ☞ Advantages of Independent Audit ☞ Relationship of Auditing with other disciplines. | |

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



Bloom's Taxonomy (BT)

Keeps You Ahead During Learning

| | | |
|--|-----------------------------------|--|
| Basis On Which Questions Are Asked In Your Exam. So Learn In a Proper, Systematic & Scientific Way. | Low Level Thinking Skills | Level 1: Knowledge Level 2: Comprehension |
| | High Level Thinking Skills | Level 3: Application Level 4: Analysis Level 5: Synthesis Level 6: Evaluation |

Focus:

Analysis of this chapter on the basis of Bloom's Taxonomy

Objective and Descriptive Questions asked in your exam are based on Low Level Thinking Skill alongwith Application Skill, but Distinguish Between Questions requires High Level Thinking Skills Specially Analysis.

► OBJECTIVE QUESTIONS

2008 - May [1]

Based on BT's Level 1

State with reasons (in short) whether the following: statement is True or False:

- (i) 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.

2008 - Nov [1]

Based on BT's Level 2

State with reasons (in short) whether the following statement is True or False:

(xi) "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 insure** 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.

2009 - Nov [1]

Based on BT's Level 1&2

State with reasons (in short) whether the following statement is true or false.

- (iv) The auditor, in the interest of the users, while explaining the nature of his reservation, can describe the work of the expert with his name in the audit report without obtaining prior consent of the expert.

(2 marks)

Answer:

False : According to SA 620, "Using the work of an Auditor's Expert," if the auditor, in the interest of the users includes the name of the expert in his audit report, he can do so only after obtaining the prior consent of expert.

2010 - May [1]

Based on BT's Level 1&2

State with reasons (in short) whether the following statements are True or False:

- (ii) The auditor compares entries in the books of accounts with vouchers and if two agrees, his work is done. (2 marks)
- (vi) When an auditor identifies a Misstatement resulting from fraud, it is his responsibility to communicate it to the regulatory and enforcement authorities apart from those charged with governance. (2 marks)

Answer:

- (ii) **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.

Answer:

- (vi) **True :** According to SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", if an auditor identifies a misstatement resulting from fraud or error, it is his responsibility to communicate the matter with those charged with the governance and, in some circumstances, when so required by laws or regulations, to regulatory and enforcement authorities also.

2014 - May [2]

Based on BT's Level 1

State with reasons (in short) whether the following statement is correct or incorrect.

- (v) 'Errors of commission' is where a transaction has been omitted either wholly or partially. (2 marks)

Answer:

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.

2014 - Nov [2]**Based on BT's Level 1**

State with reasons (in short) whether the following statement is correct or incorrect:

- (ii) The primary objective of an audit is to detect fraud and errors in Financial Statements. (2 marks)

Answer:

Incorrect: The primary objective of auditor is to give an opinion on true and fair view of financial statements. It is secondary objective to detect fraud and errors.

2015 - May [2]**Based on BT's Level 1**

State with reasons (in short) whether the following statement is correct or incorrect:

- (viii) 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.

▶ SHORT NOTES**2010 - Nov [4]****Based on BT's Level 1**

Write short note on the following :

- (d) Factors governing modes of communication of auditor with those charged with governance. (4 marks)

Answer:

Factors governing modes of communication of auditor with those charged with governance :

According to **SA 260, “Communication with Those Charged with Governance”** the auditor may decide whether to communicate orally or in writing, the extent of detail or summarisation in the communication, and whether to communicate in a structured or unstructured manner may be affected by such factors as:

- The size, operating structure, control environment, and legal structure of the entity.
- Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
- In the case of an audit of special purpose financial statements, whether the auditor also audits the entity’s general purpose financial statements.
- The amount of ongoing contact and dialogue the auditor has with those charged with governance.
- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- Whether there have been significant changes in the membership of a governing body.

2014 - Nov [7]

Based on BT’s Level 1&3

Write short note on the following:

(b) 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.

2015 - Nov [7]

Based on BT's Level 1

Write short note on the following:

(d) Fraudulent financial reporting

(4 marks)

Answer :

Fraudulent Financial Reporting:

- Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.
- It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgements by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting.
- Such a situation could occur when due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements.
- In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

6.8**■ Solved Scanner IPCC Gr. II Paper - 6****Fraudulent financial reporting may be accomplished by the following:**

- Manipulation, falsification or alteration of accounting records or supporting documents from which the financial statements are prepared.
- Misrepresentation in or intentional omission from the financial statements of events, transactions or other significant information.
- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation or disclosure.

Fraudulent financial reporting often involves, management overrides of controls that otherwise may appear to be operating effectively.

D DISTINGUISH BETWEEN**2012 - Nov [4] (b)****Based on BT's Level 4**

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. |

Auditing & Investigation under Companies Act, 2013

- Audit never undertakes discovery of specific happenings and is never started with a preconceived notion about the state of affairs.
- The auditor seeks to report what he finds in the normal course of examination of the accounts adopting generally followed techniques unless circumstances call for a special probe: fraud, error, irregularity, whatever comes to the auditor's notice in the usual course of checking, are all looked into in depth and sometimes investigation results from the *prima facie* findings of the auditor.
- **But as per sub Sec. 12 of Sec. 143 of the Companies Amendment Act, 2015** Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as is prescribed under Rule 13 of Companies (Audit and Auditors) Rules, 2014.
Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under Section 177 or to the Board in other cases within such time and in such manner as may be prescribed.
Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.
- **Rules 13 of the Companies (Audit and Auditors) Rules, 2014,** describes that in case the auditor has sufficient 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 report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated

herein below:

- (a) Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;
 - (b) On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;
 - (c) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.
 - (d) Thereafter the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment Due or by Speed post followed by an e-mail in confirmation of the same.
 - (e) This report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.
 - (f) The report shall be in the form of a statement as specified in Form ADT-4.
- No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter above if it is done in good faith.
- (g) In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the

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■ **Solved Scanner IPCC Gr. II Paper - 6**

matter specifying the following:

- (i) Nature of Fraud with description;
 - (ii) Approximate amount involved; and
 - (iii) Parties involved.
- (h) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:
- (i) Nature of Fraud with description;
 - (ii) Approximate Amount involved;
 - (iii) Parties involved, if remedial action not taken; and
 - (iv) Remedial action taken.

Important Note: The provision of this rule shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under Sec. 148 and Sec. 204 respectively. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-Sec. (12) of Sec. 143, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

► **DESCRIPTIVE QUESTIONS**

2008 - May [5] (b)

Based on BT's Level 1&2

What is the importance of having the accounts audited by an independent auditor? (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 setting 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. |

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| 10. | Assistance to government | Government may require audited and certified statements before it gives assistance or issues a license for a particular trade. |
|-----|---------------------------------|--|

2008 - Nov [3] (a)

Based on BT's Level 1

What are the basic principles which govern the Auditor's professional responsibilities while doing Audit? (5 marks)

Answer:

| Basic Principles Governing an Audit | | |
|--|--|--|
| <p>SA 200 Overall Objectives of the Independent Auditor and the Conduct of Audit in accordance with standards of auditing discusses the basic principles that govern an audit. Though the standard has been developed in the context of independent audit of financial information, the principles listed therein are also applicable to a large extent to other types of audit. The standard lays down the following basic principles:</p> | | |
| 1. | Integrity, objectivity and independence | <p>The auditor should be straight forward, honest and sincere in his approach to his professional work.</p> <p>He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.</p> |
| 2. | Confidentiality | <p>The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.</p> |
| 3. | Skills and competence | <p>(i) The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing.</p> <p>(ii) The auditor requires specialised skills and competence which are acquired through a combination of general education,</p> |

| | | |
|------------------------------------|--|--|
| | | <p>technical knowledge obtained through study and formal courses concluded by a qualifying examination recognised for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments, including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.</p> |
| 4. Work performed by others | | <p>(i) When the auditor delegates work to assistants or uses work performed by other auditors 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. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 2013, the auditor's report should expressly state the fact of such reliance.</p> <p>(ii) The auditor should carefully direct, supervise and review work delegate to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.</p> |
| 5. Documentation | | <p>The auditor should document matters which are important providing evidence that the audit was carried out in accordance with the basic</p> |

| | | |
|--------------------------|--|--|
| | | principles. |
| 6. Planning | | <ul style="list-style-type: none"> (i) The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. (ii) Plans should be made to cover, among other things: <ul style="list-style-type: none"> (a) acquiring knowledge of the client's accounting system, policies and internal control procedures; (b) establishing the expected degree of reliance to be placed on internal control; (c) determining and programming the nature, timing, and extent of the audit procedures to be performed and (d) co-ordinating the work to be performed. (iii) Plans should be further developed and revised as necessary during the course of the audit. |
| 7. Audit evidence | | <ul style="list-style-type: none"> (i) The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. (ii) Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. (iii) Substantive procedures are test designed to obtain evidence as to the completeness, accuracy and validity of the data produced |

| | | |
|-----------|---|---|
| | | <p>by the accounting system. They are of two types:</p> <ul style="list-style-type: none">(i) tests of details of transactions and balances:(ii) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items. |
| 8. | Accounting system and internal control | <ul style="list-style-type: none">(i) Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.(ii) The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.(iii) Where the auditor concludes that he can rely on certain internal controls his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing. |

| | | |
|----|---------------------------------------|---|
| 9. | Audit conclusion and reporting | <p>(i) The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of the business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:</p> <p>(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied.</p> <p>(b) the financial information complies with relevant regulations and statutory requirements.</p> <p>(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.</p> |
|----|---------------------------------------|---|

2009 - Nov [3]

Discuss the basic principles governing an audit.

Based on BT's Level 1

(10 marks)

Answer:*Please refer 2008 - Nov [3] (a) on page no. 30***2011 - May [3] (a)**

Discuss limitations of audit.

Based on BT's Level 1

(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). |
|--|--|--|

2011 - May [3] (b)

Based on BT's Level 1

Discuss prerequisites and fundamental principles to be possessed by an auditor. (8 marks)

Answer:

Please refer 2008 - Nov [3] (a) on page no. 30

2011 - Nov [6] (b)

Based on BT's Level 1

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 Co-operative Societies Banking Co's Insurance Co's Electricity Co's Public Charitable Trust | Companies Act, 2013 Multi state Co-operative Societies Act Banking Regulation Act, 1949, Banking Laws (Amendment), Act, 2012 Insurance Act & Companies Act The Electricity Act, 2003 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 which are not governed by any provisions of the Income Tax Act, 1961.

2012 - May [6] (b) *Based on BT's Level 1*
What are the advantages of an independent audit? (8 marks)

Answer:

Please refer 2008 - May [5] (b) on page no. 29

2013 - May [1] {C} (a) *Based on BT's Level 1&2*
Discuss with reference to SAs:

- (i) The auditor shall communicate all significant findings with those charged with Governance. (5 marks)

Answer:

Please refer 2010 - Nov [4] (d) on page no. 22

2013 - May [3] (b) *Based on BT's Level 1*
Explain the basic principles governing audit. (8 marks)

Answer:

Please refer 2008 - Nov [3] (a) on page no. 30

2013 - Nov [1] {C} *Based on BT's Level 1&2*
Discuss the following:

- (b) 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.

2015 - May [1] {C} *Based on BT's Level 1*
Discuss the following:

- (a) Advantages of independent audit. (5 marks)

Answer:

Please refer 2008 - May [5] (b) on page no. 29

2015 - May [1] {C}**Based on BT's Level 1**

Discuss the following:

(c) Is detection of fraud and error duty of an auditor? (5 marks)

Answer:

As per SA-240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. In exercising oversight responsibility, those charged with governance consider the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.

- The primary responsibility for detection of fraud and error is of management only. However, if the auditor finds out any issues or doubts relating to financial statements creating possible frauds and errors then it shall become responsibility of the auditor to find out where such fraud exists.
- So, the auditor's primary duty is to provide opinion on the financial statement however, if the auditor finds out any frauds or errors of possibility of occurrence then he/she should perform extended audit procedure to find out where such fraud exists.
- If the auditor finds any frauds and errors resulting from mis-statement then he should communicate the same to the management or he should mention the same in his audit report.

So, we can conclude that it is not primary responsibility of the auditor to detect and correct fraud and error. However, if he finds any doubt of fraud and error that it will become the duty of auditor to detect the same.

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.

Auditors Responsibilities Relating to Fraud under Companies Act, 2013

Please refer KZ - 1 on page no. 26

KZ - 2

Knowledge Zone

Conditions or events which increase the risk of fraud or error.

As per **SA - 240 "The Auditors responsibilities relating to fraud in an audit of Financial Statements"** following are the conditions or events that increase the risk of fraud and error.

1. **Internal control faults** : Weakness in design of internal control system and non-compliance with laid down control procedure increase the risk of fraud & error.
e.g. A single person is responsible for the receipt of all posts, mails and marking it to relevant sections or two persons are responsible for the receipt of all posts & mails, but the same is not followed in actual practice etc.
2. **Doubts regarding the integrity and competence of the management** :
e.g. - One person effectively dominates the management.

- Complex corporate system and procedure are in force.
 - High turnover rate of key personnel.
 - Prolonged under-staffing.
 - Frequent changes in auditor, legal adviser etc.
3. **Unusual pressure within an entity :**
 e.g. - All round recession in the industry.
 - Inadequate working capital.
 - Increased risk taking to earn more profit.
 - Dependent on one or few product or customer.
 - Completion of financial statements in unusually short time.
4. **Unusual transactions :**
 e.g. - Transactions that have a significant effect on earnings, at the year end.
 - Transactions with related parties.
 - Excessively high payments for service like lawyers agents etc.
5. **Problems in obtaining sufficient appropriate audit evidence :**
 e.g. - Inadequate records.
 - Inadequate documentation of transaction.
 - Non-cooperation by the officials of the entity.
 - Non-confirmation by the hired parties.

KZ - 3

Knowledge Zone

Distinguish between Auditing, Accounting and Investigation

| | Basis | Accounting | Auditing | Investigation |
|----------|----------------|---|--|--|
| 1 | Meaning | Accounting is the art of recording, classifying and summarising financial informations transactions and events and preparation of reports there on. | An Audit is an independent examination of financial information of any entity when such an examination is conducted with a view to expressing an opinion there | Investigation implies systematic critical and special examination of the records of the business for a specific purpose. |

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■ *Solved Scanner IPCC Gr. II Paper - 6*

| | | | | |
|---|---------------------|--|---|--|
| | | | on. | |
| 2 | Objective | Recording of transaction from voucher and preparing financial statements. | To critically examine the financial statement and report on truth and fairness. | To ascertain certain facts such as fraud, tax liability, value of share etc. |
| 3 | Conducted by | Managements primary responsibility to maintain and implement effective accounting statement. | A Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. | Any person as appointed by the management. |
| 4 | Coverage | Done on a regular basis for a period of one accounting year. | It is a routine exercise generally for one accounting year. | It may spread over a period longer than an year. |
| 5 | Aspect | It involves recording aspect of financial statements. | It covers examination aspect of financial statements. | It covers investigation aspect of financial statement. |

Similarly Asked Questions*

| No. | Category | Question | Marks | Frequency |
|-----|-------------|---|-------|-----------|
| 1 | Descriptive | What are the basic principles which govern the Auditor's professional responsibilities while doing Audit? 08 - Nov [3] (a), 09 - Nov [3] | 5, 10 | 2 Times |

| | | | | |
|---|-------------|---|---------|---------|
| 2 | Descriptive | Advantages of independent audit. 08 - May [5] (b), 12 - May [6] (b), 15 - May [1] (a) | 5, 8, 5 | 3 Times |
|---|-------------|---|---------|---------|

Table Showing Marks of Compulsory Questions

| Year | 12 N | 13 M | 13 N | 14 M | 14 N | 15 M | 15 N | 16 M | 16 N | 17 M |
|-------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Descriptive | | 5 | 5 | | | 10 | | | | |
| Total | | 5 | 5 | | | 10 | | | | |

* This table contains the Similarly Asked Questions. Please pay more attention to such question.