



VIVITSU

STRIVING TOWARDS KNOWLEDGE

Paper 5

Auditing & Ethics

Chapter-wise compilation
of RTPs, MTPs and PYPs



*Modified as per
new scheme*



*Applicable for
Sept'24 & Jan'25*

SAMPLE MATERIAL



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HOW TO GET THE BEST OUT OF OUR MATERIAL?

1 INITIAL READING

After your initial reading of a particular chapter in your study material, go through the questions in our 3, 5, and 11 attempts compilations, focusing on the chapter you've just covered. Make note of challenging questions for later reference.

2 FIRST REVISION

During your first revision, revisit the marked questions. If you still can't answer them, highlight them in red and review the related concepts to improve your understanding. This process helps you to grasp the key concepts and address your weak points

3 KEEP GOING WITH THE REVISIONS

Repeat the reading and revision process as often as possible before your exams. Each iteration will enhance your confidence and knowledge.

4 EXAMINERS COMMENTS

Pay attention to the examiner's comments in our compilations, as they highlight common mistakes. Learning from these errors will help you avoid them in your exams



Frequently Asked Questions

1. Why RTP's, MTP's and PYP's?

RTP's, MTP's, and PYP's are extremely important to ensure that you reproduce ICAI language. These questions train you to understand what is important and what is expected of you. At least 41% of questions* are asked from previous RTP's, MTP's and PYP's.

2. What is included?

In this compiler, all questions from the last 3, 5 or 11 attempts depending on the one you have selected will be available. There will be references to the marks and the attempt from which they were asked. Identical or similar questions have been removed and references for both attempts are mentioned.

3. What is the benefit of Chapter-wise?

We have categorized each and every question from all Old RTPs, MTP's, and PYP's into chapters. This means that you don't have to wait until you've completed your entire syllabus to tackle an RTP, MTP, or past paper. You can start solving these questions to check your conceptual clarity right after finishing a particular chapter.

4. What does amended for the latest attempt mean?

When we reviewed all the questions from the past 11 attempts of RTP, MTP, and PYP'S, we didn't just segregate them Chapterwise; we also updated them to reflect the latest provisions. All the answers provided in the compilation are applicable for the May 2024 examination. So, there's no need to stress about outdated or incorrect information.

5. How are Old RTP's, MTP's & PYP's beneficial for me?

All old RTPs, MTPs, and PYPs have been organized according to the new syllabus issued by ICAI. This means that if a specific chapter from the old scheme is not included in the new scheme, it has been omitted. If a particular chapter in the new scheme is based on concepts from two or more chapters in the old scheme, it has been adapted to align with how the chapter should be in the new scheme. If a chapter is only partially included in the new scheme, the questions related to those specific concepts are only included in the corresponding chapter of the new scheme. A comprehensive reconciliation of the chapters between the new scheme and the old scheme is provided on the following page.

6. What if a new attempt is added post my purchase?

If you have purchased materials for the May 2024 attempt, you will receive a file with the questions segregated Chapterwise specifically for that attempt.

7. What does N/A mean?

It could mean any of the following:

1. No questions from that chapter have been included in the selected attempts.
2. The chapter is newly introduced, and as a result, no questions have been previously asked in RTP's, MTP's, or PYP's.

Auditing and Ethics

Reconciliation of chapters of the new scheme (May'24) with old course

Sr No	Chapter Name as per New Syllabus	Old Chapter No.	Old Chapter Name
1	Chapter 1: Nature, Objective and Scope of Audit	1.1, 1.3 & 1.4	
1.1	Auditing Concepts	1.1	Auditing Concepts
1.2	Engagement Standards	1.3	Engagement Standards
1.3	SA 200-Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing	1.4	SA 200
2	Chapter 2: Audit Strategy, Audit Planning and Audit Programme	2.1	SA 300
3	Chapter 3: Risk Assessment and Internal Control	4.1,4.3,2.2, 4.2 & 6	SA 315, SA 320, Key concepts
4	Chapter 4: Audit Evidence	3.2, 3.3, 3.4, 3.5, 3.6, 7,8,14.4	
4.1	SA 500- Audit Evidence	3.2	SA 500
4.2	SA 610- Using the Work of Internal Auditors	14.4	SA 610
4.3	Audit Sampling	7	Audit Sampling
4.4	SA 501- Audit Evidence-Specific Considerations for Selected Items	3.3	SA 501
4.5	SA 505- External Confirmations	3.4	SA 505
4.6	SA 510- Initial Audit Engagements – Opening Balances	3.5	SA 510
4.7	SA 550- Related Parties	3.6	SA 550
4.8	Analytical Procedures	8	Analytical Procedures
5	Chapter 5: Audit of Items of Financial Statements	9	Chapter 5: Audit of Items of Financial Statements
6	Chapter 6: Audit Documentation	3.1	SA 230

7	Chapter 7: Completion and Review	3.7, 3.8,3.9, 3.10, 14.2	
7.1	SA 560- Subsequent Events	3.7	SA 560
7.2	SA 570- Going Concern	3.8	SA 570
7.3	SA 450- Evaluation of Misstatements Identified during Audit	New	
7.4	SA 580- Written Representations	3.9	SA 580
7.5	SA 260- Communication with Those Charged with Governance	3,10	SA 260
7.6	SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	14.2	SA 265
8	Chapter 8: Audit Report	11.1, 11.2, 11.3, 11.4, 11.5, 10, 5, 14.5, 14.3	
8.1	SA 700- Forming an Opinion and Reporting on Financial Statements	11.1	SA 700
8.2	SA 705- Modifications to the Opinion in the Independent Auditor's Report	11.3	SA 705
8.3	SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	11.4	SA 706
8.4	SA 701- Communicating Key Audit Matters in the Independent Auditor's Report	11.2	SA 701
8.5	SA 710- Comparative Information— Corresponding Figures and Comparative Financial Statements	11.5	SA 710
8.6	Audit of Branch Office Accounts 128(1)	14.5	SA 600
8.7	Joint Audit	14.3	SA 299
8.8	Reporting Requirements under Companies Act	10	Company Audit
8.9	CARO	10	Company Audit
9	Chapter 9: Special Features of Audit of Different Type of Entities	13	Chapter 9: Special Features of Audit of Different Type of Entities
10	Chapter 10: Audit of Banks	12	Chapter 10: Audit of Banks

11	Chapter 11: Ethics and Terms of Audit Engagements	1.5, 1.2, 1.6, 1.1, 1.4	
11.1	Ethics	1.1 & 1.4	Auditing Concepts & SA 200
11.2	SA 210- Agreeing the Terms of Audit Engagements	1.5	SA 210
11.3	SQC 1- Quality Control for Firms which Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Service Engagements	1.2	SQC 1
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MTPs: March'19, April'19, Oct'19, May'20, Oct'20, March'21, April'21, Oct '21, Nov '21, March '22, April '22, Sep '22, Oct '22, March '23, April '23, Sep '23, Oct '23, March'24 & April '24

PYPs: May'19, Nov'19, Nov'20, Jan'21, July '21, Dec '21, May'22, Nov '22, May'23, Nov'23

RTPs: May'19, Nov'19, May'20, Nov'20, May'21, Nov '21, May '22, Nov '22, May '23, Nov '23, May'24





Chapter 1 Nature, Objective and Scope of Audit

Question 1

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters. (Old SM, RTP Nov'23)

Answer 1

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

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Question 2

"An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. (MTP 4 Marks Oct'19)

The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing. (RTP May '20)

Answer 2

"An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Analysis of the Definition

1. Audit is Independent examination of Financial information.
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.
The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:
 - (i) the accounts have been drawn up with reference to entries in the books of account;
 - (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
 - (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
 - (iv) the information conveyed by the statements is clear and unambiguous;
 - (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Question 3

The relationship between auditing and law is very close one. (MTP 4 Marks Oct 19, RTP Nov '18)

Answer 3

The relationship between auditing and law: The relationship between auditing and law is very close one. Auditing involves examination of various transactions from the view point of whether or not these have been properly entered into. It necessitates that an auditor should have a good knowledge of business laws affecting the entity. He should be familiar with the law of contracts, negotiable instruments, etc. The knowledge of taxation laws is also inevitable as entity is required to prepare their financial statements taking into account various provisions affected by various tax laws. In analysing the impact of various transactions particularly from the accounting aspect, an auditor ought to have a good knowledge about the direct as well as indirect tax laws.

Question 4

Examine with reasons (in short) whether the following statements are correct or incorrect: Mr. Z, a team member of auditor of Grateful and Competent Limited was of the opinion that while conducting an audit of a company no distinction is required to be made between revenue expenditure and capital expenditure. (MTP 2 Marks Oct'20)

Answer 4

Incorrect: The opinion of Mr. Z is incorrect because one of the important aspects to be followed while conducting audit of a company is that a distinction is required to be made properly between revenue expenditure and capital expenditure.

Question 5

Examine with reasons (in short) whether the following statement is correct or incorrect: The preparation of financial statements involves judgment by management. (MTP 2 Marks Nov '21, Mar'22)

Answer 5

Correct: 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.

Question 6

Examine with reasons (in short) whether the following statements are correct or incorrect. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. (MTP 2 Marks March '23, New SM)

Answer 6

Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on 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.

Question 7

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true" Explain stating clearly the qualities of an auditor. (MTP 4 Marks March '21, RTP May'19)

OR

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating the qualities an auditor should possess. (MTP 4 Marks Oct '21)

Answer 7

It is not enough to realise what an auditor should be. He is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent. The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, Code of ethics mentions integrity, objectivity and independence as one of the fundamental principles of professional ethics.

He must have a thorough knowledge of the general principles of law which govern matters with which he is likely to be in intimate contact. The Companies Act need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the law and practice of taxation is unavoidable.

He must pursue an intensive programme of theoretical education in subjects like financial and



management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment.

The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the special features peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.

He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

Question 8

The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain (MTP 4 Marks Oct '21)

Answer 8

The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- (i) the accounts have been drawn up with reference to entries in the books of account;
- (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
- (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- (iv) the information conveyed by the statements is clear and unambiguous;
- (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Question 9

The auditor has to form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Explain the above statement with reference to "Timeliness of Financial Reporting and the Balance between Benefit and Cost". (MTP 4 Marks April 22, RTP-May'18)

Answer 9

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, recognizing 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.

Question 10

Examine with reasons (in short) whether the following statement is correct or incorrect : The objective of audit is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement. (MTP 2 Marks April 19, RTP May'23, RTP May'18)

OR

The auditor is expected to and can reduce audit risk to zero (MTP 2 Marks May 20, MTP 2 Marks Oct'21)

**Answer 10**

Incorrect: The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. In auditing, reasonable assurance can be given which is high level assurance but not absolute assurance. 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.

Question 11

Examine with reasons (in short) whether the following statements are correct or incorrect

The Auditor is expected to reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

(MTP 2 Marks Oct'22, MTP 2 Marks Oct'21, PYP 2 Marks Jan 21)

Answer 11

Incorrect: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", The auditor is 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.

Question 12

Examine with reasons (in short) whether the following statements are correct or incorrect: 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 conclusive rather than persuasive.

(MTP 2 Marks April '21)

Answer 12

Incorrect: As per SA 200, 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.

Question 13

Discuss the following:

CA Jatin is the auditor of JP Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements. Explain w.r.t SA 200. (MTP 3 Marks April '23)

OR

Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2022-23, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives. (RTP Nov '23) (PYP 3 Marks May '22)

Answer 13

Overall Objectives of the Independent Auditor: As per SA-200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (i) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

In the given case of JP Ltd, CA Jatin expressed his opinion on the financial statements of JP Ltd without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that CA Jatin did not comply with the objective of audit as stated in SA 200.

Question 14

Both accounting and auditing are closely related with each other. Explain (RTP Nov'20)

Answer 14

Both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. It naturally calls on the part of the auditor to have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements. In fact, auditing as a discipline is also closely related with various other disciplines as there is lot of linkages in the work which is done by an auditor in his day-to-day activities. To begin with, it may be noted that the discipline of auditing itself is a logical construct and everything done in auditing must be bound by the rules of logic. Ethical precepts are the basis on which the foundation of the entire accounting profession rests. The knowledge of language is also considered essential in the field of auditing as the auditor shall be required to communicate, both in writing as well as orally, in day-to-day work.

Question 15

State with reason (in short) whether the following statements are true or false:

The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. (RTP May '19)

Answer 15

Incorrect: 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.

Question 16

State with reason (in short) whether the following statements are true or false: An audit is an official investigation into alleged wrongdoing. (RTP May '19, Nov'18)

Answer 16

Incorrect: An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Question 17

State with reason (in short) whether the following statements are true or false:

There is no difference between "audit" and "review." .(RTP Nov'22)

Answer 17

Incorrect: "Audit" and "Review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement

Question 18

The knowledge of human behavior is indeed very essential for an auditor so as to effectively discharge his duties. Explain. (RTP Nov '21)

Answer 18

The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioral science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organization. As against the financial Auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until

and unless the people who are working in the organization are competent and honest. The knowledge of human behavior is indeed very essential for an auditor so as to effectively discharge his duties.

Question 19

An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss. (RTP May '23, Old SM)

Answer 19

Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The objective of audit, on the other hand as we have already discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts.

However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.

Question 20

Explain the objectives of an Audit as per SA 200. (RTP May '20, May'19)

Answer 20

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Question 21

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

(RTP May '20, PYP 3 Marks July '21)

Answer 21

Other Matters that Affect the Limitations of an Audit: In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

Fraud, particularly fraud involving senior management or collusion.

- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Question 22

State with reason (in short) whether the following statements are true or false:

The auditor's opinion helps determination of the true and correct view of the financial position and operating results of an enterprise. (RTP May '21)

Answer 22

Incorrect: The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise.

Question 23

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. (RTP Nov '21, May'20, Old SM)

Answer 23

There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

1. 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.
2. Fraud may involve sophisticated and carefully organized 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.
3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Question 24

State with reason (in short) whether the following statements are true or false:

The matter of difficulty, time, or cost involved is in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative. (RTP Nov '18, RTP Nov'21)

Answer 24

Incorrect: 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.

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.

Question 25

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. Explain. (RTP Nov '18, New SM)

Answer 25

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. The inherent limitations of an audit arise from:

- (i) **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.
- (ii) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:
 1. 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.
 2. Fraud may involve sophisticated and carefully organized 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.
 3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

- (iii) **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.

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.

- (iv) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
- Fraud, particularly fraud involving senior management or collusion.
 - The existence and completeness of related party relationships and transactions.
 - The occurrence of non-compliance with laws and regulations.
 - Future events or conditions that may cause an entity to cease to continue as a going concern.

Question 26

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation. (RTP Nov 22, Nov'23)

Answer 26

The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

1. 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.
2. Fraud may involve sophisticated and carefully organized 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.
3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

We have to clearly understand that audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The objective of audit, on the other hand as we have already discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrongdoing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.

Question 27

Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples. (RTP May '22)

Answer 27

It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Remember that Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.

"Historical financial information means" information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Here, we have to broadly understand that "audit" and "review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement,

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are:

- (i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- (ii) SA 230 Audit Documentation
- (iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- (iv) SA 500 Audit Evidence
- (v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements Examples of Standards on Review engagements are
 - (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
 - (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

Question 28

M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotivemarkets.

GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements. Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing. (RTP May'24)

Answer 28

In conducting audit of financial statements, objectives of auditor in accordance with SA-200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are: -

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

An analysis of above brings out following points clearly: -

- (1) The auditor's objective is to obtain a reasonable assurance whether financial statements as a whole are free from material misstatement whether due to fraud or error.

Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On the basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.

- (2) Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on financial statements as a whole, in totality.
- (3) Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- (4) The opinion is reported and communicated in accordance with audit findings through a written



report as required by Standardson Auditing.

Therefore, perception of both assistants is not proper. Auditor of financial statements does not seek to provide guarantee that financial statements are free from material misstatements causedby frauds or errors. He obtains reasonable assurance.

Question 29

Standards on Auditing (SAs) apply in “audit of historical financialinformation” whereas Standards on Review Engagements (SREs) apply in “review of historical financial information.” Explain in detail giving examples. (RTP May’24)

Answer 29

Standards on Auditing (SAs) apply in “audit of historical financialinformation” whereas Standards on Review Engagements (SREs) apply in “review of historical financial information”. Standards on auditing applyin “audit” of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagementsapply in “review” of historical financial information which is a limited assurance engagement only.

“Historical financial information means” information expressed in financial terms in relation to a particular entity, derived primarily fromthat entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

“Audit” and “review” are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, “review” is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level thatis acceptable in the circumstances of the engagement.

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are:

- (i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- (ii) SA 230 Audit Documentation
- (iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- (iv) SA 500 Audit Evidence
- (v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

Question 30

(a) The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. (MTP 3 Marks Mar’24)(SM)

Answer 30

The auditor should decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.

The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

Question 31

KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement? (MTP 3 Marks Apr'24)

Answer 31

As given above, the engagement involves gathering of sufficient appropriate evidence on the basis of which limited conclusion can be drawn up. It is a limited assurance engagement like review. Other two features of such type of engagement are: -

- (1) It provides lower level of assurance than reasonable assurance engagement.
- (2) It performs fewer procedures than reasonable assurance engagement.

Question 32

Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain. (MTP 3 Marks Apr'24)

Answer 32

Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

Therefore, nature of financial reporting itself is one of causes inherent limitations of audit.

MULTIPLE CHOICE QUESTIONS (MCQS)

1. **The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are :**
 - (a) management
 - (b) Those charged with governance –
 - (c) audit committee
 - (d) board of directors **(MTP 1 Marks March '21, Oct'23, RTP May '21, Nov'21, Nov'23)**

Ans: (b)

2. **The Auditor of a Sole Proprietor Concern is appointed by**
 - (a) CAG
 - (b) Bank
 - (c) Sole Proprietor himself
 - (d) District Administration **(MTP 1 Mark April 22)**

Ans: (c)

3. **Which of the following is Incorrect:**
 - (a) An auditor conducting an audit in accordance with SAs is responsible for obtaining absolute assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
 - (b) As described in SA 200, owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
 - (c) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
 - (d) The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud. **(MTP 1 Mark March '23)**

Ans: (a)

4. With respect to auditing, which of the following statement is correct:

- (a) Audited financial statements are absolutely free from all material misstatement due to fraud or error.
- (b) An audit is an official investigation into alleged wrongdoing and auditor has specific legal powers to conduct investigation
- (c) The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it.
- (d) An auditor's opinion is an assurance as the future viability of the enterprise or the efficiency or effectiveness of the management. **(MTP 1 Marks April '23)**

Ans: (c)

5. The matter of difficulty, time, or cost involved is :

- (a) not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.
- (b) in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.
- (c) not in itself a valid basis for the auditor to omit an audit procedure for which alternative exists.
- (d) not in itself a valid basis for the auditor to omit an audit procedure. **(MTP 1 Mark March '19)**

Ans: (a)

6. Determining a percentage to be applied to a chosen benchmark (in relation to materiality) involves the exercise of

- (a) Independence
- (b) Professional Judgement
- (c) Professional skepticism
- (d) All of the above **(MTP 1 Mark April'19)**

Ans: (b)

7. Which of the following is the responsibility of the auditor:

- (a) Preparation and presentation of the financial statements in accordance with applicable financial reporting
- (b) Design, implementation and maintenance of internal controls
- (c) Express an opinion on the Financial Statements
- (d) To obtain limited assurance. **(MTP1 Mark April' 22)**

Ans: (c)

8. The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are

- (a) Management
- (b) those charged with governance
- (c) audit committee
- (d) board of directors **(RTP May '21, Nov'21)**

Ans: (b)

9. M/s KYC & Co. is a reputed Audit firm in Mumbai. They are appointed as Statutory Auditors of Blessed Ltd. Which of the below is the responsibility of M/s KYC & Co.

- (a) Preparation of financial statements
- (b) Designing, implementation and maintenance of internal control system
- (c) Reporting on true and fair view of financial statements
- (d) Compliance with the applicable law and regulation. **(RTP Nov'20)**

Ans:(c)