

CA Inter

AUDITING AND ETHICS

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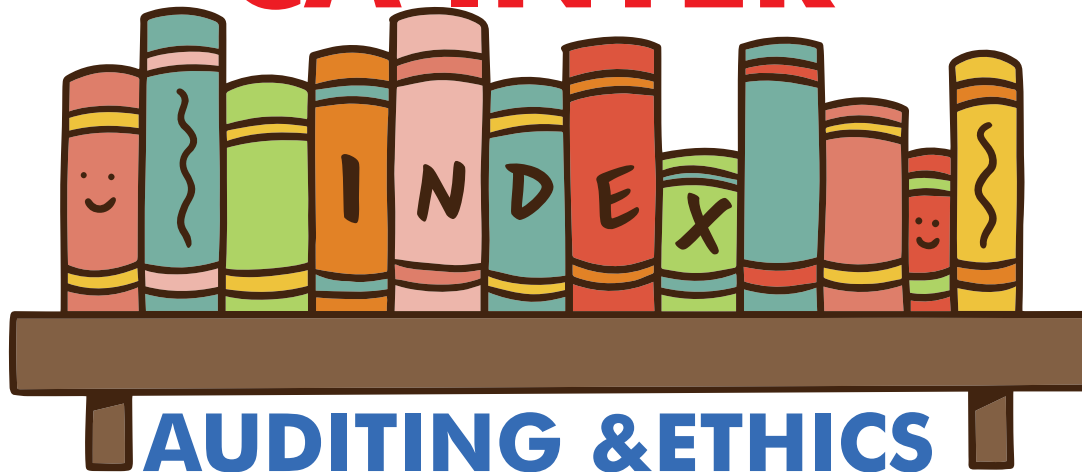
CA INTER
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QUESTION
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MCQ BOOK

अब! **Audit** होगा सबसे **Scoring**

CA INTER



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CHAPTER 1

NATURE, OBJECTIVE AND SCOPE OF AUDIT

Objectives of Audit (Refer Topic 4 of Brahmastra)

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| 1. | <p>RST Ltd., a retail company, has set up internal controls requiring all invoices to be stamped and signed by an authorised person in “Goods Receiving Section” of the company stating the date and time of receiving goods in premises to ensure that only those purchase bills are produced for payment for which goods have been actually received.</p> <p>During the audit, the auditor finds that two employees – a purchasing manager and an accounts clerk – have worked together to bypass this control, submitting fake invoices that resulted in payments for goods that were never received. You are required to state the objectives of an audit, as per SA 200, when it comes to ensuring the reliability of financial statements? Also explain, why auditor can provide only reasonable, rather than absolute, assurance that the financial statements are free from material misstatement due to fraud or error in the context of the given situation? (RTP-Jan-2025)</p> |
| Ans. | <p>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: -</p> <p>(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</p> <p>(b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.</p> <p>The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the factors such as nature of financial reporting, nature of audit procedures, not in the nature of investigation, timeliness of financial reporting and decrease in relevance of information over time and future events.</p> <p>Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, the 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.</p> <p>In the context of RST Ltd., the management designed a control requiring that all invoices be stamped and signed by an authorized person in the Goods Receiving Section to confirm receipt of goods. However, collusion between two employees—the purchasing manager and the accounts clerk—allowed them to bypass this control by submitting fake invoices for payment. Collusion is a significant limitation of internal controls, as it overrides controls designed to prevent such fraud.</p> <p>Given these factors, the auditor cannot provide absolute assurance that the financial statements are entirely free from material misstatements due to fraud or error.</p> |
| 2. | <p>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-May-2023)</p> |

Ans.	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.
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Scope of Audit (Refer Topic 5 of Brahmastra)

3.	A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. (SM)
Ans.	It is not a reasonable assurance engagement. It is in nature of investigation.
4.	"Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies. (SM)
Ans.	Choosing of appropriate accounting policies is responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management. The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, <i>choosing of appropriate accounting policies</i> 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.
5.	PD & Co. Chartered Accountants, were appointed as the statutory auditors of MR Limited for the financial year 2023-24. MR Limited included the following clause in the appointment letter to the auditors : "The Auditor shall be responsible for detecting the frauds that may happen in the company during the financial year 2023-24." The auditor objected to inclusion of such a clause in the appointment letter. Discuss in the light of scope of audit. (Sept-2024)
Ans.	Scope of Audit in detection of Fraud: 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" 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. An audit is not an official investigation into alleged wrongdoing. The auditor does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation. 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 scope of audit is general and broad whereas scope of investigation is specific and narrow. Thus, inclusion of such a clause in the engagement letter is uncalled for and outside the scope of audit.

6.	XYZ Ltd., a manufacturing company based in India, operates multiple plants across the country and deals in complex machinery, which requires specialized maintenance and valuation expertise. XYZ Ltd. appointed CA Dhruv as Statutory auditor. During the audit, he observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher reported profits. Does such a matter fall within scope of audit? (RTP-May-2025)
Ans.	The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. The scope of audit of financial statements includes coverage of all aspects of entity, reliability and sufficiency of financial information and proper disclosure of financial information. In the given situation, CA. Dhruv observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher profits. Since proper disclosure of financial information is covered under the scope of audit, thus, 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. 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 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. Thus, it can be concluded that proper disclosure of financial information is well within scope of audit.
7.	The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. (MTP-May-2024)
Ans.	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.
8.	Scope of Audit Mini & Associates, Chartered Accountants, were appointed as the auditor of CIN Ltd., a construction company. During the audit, CA Mini, a Partner of the firm noticed the following: • The company has several ongoing projects, but only selected project revenues have been reported. • Several expense vouchers are either missing or are handwritten and lack proper authorisation. • The company has changed its depreciation method from the straight-line method to the written-down value method without adequate disclosure in the financial statements. These matters were brought to the attention of management. However, management argued that these issues fall outside the auditor's scope of responsibility. Whether contention of the management is correct? (RTP-Sept-2025)

Ans.	The following points are included in scope of audit of financial statements: (1) Coverage of all aspects of entity Audit of financial statements should be organised adequately to cover all aspects of the entity relevant to the financial statements being audited. (2) Reliability and sufficiency of financial information The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements. The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures. (3) Proper disclosure of financial information The auditor should also 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. In view of above, the management's contention is not correct. The matters identified by CA Mini such as incomplete revenue recognition, missing or unauthorised expense vouchers, and inadequate disclosure of changes in accounting policy are well within the scope of the audit of financial statements, as they impact the reliability, completeness, and proper presentation of financial information.
9.	Audit Vs Investigation The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word "audit" in proposed assignment. Comment. Also, discuss how audit is different from investigation. (MTP-Sept-2024)
Ans.	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, 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. The scope of audit is general and broad whereas scope of investigation is specific and narrow. In the given situation, management of company suspects that some of its employees may be involved in making fraudulent payments on account of dummy workers at its different plants in the country. Such an assignment is in the nature of "investigation". Therefore, Mr. P is right in objecting the use of word "audit" in the proposed assignment.
9A.	RKP & Co., Chartered Accountants, were appointed as the statutory auditors of Orion Engineering Ltd., a company engaged in manufacturing heavy industrial equipment. During the course of audit, certain shareholders raised concerns before the auditors regarding the following matters: 1. They asked the auditor to certify whether the sophisticated imported machinery installed in the factory was in perfect physical condition and to estimate its remaining useful life. 2. Some shareholders also requested the auditor to confirm the genuineness of certain supplier invoices and contracts, alleging that some documents might be forged.

	3. A group of investors further demanded that the auditor conduct a detailed investigation into an alleged fraud by a senior employee, including questioning employees and recording statements under oath. With reference to the above situation, explain the matters which fall outside the scope of an audit. Also distinguish between audit and investigation. (MTP-May-2026)
Ans.	In the given case, the shareholders of Orion Engineering Ltd. have requested the auditor to perform certain activities which fall outside the normal scope of audit. The scope of audit does not include the following: 1. Matters outside the auditor's technical competence: An auditor is not expected to perform duties that require specialised technical expertise beyond accounting and auditing knowledge. For instance, determining the physical condition or useful life of sophisticated machinery or assessing the structural suitability of buildings requires technical skills of engineers or other experts. Therefore, the auditor cannot certify such matters. 2. Authentication of documents: An auditor is not an expert in detecting forgery or verifying the genuineness of documents. While the auditor may examine documents as audit evidence, he cannot guarantee their authenticity because he does not possess specialised expertise in forensic document verification. 3. Conducting an official investigation: An audit is not an official investigation into alleged wrongdoing. The auditor does not possess legal powers such as searching premises or recording statements of witnesses on oath, which are generally available to investigative authorities. 4. Audit is distinct from investigation: Investigation involves a critical examination of accounts with a specific purpose, such as determining whether fraud exists. Its scope is specific and narrow. On the other hand, the objective of audit 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. The scope of audit is general and broad, whereas the scope of investigation is specific and narrow. Accordingly, in the given case, the auditor of Orion Engineering Ltd. is justified in clarifying that certification of technical condition of machinery, authentication of documents, and conducting a detailed fraud investigation fall outside the normal scope of audit and such matters may require involvement of experts or a separate investigation.

Inherent Limitations of Audit (Refer Topic 6 of Brahmastra)

10.	An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (SM, MTP-Nov-2023)
Ans.	The Nature of Audit Procedures: The auditor carries out his work by obtaining audit evidence through performance of audit procedures. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example: 1. There is 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 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. 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.

11.	You are appointed as statutory auditor of Zebra Industries Ltd. for FY 2024–25. During the course of audit, you observe that the company's management frequently delays in providing certain documents and explanations requested by you. A portion of the accounting records related to "special procurement" is supported only by basic acknowledgements without proper vendor details. You also notice that some transactions appear to be with entities that may be related to the company, but management denies the existence of any such relationships. Further, during verification, you find that some documents produced as evidence appear unusually uniform and lack standard commercial markings, raising concerns about their authenticity. Since your audit is conducted on a test-check basis, you are unable to verify all such transactions individually. Based on the above, explain the inherent limitations of an audit that restrict the auditor from obtaining absolute assurance that the financial statements of Zebra Industries Ltd. are free from material misstatement. (RTP-May-2026)
Ans.	The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence. Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of <i>legal limitation</i> on auditor's ability to obtain audit evidence. The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organised schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. Auditor is not an expert in authentication of documents. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents. It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions. These factors collectively demonstrate that, due to practical constraints, legal boundaries, management fraud risks, and limitations in detecting related party transactions, the auditor can obtain only reasonable assurance and not absolute assurance regarding the accuracy of the financial statements.
12.	During audit of Himani Electronics Ltd., the auditor identifies that several purchase bills bearing proper stamps and signatures of authorised person from the "Goods Receiving Section" have been processed and paid. However, during verification of store records, the auditor observes that goods related to some of these bills were never actually received. On inquiry, it is discovered that the accountant responsible for processing purchase bills and the authorised person in the Goods Receiving Section had colluded, allowing false bills to appear genuine. Management argues that because proper internal controls existed, the auditor should have detected such misstatements and prevented their occurrence. With reference to inherent limitations of audit, explain why the auditor cannot obtain absolute assurance that financial statements are free from material misstatement. Also explain how the above situation illustrates these inherent limitations. (MTP-Jan-2026)
Ans.	The auditor cannot obtain absolute assurance that financial statements are free from material misstatement because the process of audit suffers from certain inbuilt or inherent limitations. Preparation of financial statements involves making many judgments by management. These judgments may involve subjective

	decisions or a degree of uncertainty. Therefore, the 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 for preparation of financial statements in accordance with the 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. In Himani Electronics Ltd., management devised a control that all purchase bills should reflect stamp and signatures of an authorised person in the “Goods Receiving Section” stating the date and time of receipt of goods. This control was meant to ensure that only those purchase bills are processed for payment for which goods have actually been received. However, the concerned accountant and authorised person in the “Goods Receiving Section” colluded, and false bills were stamped and processed. This is a case of overriding of internal controls due to collusion between two persons. Such probable collusion is itself a limitation of internal controls. Because such collusion and control failures can occur, an audit provides only reasonable assurance. The existence of proper controls does not eliminate the inherent limitations of audit, nor does it guarantee detection of all frauds or errors. Hence, the auditor cannot obtain absolute assurance that financial statements are free from material misstatement.
13.	Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain. (MTP-May-2024)
Ans.	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.
14.	Inherent limitations of an audit 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. (MTP-May-2025)
Ans.	The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors: - (i) The Nature of Financial Reporting: The preparation of financial statements involves judgment 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. (ii) The Nature of Audit Procedures: There are practical and legal limitations on the auditor’s ability to obtain audit evidence such as: • Possibility that management or others may not provide, intentionally or unintentionally, the complete information relevant for preparation and presentation of FS. • Fraud may involve sophisticated and carefully organised schemes. (iii) Not in the nature of Investigation: An audit is not an official investigation into alleged wrongdoing. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

	(iv) Timeliness of financial reporting and decrease in relevance of information over time: 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. (v) Future events: Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business.
15.	Absolute Assurance You are auditing the financial statements of JEN Ltd., a manufacturing company. During a meeting, Mr. Jai CEO questions the auditor's ability to detect all material misstatements, including those caused by fraud. He insists that since the auditor is a professional, the audit should provide absolute assurance on the accuracy of the financial statements. Is the contention of Mr. Jai correct. Discuss the objectives of auditor in accordance with relevant SA. (MTP-Sept-2025)
Ans.	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: (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. 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 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. It may be noted that 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. 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. In the given case, Mr. Jai, CEO of JEN Ltd., questions the auditor's ability to detect all material misstatements and insists that auditor should provide absolute assurance. As per SA 200, the auditor's objective is to obtain reasonable assurance. Therefore, contention of the CEO Mr. Jai is not correct.
16.	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 automotive markets. 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-2024) OR Micky & Associates, Chartered Accountants, were appointed as the auditors of STI Ltd., a Textile manufacturing company, for the financial year 2024-25. Management of the company discussed with the newly appointed auditors that the company has been suffering losses for the last few years and also the Directors are suspecting that accounts are not properly maintained and might contain errors and frauds. So, in the given situation,

	management of the company requested the auditors to give complete assurance/guarantee about the financial statements of the company. Can the auditors give complete assurance/guarantee in the above situation? Discuss with reference to objectives of Audit. (RTP-Jan-2026)
Ans.	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: - - 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 - 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: - - 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. - 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. - 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. - The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on 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 caused by frauds or errors. He obtains reasonable assurance.
17.	JK Ltd. was having a 'Pager' manufacturing plant and looking at the demand it was of the view that the company will grow continuously in future. But, with the introduction of mobile phones in the market, the plant was shut down completely. The shareholders of the company were of the view that auditor failed to perform their duty and have not informed to them about the company's inability to continue its business, otherwise they might not have suffered the loss. List down the factors giving rise to the inherent limitations due to which auditor cannot provide a guarantee that the financial statements are free from material misstatement due to fraud or error. (May-2024)
Ans.	Inherent limitations of audit: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors: -

- (1) **Nature of financial reporting:** 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.
- (2) **Nature of Audit procedures:** The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence. Further, fraud may involve sophisticated and carefully organized schemes.
- (3) **Not in nature of investigation:** Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.
- (4) **Timeliness of financial reporting and decrease in relevance of information over time:** The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.
- (5) **Future events:** Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

Benefits of audit-why audit is needed? (Refer Topic 8 of Brahmastra)

18.

Benefits of Audit

CA students Sriranga and Manga were discussing on the assurance, which the auditing services provide to the users, in the form of opinion on financial statements, by means of a written report. Such an assurance lends credibility to financial statements. You are required to state some of the aspects examined by the auditor, to ensure that the financial statements which are audited are not misleading. (Sept-2025)

Ans.

Aspects to be examined by the auditor to ensure that the financial statements which are audited are not misleading are as under:

- (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.
- (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 presents a true and fair picture of the operational results and of the assets and liabilities.

19.

OPQ Ltd. is a widely held company engaged in manufacturing activities. The management of the company is responsible for preparation of financial statements. The shareholders of the company are not involved in day-to-day operations.

Recently, during a board meeting, one of the directors questioned the necessity of conducting a statutory audit, stating that it only increases cost and does not add significant value. However, the CFO of the company argued



Founder of FAST
Career Consultants India's
largest private CA Placement
Company placing CA Freshers
across India at packages
upto 35 Lacs

46th AIR
Rank Holder in
CA Final

180,000+
CA Students
taught till
date



336+
AIRs including
AIR 1 & 2



Faculty of
Audit and FR/
Accounts at CA Final
and Intermediate
Level

Chief
Mentor of
FAST TEST
SERIES



Degree in
Management and
Administration



AUDITING & ETHICS

by CA. SARTHAK JAIN

AIR 1 & 2 from FAST



F.A.S.T
first attempt success tutorials

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