

CA Inter

AUDITING AND ETHICS

Question Bank with MCQs



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CHAPTER 1

NATURE, OBJECTIVE AND SCOPE OF AUDIT

Descriptive Questions & Answers

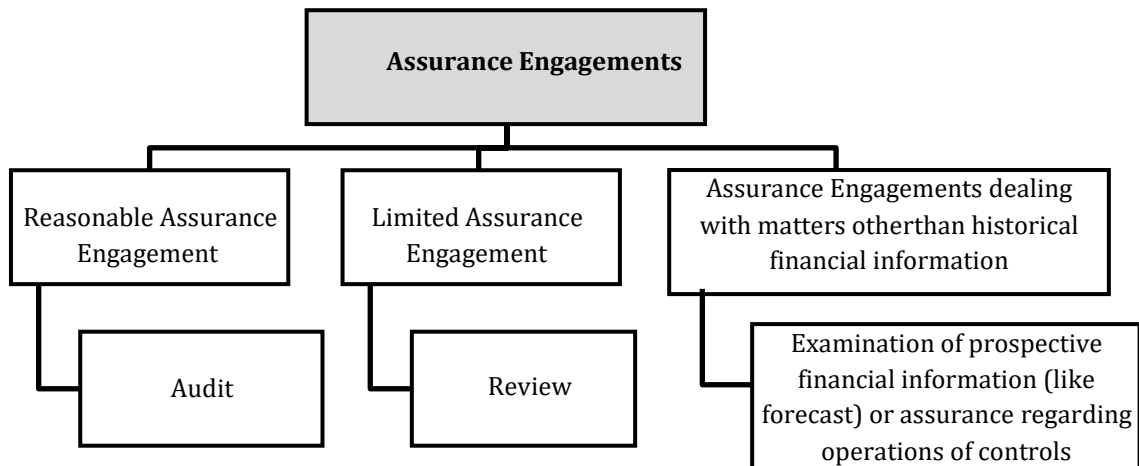
1. “Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management”. Do you agree? Discuss duty of auditor, if any, in relation to accounting policies. **(SM)**

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, *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.

2. Assurance engagements are not restricted to audit of financial statements alone. Discuss. **(SM)**

Ans. Assurance engagements covers all of the following engagements:

Checkbox	Example of assurance engagement	Type of assurance engagement
✓	Audit of financial statements	Reasonable assurance engagement
✓	Review of financial statements	Limited assurance engagement
✓	Examination of Prospective financial information	Provides assurance regarding reasonability of assumptions forming basis of projections and related matters
✓	Report on controls operating at an organization	Provides assurance regarding design and operation of controls



3. An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement. **(SM)**

Ans. **A three party relationship involving a practitioner, a responsible party, and intended users**
An assurance engagement involves above said three parties. A practitioner is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

	A responsible party is the party responsible for preparation of subject matter. Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.
4.	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.
5.	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.	<p>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:</p> <ol style="list-style-type: none"> 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.
6.	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)
Ans.	<p>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:</p> <ol style="list-style-type: none"> (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. <p>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.</p>
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.	<p>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.</p> <p>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.</p> <p>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.</p>

	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.	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-May-2024)
Ans.	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.
9.	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.
10.	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)
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: - (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) 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.

	<p>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.</p> <p>(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.</p> <p>(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.</p> <p>(4) The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing.</p> <p>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.</p>
11.	<p>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.</p> <p style="text-align: right;">(RTP-May-2024)</p>
Ans.	<p>Standards on Auditing (SAs) apply in “audit of historical financial information” whereas Standards on Review Engagements (SREs) apply in “review of historical financial information”. 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.</p> <p>“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.</p> <p>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.</p> <p>Some examples of Standards on Auditing are:</p> <ul style="list-style-type: none"> (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 <p>Examples of Standards on Review engagements are</p> <ul style="list-style-type: none"> (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

12.	<p>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.</p> <p style="text-align: right;">(May-2024)</p>
Ans.	<p>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: -</p> <p>(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.</p> <p>(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.</p> <p>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.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p>
13.	<p>Prospective Financial Information</p> <p>XYZ Ltd., a manufacturing company engaged in the production of various types of yarn, is planning to expand its operations into a new geographical market and also add new products. Company has prepared prospective financial information to be presented to potential investors and financial institutions to secure funding for the expansion.</p> <p>XYZ Ltd. engages a firm of auditors to conduct an assurance engagement on this prospective financial information. During the engagement, the auditors reviewed the assumptions made by XYZ Ltd.'s management and issued a report.</p> <p>Explain the key differences between prospective financial information and historical information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information?</p> <p style="text-align: right;">(Jan-2025)</p>
Ans.	<p>Difference between "Historical financial information" and "Prospective financial information": The "Historical financial information" relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The "Prospective financial information" relates to</p>

	<p>financial information based on assumptions about occurrence of future events and possible actions by an entity.</p> <p>Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.</p> <p>In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed. Prospective financial information relates to future events. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future-oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.</p> <p>Therefore, in such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection. Hence, such type of assurance engagement provides only a "moderate" level of assurance.</p>
14.	<p>Kriti, a CA student, has joined articles in a reputed audit firm. She considers audit engagement to be an "assurance engagement". Her understanding is that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form. However, her friend Somaya, does not agree with her. She is of the view that assurance engagements are not restricted to audit alone. Besides, Somaya also thinks that assurance engagements can also relate to matters other than historical financial information. Whose view appears to be correct? State with reasons. (RTP-Sept-2024)</p>
Ans.	<p>Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements, engagements providing assurance involving prospective financial information, engagements providing assurance on internal controls in an entity. Assurance engagements provide assurance to users. The difference is of degree. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit.</p> <p>There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving prospective financial information and providing assurance on internal controls in an entity. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions, and it is properly presented, and all material assumptions are adequately disclosed.</p> <p>In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas is of the view that assurance engagements are not restricted to audit alone. Thus, view of Somaya is correct.</p>
15.	<p>Audit Vs Investigation</p> <p>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)</p>
Ans.	<p>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</p>

	<p>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.</p> <p>The scope of audit is general and broad whereas scope of investigation is specific and narrow.</p> <p>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”.</p> <p>Therefore, Mr. P is right in objecting the use of word “audit” in the proposed assignment.</p>
16.	<p>Assurance engagement</p> <p>“Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. In this context, give three examples of assurance engagements highlighting difference in nature of assurance provided by such engagements.</p> <p style="text-align: right;">(MTP-Sept-2024)</p>
Ans.	<p>Three examples of assurance engagements are as under :-</p> <p>(i) Audit of financial statements</p> <p>An audit of financial statements provides 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.</p> <p>(ii) Review of financial statements</p> <p>Review provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.</p> <p>(iii) Examination of prospective financial information</p> <p>In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management’s assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed. Such type of assurance engagement provides a moderate assurance.</p>
17.	<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?</p> <p style="text-align: right;">(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>
18.	<p>Rajul Ltd. engaged an external practitioner CA Rajul to provide assurance on its prospective financial information for the upcoming year, which includes projections for a new product line. The company projected a 15% increase in revenue, estimating total sales of ₹ 75 crore, driven by the expected launch of this new product. Mention the applicable Engagement and Quality Control Standard and the level of assurance that will be provided in the given situation. Also explain how Prospective Financial Information is different from Historical Financial Information.</p> <p style="text-align: right;">(MTP-Jan-2025)</p>
Ans.	<p>In the given situation, Standards on Assurance Engagements will be applicable and such type of assurance engagement provides only a “moderate” level of assurance.</p> <p>In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management’s assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.</p> <p>“Historical financial information” and “Prospective financial information.” The former relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The latter relates to financial information based on assumptions about occurrence of future events and possible actions by an entity. Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.</p>
19.	<p>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 :</p> <p>"The Auditor shall be responsible for detecting the frauds that may happen in the company during the financial year 2023-24."</p> <p>The auditor objected to inclusion of such a clause in the appointment letter. Discuss in the light of scope of audit.</p> <p style="text-align: right;">(Sept-2024)</p>
Ans.	<p>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.</p>

	<p>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.</p> <p>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.</p> <p>The scope of audit is general and broad whereas scope of investigation is specific and narrow.</p> <p>Thus, inclusion of such a clause in the engagement letter is uncalled for and outside the scope of audit.</p>
20.	<p>RST Ltd., a mid-sized trading company, recently faced challenges in securing a bank loan due to doubts about the reliability of its financial statements. The management realised the importance of having audited accounts to build confidence among lenders and other stakeholders. Elucidate the benefits and need of an audit.</p> <p style="text-align: right;">(MTP-Jan-2025)</p>
Ans.	<p>Benefits and need of Audit:</p> <ul style="list-style-type: none"> • Audited accounts provide high quality information. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally. • In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their interest is safeguarded by an audit. • An audit acts as a moral check on employees from committing frauds for the fear of being discovered by audit. • Audited financial statements are helpful to government authorities for determining tax liabilities. • Audited financial statements can be relied upon by lenders, bankers for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
21.	<p>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?</p> <p style="text-align: right;">(RTP-May-2025)</p>
Ans.	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>Thus, it can be concluded that proper disclosure of financial information is well within scope of audit.</p>

- 22. Reasonable Assurance Engagements and Limited Assurance Engagements**
 An audit is a reasonable assurance engagement, whereas a review is a limited assurance engagement. Both types of assurance engagements provide assurance to users, but they differ in the degree of assurance offered. In light of this, explain the difference between reasonable assurance engagements and limited assurance engagements, with examples. **(MTP-May-2025)**

Ans. Reasonable Assurance Engagements and Limited Assurance Engagements

Reasonable assurance engagement	Limited assurance engagement
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement, Audit of financial statements.	Example of limited assurance engagement is review engagement, Review of financial statements.

Test Your Understanding

- 23.** Lalji Bhai has purchased shares of a company listed on NSE. The **audited financial statements** of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, **he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money**. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct? **(SM)**

Ans. An audit does not provide assurance to investor in shares regarding safety of his money. Share prices of securities are affected by range of factors. An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. Hence, thinking of Lalji Bhai is not correct.

- 24.** Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for **not following certain environmental regulations involving imposition of hefty monetary penalty on the company**. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit? **(SM)**

Ans. Proper disclosure of financial information is well within scope of audit.

- 25.** A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of **insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss**. He was also requested to submit an early report. **Would the report by CA in nature of audit report?** **(SM)**

Ans. Appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. It is an investigation and not in nature of audit report.



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