**CA IPC (Inter) Nov. 2015 Examinations – Suggested Answer (Compiled by CA. Pankaj Garg)**

**Paper 6 – Auditing & Assurance"**

**Marks**

**1 Discuss the following:**

**(a) With reference to SA 320 indicate the factors which may affect the identification of an appropriate bench mark in determining materiality for the financial statement as a whole.** **5**

**Answer: Factors affecting identification of appropriate benchmark as per SA 320**:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

1. The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
2. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
3. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
4. The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
5. The relative volatility of the benchmark.

**(b) The assertions used by auditor to consider potential misstatements about account balances at the period end.** **5**

**Answer: Assertions used by auditor about account balances at the period end**:

- SA 315 "Identifying and Assessing Risk of Material Misstatements through understanding the Entity and its Eenvironment" requires the auditor to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. Assertions used by auditor with respect to account balances at the period end are:

  1. **Existence** – assets and liabilities shown in the balance sheet exists.
  2. **Rights and obligations** – rights of the entity have been shown as assets and the obligations have been shown as liabilities.
  3. **Completeness** – assets and liabilities have been recorded completely.
  4. **Valuation and allocation** – assets and liabilities are included in the financial statements at appropriate amounts and any allocation adjustments are appropriately recorded.

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| (c) | **'P' an auditor decides not to send a new audit engagement letter to G Ltd. every year. Whether he is right in his approach? State the circumstances where sending new engagement letter, would be appropriate.** | 5 |

**Answer: Engagement Letter in case of Recurring Audit**:

SA 210 "Agreeing the Terms of Audit Engagement" provides that in case of recurring audits, the auditor shall assess whether circumstances require revision in terms of the audit engagement and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

1. Any indication that the entity misunderstands the objective and scope of the audit.
2. Any revised or special terms of the audit engagement.
3. A recent change of senior management.
4. A significant change in ownership.
5. A significant change in nature or size of the entity's business.
6. A change in legal or regulatory requirements.
7. A change in the financial reporting framework adopted in the preparation of the F.S.
8. A change in other reporting requirements.

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| (d) | **State the principal aspects to be covered in an audit concerning financial statement of account.** | 5 |

**Answer: Principal Aspects to be covered in an audit:**

1. **Examination of Accounting System & Internal Control**
   - To ascertain whether it is appropriate for the business and helps in properly recording all the transactions.
   - To determine the Nature, Timing and Extent (NTE) of Audit Procedures to be performed.
2. **Reviewing the system and procedures**
   - To find out whether they are adequate and comprehensive.
3. **Vouching of the transactions**
   - To ensure their authenticity and validity of transactions.
   - To check the arithmetical accuracy of the books of accounts.
   - To ascertain proper distinction into capital and revenue items.
4. **Verification of Assets & Liabilities**
   - To ensure existence and valuation of the assets and liabilities appearing the balance sheet.
5. **Statutory Compliances**
   - In case of entities governed by some law, rules or regulations, for example in case of audit of a company incorporated under Companies Act 2013.
6. **Expression of Opinion**
   - On true and fair view of state of Affairs as reflected by Balance Sheet.
   - On true and fair view of Financial Results as reflected by Profit and Loss account.
   - On true and fair view of Cash Flows as reflected by Cash Flow Statement.
7. **Reporting on Other matters**
   - As required by the law governing the entity.

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| **2.** | **State with reasons (in short) whether the following statements are correct or incorrect. (Answer any eight)** | | **8x2 =16** |
| | **(i)** | **AB & Co. is an audit firm having partners Mr. A and Mr. B Mr. C, the relative of Mr. is holding securities having face value of Rs. 2,00,000 in XYZ Ltd. AB & Co. is qualified for an auditor of XYZ Ltd.** | |
| | | Answer: Statement is Incorrect.<br>• Sec. 141(3)(d)(i) of the Companies Act, 2013, disqualifies a person to be appointed as auditor of a company if the person or his relative or his partner is holding securities in the company. However Relative may hold securities of face value up to Rs. 1,00,000.<br>• AB & Co. is disqualified to be appointed as auditor of XYZ Ltd. as relative of Mr. B, the partner of the AB & Co. is holding securities of face value of Rs. 2,00,000. | |
| | **(ii)** | **Working papers are property of client, as it contains client's information's.** | |
| | | Answer: Statement is incorrect.<br>• SA 230 "Audit Documentation" states that unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion make portions of working papers available to client.<br>• Working papers cannot be considered as property of the client, irrespective of the matter that it contains client's infomration. | |
| | **(iii)** | **The auditor of A Ltd. Company wanted to refer to the minute books during audit but boards of directors refused to show the minute books to the auditors.** | |
| | | **Answer:** Statement is Incorrect.<br>• Sec. 141(3) of Companies Act 2013 provides that every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place.<br>• The term 'books of accounts and vouchers' includes all books which have any bearing, or are likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books. | |
| | **(iv)** | **The auditor has to report to Central Govt. within 90 days of his knowledge of an offence involving fraud.** | |
| | | **Answer:** Statement is Incorrect.<br>• Sec. 141(12) of Companies Act 2013 provides that if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the CG within such time and in such manner as may be prescribed.<br>• Rule 13 of companies (Audit and Auditor's) Rules, 2013 provides that if the auditor has reason to believe for occurrence of fraud, he shall report the matter to the Central Government immediately but not later than 60 days of his knowledge | |
| | **(v)** | **Manner of rotation of auditor will not be applicable to company A, which is having paid up share capital of Rs. 15 crores and having public borrowing from nationalized bank of Rs. 50 crore because it is a Private Limited Company.** | |
| | | **Answer**: Statement is Incorrect.<br>• Provisions related with rotation of auditors are applicable in case of private companies having paid up capital of Rs. 20 Crore or more and to companies having paid up capital below Rs. 20 Crore, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 Crore or More.<br>• In the instant case, as borrowings is of Rs. 50 Crore, provisions related with rotation of auditors are applicable. | |

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| (vi) | **The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.** | |
| | **Answer:** Statement is Incorrect.<br>• Memorandum of Association lays down the object to be carried on and Articles of Associations reflects the regulations of the company to govern its internal management and to regulate the rights of the members.<br>• Auditor should ascertain whether the company has complied with provisions of section 139 and 140 to ensure validity of his appointment. | |
| (vii) | **Teeming and lading is one of the techniques of inflating cash payments.** | |
| | **Answer**: Statement is incorrect.<br>• Teeming and lading Is not a technique of inflating cash payment.<br>• Teeming and lading is a technique of suppressing cash receipts by misappropriating the amount received from a customer. | |
| (viii) | **Managing director of A Ltd. himself appointed the first auditor of the company.** | |
| | Answer: Statement is Incorrect.<br>• Sec. 139(6) of Companies Act, 2013 provides that the first auditor of the company is to be appointed by the Board of Directors within 30 days of registration of the company. If the Board fails, members shall within 90 days appoint the auditor in EGM. In case of Government company, the first auditor is to be appointed by CAG of India.<br>• Appointment of first auditor by the managing director is not correct. | |
| (ix) | **A Chartered Accountant holding securities of S Ltd. having face value of Rs. 950 is qualified for appointment as an auditor of S Ltd.** | |
| | **Answer**: Statement is Incorrect.<br>• Sec. 141(3)(d)(i) of the Companies Act, 2013, disqualifies a person to be appointed as auditor of a company if the person or his relative or his partner is holding securities in the company.<br>• Chartered accountant is disqualified to be appointed as auditor of S Ltd. as he is holding securities of face value of Rs. 950. | |
| (x) | **Mr. N, a member of the Institute of Chartered Accountant of England and Wales, is qualified to be appointed as auditor of Indian Companies.** | |
| | **Answer**: Statement is Incorrect.<br>• As per Section 141(1) of Companies Act 2013, a person shall be eligible to be appointed as auditor of an Indian company only if he is a Chartered Accountant. Chartered Accountant implies the member of Institute of Chartered Accountant of India holding certificate of practice.<br>• Mr. N, member of Institute of Chartered Accountant of England and Wales is disqualified to be appointed as auditor of Indian companies. | |

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| **3.** | **How will you vouch/verify the following?** | | **4x4 =16** |
| | **(a)** | **Refund of General Insurance premium paid.** | |
| | | **Answer: Vouching of Refund of General Insurance Premium Paid**:<br>In order to vouch the refund of general insurance premium paid, the auditor should take the following steps:<br>(a) Determine the reasons for refund of insurance premium.<br>(b) Examine the premium paid certificate or the insurance policy to find out the amount of premium.<br>(c) Examine the advice of refund received from the insurance company.<br>(d) Examine the receipt of refund amount in the bank statement.<br>(e) Scrutinise correspondence between the insurance company and the client. | |
| | **(b)** | **Payment of Taxes.** | |
| | | **Answer: Steps for Vouching of Payment of Taxes**:<br>1. Obtain the computation of income prepared by the client and verify whether it is as per the Income-tax Act, 1961 and Rules made there under.<br>2. Review adjustments, expenses disallowed, special rebates etc. with particular reference to the last available completed assessment.<br>3. Examine relevant records and documents pertaining to payment of advance tax, self assessment tax, TDS and other demands.<br>4. Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order and notice of demand.<br>5. Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.<br>6. The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.<br>7. Ensure that the requirements of AS 22 on 'Accounting for Taxes on Income' have been appropriately followed for the period under audit. | |
| | **(c)** | **Sale Proceeds of junk material** | |
| | | Answer: Vouching of Sale proceeds of Junk Materials:<br>(a) Review the internal control on junk materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.<br>(b) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of junk materials.<br>(c) Review the production and cost records for the determination of the extent of junk materials that may arise in a given period.<br>(d) Compare the income from the sale of junk materials with the corresponding figures of the preceding three years.<br>(e) Check the rates at which different types of junk materials have been sold and compare the same with the rates that prevailed in the preceding year.<br>(f) See that all junk materials sold have been billed and check the calculations on the invoices.<br>(g) Ensure that there exists a proper procedure to identify the junk material and good quality material is not mixed up with it.<br>(h) Make an overall assessment of the value of the realisation from the sale of junk materials as to its reasonableness. Ensure that proper accounting has been done for it. | |

**(d) Intangible Assets**

**Answer: Verification of Intangible Assets**:

- AS – 26 "Intangible Assets" defines an Intangible Asset as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
- An intangible asset should be recognised if, and only if:
  (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
  (b) the cost of the asset can be measured reliably.
- An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.
- If an item covered does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.
- Schedule III to the Companies Act, 2013 requires that company shall disclose "Intangible Assets" in notes to accounts as follows:
  (a) Goodwill.
  (b) Brands / trademarks.
  (c) Computer software.
  (d) Mastheads and publishing titles.
  (e) Mining rights.
  (f) Copyrights, and patents and other intellectual property rights, services and operating rights.
  (g) Recipes, formulae, models, designs and prototypes.
  (h) Licenses and franchise.
  (i) Others (specify nature).

**4. (a) Mention the points/areas in which all the joint auditors are jointly and severally responsible.** **6**

**Answer: Areas of Joint Responsibility in case of Joint auditors**:

SA 299 "Responsibilities of Joint Auditors" deals with the responsibilities of joint auditors. Accordingly, in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible for the followings:

1. Audit work which is not divided;
2. Decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
   It may, however, be noted that proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;
3. Matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors
4. Examining that the F.S. of the entity comply with the disclosure requirements of the relevant statute; and
5. Ensuring that the audit report complies with the requirements of the relevant statute

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| (b) | **Mr. A was appointed statutory auditor of P Ltd., but he was not able to gather the sufficient audit evidences. Discuss how he should proceed to gather more audit evidences.** | 6 |

**Answer: Methods to obtain audit evidences**:

SA 500 "Audit Evidence" deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. For the purpose of collecting sufficient appropriate audit evidences, auditor may perform one or more of the following methods:

1. **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
2. **Observation:** Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel.
3. **External Confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
4. **Recalculation:** It consists of checking mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.
5. **Re-performance:** It involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
6. **Analytical Procedures:** It consist of evaluations of financial information made by a study of relationships among both financial and non financial data.
7. **Inquiry:** Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.

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| (c) | **Discuss the recognition principles of contingent liability.** | 4 |

**Answer: Recognition principles of Contingent Liabilities**:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" defines a Contingent liability as:

(a) A possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) A present obligation that arises from past events but is not recognised because:

1. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
2. A reliable estimate of the amount of the obligation cannot be made.

Para 26 of AS-29 states that an enterprise should not recognise a contingent liability. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect;

(b) an indication of the uncertainties relating to any outflow; and

**(c)** the possibility of any reimbursement.

Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

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| 5. | (a) | **Discuss about the provisions for removal of auditor before expiry date.** | 6 |

**Answer: Removal of Auditor before expiry of term**:

Section 140(1) of Companies Act, 2013 deals with the provisions related with the removal of auditor before of expiry of term. The provisions stated in section 140(1) are as follows:

- The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company and after obtaining the previous approval of the Central Government by making an application in Form ADT-2 and shall be accompanied with the prescribed fees.
- The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.
- Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

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| | (b) | **As the statutory auditor of A Ltd., you have observed that the gross profit of the company has decreased in comparison to last years. Mention the possible factors which may responsible for decrease in gross profit.** | 6 |

**Answer: Factors responsible for decrease in gross profit**:

1. **Decrease in Sales Prices:** Auditor should enquire whether there have been general or specific price decrease and the reasons for the same. He should obtain copies of the company price lists prevailing at different point of time for the purpose of comparison.
2. **Increase in Cost of Manufacturing:** The auditor should compare current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.
3. **Alteration in Sales-mix:** Auditor should analyse the sales in detail to ascertain whether the less profitable lines constituted a large proportion of the total sales.
4. **Impact of Manual Work:** The work through the labour force instead of machines may have resulted in considerable increase in labour cost and this possibility could be easily verify by comparisons of wages records.
5. **Adherence to Cut-off Procedures:** The company cut-off procedures as regards closing stock and work-in-progress should be investigated, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio.
6. **Manipulating Sales:** The possibility of items which have been sent to customers on 'sale or return' basis being approved but not included in sales, should be investigated, as this would give effect for decrease in the rate of gross profit.
7. **Adjustment in opening and closing inventory:** Gross profit may be decreased by making adjustment in the following manner:
   - Overstatement of opening inventory
   - understatement of Closing Inventory
   - Alteration of basis of valuation of inventory.

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| | (c) | **State the precautions to be taken to avoid the disadvantage of a continuous audit.** | 4 |
| | | **Answer: Precautions to be taken to avoid disadvantages of audit**:<br>1. During the course of each visit, work should be completed upto a definite stage so as to avoid loose ends.<br>2. At the end of each visit, important balances should be noted down and the same should be compared at the time of the next visit.<br>3. The visits should be at irregular intervals of time so that the client's staff may not in advance know the exact date when the audit would be resumed and thus may be able to prepare themselves in advance for the same.<br>4. The nominal accounts should be checked only at the time of final closing.<br>5. The client's staff should be instructed not to alter or correct audited figures. The auditor should also device a special form of ticks for being placed against figures which have been altered and neither its purpose nor significance should be disclosed to the client's staff. | |
| 6. | (a) | **The form, contents & extent of audit documents depend on certain factors. Explain with reference to SA 230.** | 4 |
| | | Answer: Factors affecting Form, Content and Extent of Audit Documents:<br>SA 230 "Audit Documentation" expounds the basic principle of documentation and requires that the working papers should be prepared or obtained by the auditor and retained by him in connection with the performance of his audit. As per SA 230, various factors which may affect the form, content and extent of audit documents are as below:<br>1. The size and complexity of the entity.<br>2. The nature of the audit procedures to be performed.<br>3. The identified risks of material misstatement.<br>4. The significance of the audit evidence obtained.<br>5. The nature and extent of exceptions identified.<br>6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.<br>7. The audit methodology and tools used. | |
| | (b) | **Why tests of Control are performed? Also explain what does they include.** | 4 |
| | | **Answer: Need of Tests of controls**:<br>• The auditor in forming his opinion on financial information needs reasonable assurance that transactions should be properly authorised and recorded in the accounting records and that transactions have not been omitted.<br>• Internal controls, even though if fairly simple, may contribute to the reasonable assurance the auditor seeks.<br>• The auditor's objective in studying and evaluating internal controls is to establish the reliance he can place thereon in determining the nature, timing and extent of his substantive audit procedures.<br>**Components of Tests of Controls**: Test of Controls may include:<br>(a) Inspection of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly.<br>(b) Inquiries about and observation of internal controls which leave no audit trail.<br>(c) Re-performance of internal controls.<br>(d) Testing of internal controls operating on specific computerised applications. | |

**(c) State the Standards issued by AASB which are collectively known as engagement standards.** **4**

**Answer: Standards issued by AASB**:

The Preface to Standards on Quality Control, Auditing, Review, Other Assurance and Related Services categorises the Standards based on the nature of service being provided by a member. It, therefore, introduces an umbrella concept of Engagement Standards. The term “Engagement Standards” comprises the following Standards:

1. **Standards on Auditing (SAs):** to be applied in the audit of historical financial information.
2. **Standards on Review Engagements (SREs):** to be applied in the review of historical financial information.
3. **Standards on Assurance Engagements (SAEs):** to be applied in assurance engagements, engagements dealing with subject matter other than historical financial information.
4. **Standards on Related Services (SRRs):** to be applied to engagements involving application of agreed upon procedures to information and other related services such as compilation engagements.

**(d) State the factors which are to be considered in determining materiality.** **4**

**Answer: Factors to be considered in determining materiality**:

- SA 320 on “Materiality in Planning and Performing an Audit” lays down the standard on the concept of materiality and its relationship with audit risk. As per SA 320 information is material if its mis-statement (i.e. omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information.
- Materiality may be influenced by following factors:
  1. Legal and regulatory requirements, non-compliance of which may have a significant bearing on the financial information, and
  2. Considerations which may have a significant bearing on the financial information, and
  3. Considerations relating to individual account balances and relationships.
- These factors may results in different levels of materiality depending on the matter being audited.

**7. Write short notes on any four of the following:** **4x4 =16**

**(a) Remuneration paid to directors in case of a public limited company.**

**Answer: Remuneration paid to directors**:

In order to examine the remuneration paid to directors, auditor should take the following steps:

(a) Refer to General Meeting or Board meeting resolution for the appointment and terms of appointment of the director.

(b) Examine Articles of Association and general meeting resolution to determine the mode of payment-monthly, quarterly, or at a specified percentage of the net profits.

(c) Check agreement with the director.

(d) Verify director's attendance in the board meetings.

(e) Ensure compliance with the provisions of Sections 197, 198 and Schedule V of the Companies Act, 2013, where appropriate.

(f) Check computation of the net profits and the commission payable to directors.

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| **(b)** | **Payment for acquisition of assets.** |
| | **Answer: Payment for acquisition of asset**:<br>In order to examine the payment made for acquisition of assets, auditor should take the following steps:<br>1. The purchase of an asset must be duly supported by the receipt for the amount paid.<br>2. Inspect the title deeds in case of acquisition of an immovable property, to ensure that property has been registered in the purchaser's name.<br>3. In the case of movable property requiring registration of ownership, e.g., a car or a ship, examine the registration certificate issue by the appropriate authorities.<br>4. Ensure that assets has been purchased by the persons having authority to purchase. In case of companies, purchase of fixed assets can be made only under the authority of Board of Directors.<br>5. In the case of self constructed assets i.e. an asset constructed or manufactured by the client himself, allocation of expenses should be checked. |
| **(c)** | **A qualified opinion.** |
| | **Answer: Qualified Opinion**:<br>The auditor shall express a qualified opinion when:<br>(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or<br>(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.<br>SA 705 "Modification to the Opinion in the Independent Auditor's Report" requires the auditor to add one more para named as "Basis for Qualified Opinion Para" in the audit report immediately before the opinion para stating therein the reasons for the qualified opinion.<br>The opinion para in case of qualified opinion will be worded as follow:<br>"Except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph, the Financial statements gives a true and fair view in all material respects in accordance with the applicable FRF". |
| **(d)** | **Fraudulent financial reporting.** |
| | **Answer: Fraudulent Financial Reporting**:<br>As per SA 240 "Auditor's Responsibilities relating to fraud in an audit of financial statements" the auditor is concerned with fraud that causes a material misstatement in the financial statements. Misstatement may result from fraudulent financial reporting or from misappropriation of assets.<br>The various ways in which misstatements may be caused from fraudulent financial reporting are: |

1. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
2. Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
3. Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
4. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
5. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
6. Altering records and terms related to significant and unusual transactions.

**(e) Surprise checks.**

**Answer: Surprise Check**:

- Surprise checks are a part of normal audit, wherein element of surprise may be incorporated by the auditor in audit programme with respect to time of audit, items to be examined etc.
- ICAI has recommended the following with respect to surprise check:
  1. Surprise checks should be considered as a desirable part of each audit.
  2. The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include:
     (a) Verification of cash and investments.
     (b) Test-verification of stores and stocks and the records relating thereto.
     (c) Verification of books of prime entry and statutory registers normally required to be examined for the purposes of audit.
  3. The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.
  4. The results of the surprise checks should be communicated to the management if they reveal any weakness in the system of internal control or any fraud or error or deficiency in the maintenance of records.
  5. The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.
  6. It is not necessary in all cases for the results of the surprise checks to be included in the auditors' report on the accounts. They should, however, be included if in the opinion of the auditor they are material and affect a true and fair view of the accounts on which he is reporting.



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