2. BASIC CONCEPTS IN AUDITING

Q.No.1. Write a short note on: Audit procedures. (B) **(SM)**

MEANING: They represent the broad framework of handling the audit work, and a single procedure may comprise of number of techniques.

TYPES:

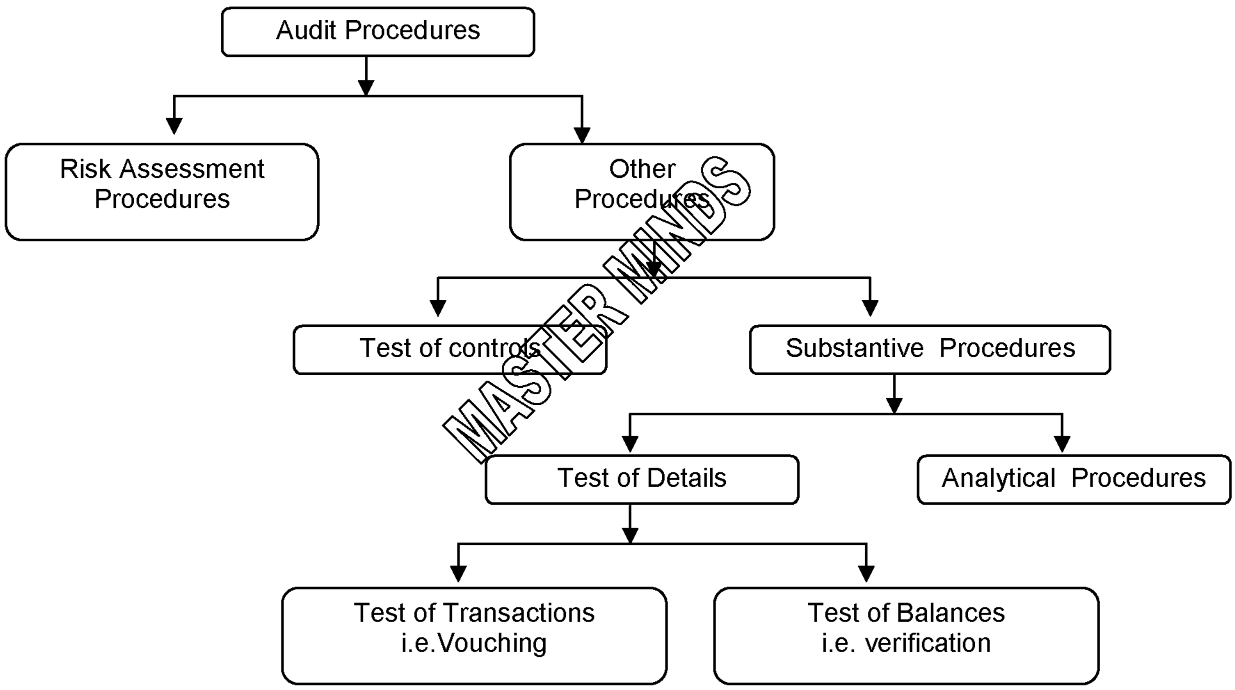
1. Risk assessment procedures.

2. Further audit procedures.

   a) Compliance procedures

   b) Substantive procedures

   - Test of details.
   - Analytical procedures.



Q.No.2. State briefly about Audit Techniques. (A) **(PM, M15, N16 – RTP, M12 - 4M)**

Audit techniques refer to tools adopted for collection and accumulation of audit evidence. Some of the techniques commonly adopted by the auditors are the following:

1. Posting checking

2. Casting checking

3. Physical examination and count

4. Confirmation

5. Inquiry

6. Year-end scrutiny

7. Re-computation

8. Tracing in subsequent period

9. Bank Reconciliation.

The Audit technique stand for the methods employed for carrying out the procedure. For example, the carrying out the procedure called vouching, the techniques of inspection and checking computation of documentary evidence are employed.

A combination of techniques can be applied for a single procedure.

Q.No.3. Why Tests of Control are performed? Also explain what does they include. (B) (PM, RTP N17, N15 – 4M)

1. **MEANING:** Tests of control are performed to obtain audit evidence about the effectiveness of:
   - a) Design of the accounting and internal control systems, that is, whether they are suitably designed to prevent or detect and correct material misstatements or not; and
   - b) Operation of the internal controls throughout the period.
2. **TESTS OF CONTROL MAY INCLUDE:**
   - a) **Inspection** of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly. For example, verifying that a transaction has been authorized.
   - b) **Inquiries** about internal controls and observation of internal controls. For example, determining who actually performs each function and not merely who is supposed to perform it.
   - c) **Re-performance** of internal controls. For example, reconciliation of bank accounts, to ensure that they were correctly performed by the entity.
   - d) **Testing** of internal control operating on specific computerised applications or over the overall information technology function. For example, access or program change controls.
3. **ASSERTIONS CONCERNING COMPLIANCE PROCEDURES:** Compliance procedures are performed to obtain audit evidence about the internal controls with respect to the following assertions.
   - a) **Existence:** Whether the control is in existence.
   - b) **Effectiveness:** Whether the internal control is operating effectively.
   - c) **Continuity:** Whether the internal control has been so operated throughout the period.

Q.No.4. Discuss the matters the auditor may consider in determining the extent of tests of controls. (B) (M 17 RTP)

MATTERS THE AUDITOR MAY CONSIDER IN DETERMINING THE EXTENT OF TESTS OF CONTROLS:

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.

Matters the auditor may consider in determining the extent of tests of controls include the following:

1. The frequency of the performance of the control by the entity during the period.
2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The expected rate of deviation from a control.
4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.

Q.No.5. Write short notes on Substantive Procedures. And what are the various assertions an auditor is concerned with while obtaining audit evidence from substantive procedure? (A) (PM, M10 – 5M, N14 – 4M)

A) MEANING: These procedures are performed to check the completeness, accuracy and validity of transactions and balances. They are designed to obtain evidence to verify various assertions with respect to account balances, class of transactions etc.
They are classified as

a) Test of details of transactions and balances or

b) Analytical review procedures

B) **ASSERTIONS CONCERNING SUBSTANTIVE PROCEDURES:**

Assertions refer to representations by management, explicit or otherwise, that are included in the financial statements. They are used by the auditor to consider different types of potential misstatements that may occur.

In obtaining audit evidence from substantive procedures, the auditor is concerned with the following assertions:

1. **Existence** - that an assets or liability exists at a given date.
2. **Rights and obligations** - that an asset is a right of the entity and a liability is an obligation at a given date.
3. **Occurrence** - that a transaction or event took place which pertains to the entity.
4. **Completeness** - that there are no unrecorded assets, liabilities or transaction.
5. **Valuation** - that an asset or liability is recorded at an appropriate carrying value.
6. **Measurement** - that a transaction is recorded in the proper amount and revenue or expenses are allocated to proper period.
7. **Presentation & disclosure** - that an item is disclosed, classified and described in accordance with recognized accounting policies, practices and statutory requirements.

REFER PRACTICAL QUESTION NO. – 1

Q.No.6. "Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered." Explain stating the different categories of assertions used by the auditor. (A) (PM, MTP N17, RTP N17, N15 RTP, N16 RTP)

The following are different categories of assertions used by the auditor in order to consider risk of material misstatement at the assertion level

A. **ASSERTIONS ABOUT CLASSES OF TRANSACTIONS AND EVENTS FOR THE PERIOD UNDER AUDIT:**

1. **Occurrence** - transactions and events that have been recorded have occurred and pertain to the entity.
2. **Cut-off** - transactions and events have been recorded in the correct accounting period.
3. **Classification** - transactions and events have been recorded in the proper accounts.
4. **Measurement** - amounts and other data relating to recorded transactions and events have been recorded appropriately.
5. **Completeness** - all transactions and events that should have been recorded have been recorded.

B. **ASSERTIONS ABOUT ACCOUNT BALANCES AT THE PERIOD END:** **(M13 – 4M, N15 – 5M)**

1. **Existence** - assets, liabilities, and equity interests exist.

2. **Rights and obligations –** assets are the rights and liabilities are the obligations of the entity.
3. **Valuation and allocation** - assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
4. **Completeness** - all assets, liabilities and equity interests have been recorded without any omission.

C. **Assertions about presentation and disclosure:**

1. **Occurrence** - disclosed events, transactions and other matters have occurred and pertain to the entity.
2. **Completeness** - all disclosures have been included in the financial statements without any omissions.
3. **Classification and understandability** - financial information is appropriately presented, described and classified.
4. **Accuracy and valuation** - financial and other information are disclosed fairly and at appropriate amounts.

SIMILAR QUESTIONS:

1. **In auditing, the auditor checks the specific assertions of the items appearing in the financial statements and opines about the overall assertions they signify. Explain specific assertions and overall assertions in this context.**

A. Refer above answer.

2. **Explain the assertions need to be considered about the classes of transactions and events for the period under audit. (N17 – 4M)**

A. Refer above point (a) in above.

3. **Assertions about account balances at the period end. (M13 – 4M, N15 – 5M)**

A. Refer above point (b) in above.

Q.No.7. Define the term "Audit Evidence" and explain various types of Audit evidence. (B) (PM, M17 RTP)

1. AUDIT EVIDENCE: As per **"SA 500 - Audit Evidence"** it is the information obtained by the auditor by performing audit procedures in order to arrive at the conclusions on which the auditor's opinion is based.

   It includes both

   - Information contained in the books of account and Financial statements and
   - Any other information obtained by the auditor during the course of audit.

2. TYPES OF AUDIT EVIDENCE:

   a) **Based on Form / nature:**

      i) **Documentary:** Evidence which is obtained in written, either in paper or electronic form. **E.g.:** Registration documents, title deeds, vouchers and Bills etc.

      ii) **Oral:** Evidence which is obtained by words of mouth. **E.g.:** Answers to Inquiries made by auditor.

      iii) **Visual:** Evidence which is obtained by the auditor through actual observation procedure. **E.g.:** Physical inspection of Fixed Assets, Cash, etc.

b) Based on Source:

i) Internal evidence: Evidence which is generated within the entity being audited is called internal evidence. **E.g.:** Sales invoice, GRN, Debit and Credit note, internal confirmations, etc.

ii) External evidence: Evidence, which is created outside the entity being audited, is called external evidence. **E.g.:** Purchase invoice, Debit notes and Credit notes, Quotations, External confirmation, etc.

c) Based on Impact/ Conclusion/ Effect:

i) Persuasive: Leads to a conclusion by implication.

ii) Conclusive: Provides complete assurance, free of risks.

Q.No.8. Distinguish between Internal evidence and External evidence.(A) (PM)

INTERNAL EVIDENCE V/S EXTERNAL EVIDENCE:

1. On the basis of Definition:

a) Internal evidence is the evidence which originates within the organization being audited.

E.g.: sales invoice, goods received notes, cash memo, etc.

b) External evidence is the evidence that originates outside the client's organization.

E.g.: purchase invoice, quotations, confirmations, etc.

2. On the basis of availability: In an audit situation, the bulk of evidence that an auditor gets is internal in nature. However, Substantial external evidence is also available to the auditor but lesser in comparison to internal audit evidence.

3. On the basis of Reliability:

a) Internal evidence:

i) Client and his staff will have control on the internal evidence. So, the auditor should be careful in putting reliance on such evidence.

ii) It does not mean that all the internal evidence needs to be suspected. But an auditor has to be alert to the possibilities of manipulation and creation of false and misleading evidence.

b) External evidence:

i) It is generally considered to be more reliable as they come from third parties who are not normally interested in manipulation of the accounting information of others.

ii) However, if the auditor has any reason to doubt the independence of any third party who has provided any material evidence, then he should exercise greater care in that matter. **E.g.,** an invoice of an associated concern,

Conclusion: As an ordinary rule the auditor should try to match internal and external evidence as far as practicable. Where external evidence is not readily available to match, the auditor should try to match various internal evidences in support of each other.

Q.No.9. What do you mean by the term 'Sufficient Appropriate Audit Evidence'? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence. (B) (N17 – 4M, N10 – 6M, M15 RTP)

AUDIT EVIDENCE: Information used by the auditor in arriving at the conclusions on which the auditor basis his opinion.

Audit evidence includes both the information contained in the accounting records underlying the financial statements and other information

SUFFICIENCY AND APPROPRIATENESS OF AUDIT EVIDENCE:

1. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.
2. The sufficiency and appropriateness of audit evidence are interrelated.
3. **Sufficiency (of audit evidence):** Sufficiency is the measure of the quantity of audit evidence.
   - **a)** The quantity of audit evidence needed is affected by the
     - Auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also
     - Quality of such audit evidence (the higher the quality, the less may be required).
   - **b)** However obtaining more audit evidence may not compensate for its poor quality.
4. **Appropriateness (of audit evidence):** Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
   - **a)** The reliability of evidence is influenced
     - **i)** by its source and by its nature, and
     - **ii)** is dependent on the individual circumstances under which it is obtained.
5. **Professional judgment:** Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and there by enable the auditor to draw reasonable conclusions on which to base the auditor's opinion is a matter of professional judgment.

Q.No.10. What are the factors influencing the auditor's judgment as to what is sufficient and appropriate audit evidence? (B)

1. Degree of risk of misstatements which may be affected by factors such as the
   - **i)** Nature of items,
   - **ii)** Adequacy of internal control,
   - **iii)** Nature and size of businesses carried out by the entity,
   - **iv)** Situations which may exert an unusual influence on management and
   - **v)** The financial position of the entity.
2. The materiality of the item.
3. The experience gained during previous audits.
4. The results of auditing procedures, including fraud and errors which may have been found.
5. The type of information available.
6. The trend indicated by accounting ratios and analysis.

Q.No.11. Discuss the principles, which are useful in assessing the reliability of audit evidence. (A) (PM, N11 – 4M, N13 – 5M, N14 – RTP, M17 – RTP)

The following are the principles useful in assessing the reliability of audit evidence

1. The reliability of audit evidence is increased when it is obtained from independent sources outside the entity i.e. external audit evidence.

2. The reliability of internal audit evidence is increased when the related controls, including those over its preparation and maintenance, are effective.

3. Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.

4. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

5. Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly (for example, inquiry about the application of a control).

6. Consistent Audit evidence is more reliable than inconsistent Audit evidence.

SIMILAR QUESTIONS:

1. **The reliability of audit evidence is influenced by its source, nature and circumstances under which it is obtained.**

2. **State the generalizations about the reliability of audit evidence.**

A. Refer above answer for all these questions.

Q.No.12. Write about different methods to obtain audit evidence? (A)
(PM, M11 – 8M, M15 – 4M, N15 – 6M N14 - RTP)

The following methods are employed for carrying out the above procedures for the purpose of obtaining audit evidence.

a) **Inspection:**
   i) 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.
   ii) The reliability of audit evidence obtained through inspection depends on their nature and source and, e.g.: in the case of internal records and documents, it depends on the effectiveness of the controls over their preparation.

b) **Inquiry:**
   i) Inquiry consists of seeking information from knowledgeable persons, both financial and non-financial, within the entity or outside the entity.
   ii) Inquiries may range from formal written inquiries to informal oral inquiries.
   iii) Evaluation of responses to inquiries is an integral part of inquiry process.

c) **Observation:**
   i) 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 internal controls
   ii) Observation provides audit evidence about the performance of a process or procedure, but it is limited to the point in time at which the observation takes place.

d) **External Confirmation:**
   i) 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).
   ii) It can be obtained in paper form or by electronic or other medium.

e) **Re-calculation:** Recalculation consists of checking the arithmetical accuracy of documents or records. Recalculation may be performed manually or electronically.

f) **Re-performance:** Re-performance involves the auditor's independent execution of procedures or controls that were originally performed by the entity's internal control.

g) Analytical Procedures:

i) Analytical procedures consist of evaluation of financial information by a study of acceptable relationships among both financial and non-financial data.

ii) Analytical procedures also include

- Analysis of trends and ratios,
- Identification of abnormal deviations and
- Investigation of those deviations.

SIMILAR QUESTIONS:

1. Mr. A was appointed as statutory auditor of P Ltd. But he was unable to gather sufficient audit evidence. Discuss how he should proceed gather more audit evidence.

A. Refer above answer. **(N15 – 6M)**

Q.No.13. Inquiry is used extensively throughout the audit in addition to other audit procedures. Explain. (B) (M17 RTP, M13 – 5M)

1. Inquiry consists of seeking information from knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

2. Inquiries may range from formal written inquiries to informal oral inquiries.

3. Evaluation of responses :

a) Evaluating responses to inquiries is an integral part of inquiry process.

b) Responses to inquiries may provide the auditor with

i) Information not previously obtained or with some supportive audit evidence to earlier obtained evidence.

ii) Information that differs significantly from other information that the auditor has obtained.

iii) A basis for the auditor to modify or perform additional audit procedures.

4. Corroboration of evidence: Corroboration of evidence obtained through inquiry is often of significant Importance.

a) However in the case of inquiries about management's actions or decisions, the information available to support such actions or decisions may be limited.

b) In such cases, the auditor should understand the following to provide him relevant information to support the evidence obtained through inquiry.

- Management's past history of carrying out its stated intentions,
- Management's stated reasons for choosing a particular course of action, and
- Management's ability to pursue a specific course of action

5. In respect of some matters, the auditor may consider it necessary to obtain written Representations from management and, where appropriate, Those charged with Governance to confirm responses to oral inquiries.

SIMILAR QUESTION:

1. Inquiry is one of the audit procedures to obtain audit evidence. Explain. (M13 – 5M)

A. Refer above answer.

Q.No.14. Discuss the concept of "True and Fair". (A)
(PM, RTP N17, N15 RTP, N16 RTP, N12 – 6M)

1. **Auditor objective:**

   a) The concept of "true and fair" is a fundamental concept in auditing.

   b) The word "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the financial statements are
   - Showing true and fair view of state of affairs of the entity and
   - Prepared and presented in accordance with the applicable financial reporting framework.

2. **Requirement as per Companies Act w.r.t true and fair view:**

   a) Provisions of Section 128: It provides that every company shall prepare and keep at its registered office books of account and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any.

   Such books of Account shall be kept on accrual basis and according to the **double entry system of accounting**.

   b) Provisions of Section 129:

   i) It provides that financial statements must comply with the Accounting Standards specified under section 133 so as to give a true and fair view of the state of affairs of the company.

   If not complied with Accounting Standards, the company shall disclose in its financial statements, the deviation from the Accounting Standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

   ii) Financial statements should be presented in the format given under Schedule III

   Exceptions: The following companies are not required to comply with schedule III
   - Insurance companies
   - Banking companies
   - Companies engaged in the generation or supply of electricity
   - Companies governed by any other law
   - However in the case of above mentioned companies, it cannot be said that financial statements are not showing true and fair view merely by reason of the fact that they are not containing certain matters prescribed in schedule III but which are not required as per their relevant governing acts.

3. **Duty of auditor w.r.t true and fair view:**

   i) Provisions of section 143(2): It provides that the auditor is required to make a report to the members of the company indicating that, the Financial statements give a true and fair view of the state of affairs of the company as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

   ii) Requirement as per SA 700: SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained.

SIMILAR QUESTIONS:

1. **Under what circumstances / conditions the financial statements are considered to present a "true and fair" state of affairs?**

A: Refer above answer.

Q.No.15. What constitutes true and fair view is a matter of auditor's judgement, but some specific points must be seen by the auditor to ensure true and fair view. (A) (N 16 - 5 M)

TRUE & FAIR VIEW:

What constitutes a 'true and fair' view is a matter of an auditor's judgment in the particular circumstances of a case.

In more specific terms, to ensure true and fair view, an auditor has to see:

1. That the assets are neither undervalued nor overvalued, according to the applicable accounting principles.
2. No material asset is omitted.
3. The charge, if any, on assets are disclosed.
4. Material liabilities should not be omitted.
5. The Profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the Balance sheet has been prepared in accordance with Part I of Schedule III.
6. Accounting policies have been followed consistently.
7. All unusual, exceptional or non-recurring items have been disclosed separately.

Q.No.16. Are surprise checks desirable in audit, if so, give important recommendations. (A) (PM, N15 RTP, M 13 - 5M, N15 - 4M)

MEANING: The auditor visiting the premises of client without giving prior intimation.
Surprise checks are a part of normal audit procedures. An element of surprise can significantly improve the audit effectiveness. Wherever practical, an element of surprise should be incorporated in the audit procedures.

The following are the important recommendations-

1. The element of surprise in an audit may be, both in regard to the time of audit, (i.e. selection of date of surprise check) and selection of areas of check.
2. **Areas of surprise check:** The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include:
   - **a)** Cash and investments.
   - **b)** Stores and inventories.
   - **c)** Books of prime entry and statutory registers.
   - **d)** Internal controls and internal checks.
3. **Frequency of surprise checks:** 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.

   It would depend upon the extent to which the auditor considers,
   - **a)** Internal control system as adequate,
   - **b)** Nature of the client's transaction,
   - **c)** Locations from which he operates and
   - **d)** Relevant importance of the item to be surprise checked such as cash, investments etc.
4. **Results of Surprise checks:**

i) 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.

ii) The auditor should satisfy himself that the adequate action has been taken by the management on the matters communicated by him.

iii) It is not necessary in all cases for the results of the surprise checks to be included in the auditor's 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.

SIMILAR QUESTIONS:

1. **Write a short note on the Surprise checks.**

2. **"An element of surprise can significantly improve audit effectiveness." (RTP N17)**

A. Refer above answer for both these questions.

3. **Mention, any four, areas where surprise checks can significantly improve the effectiveness of an audit. (MTP N17, N16 RTP)**

A. Refer Meaning and Point no. 2 in the above recommendations.

Q.NO.17. State any ten areas in which different accounting policies may be encountered. (A) (PM, RTP M16, N 12 - 10M, N11 - 6M)

1. Method of depreciation, depletion and amortization – Straight Line Method, Written Down Value method.
2. Valuation of inventories – FIFO, LIFO, weighted average etc.
3. Treatment of goodwill – write off, retain.
4. Valuation of investments – at cost, market or net realizable value etc.
5. Treatment of retirement benefits – Actuarial, funded through trust, insurance policy etc.
6. Valuation of fixed assets – historical cost, revaluation price, exchange fluctuation etc.
7. Treatment of expenditure during construction i.e. write off, capitalization, deferment.
8. Recognition of profit on long term contracts – year to year, % completion etc.
9. Conversion or translation of foreign currency items – average rate, actual, buying rate etc.
10. Treatment of contingent liabilities.

SIMILAR QUESTION:

1. **State any six areas in which different accounting policies may be encountered.**

A. Refer above answer.

Q.NO.18. Write a short note on Fundamental Accounting Assumptions. (B) (SM, M 15 – 4M)

According to AS 1 on "Disclosure of Accounting Policies", there are certain fundamental accounting assumptions in preparing and presenting of financial statements.

FUNDAMENTAL ACCOUNTING ASSUMPTIONS:

1. **Going Concern:**

a) The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future.

b) It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

2. **Consistency:** It is assumed that accounting policies are consistent from one period to another.

3. **Accrual:** All Revenues and costs should be accrued, that is, recognized as and when they are earned (whether received or receivable) or incurred (whether paid or payable) and should be recorded in the financial statements of the periods to which they relate.

DISCLOSURE REQUIREMENTS:

- Usually they are not specifically stated because their acceptance and use are assumed.
- Thus, if the fundamental accounting assumptions, viz., Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required.
- However, if any fundamental accounting assumption is not followed, the fact should be disclosed.

Q.No.19. What are the major considerations which govern the selection of Accounting policies? (B) (SM, RTP N17)

The responsibility of selection of appropriate accounting policies in the preparation and presentation of financial statements lies with the management.

Therefore, management should select accounting policies subject to the satisfaction of the following considerations

1. The **Primary Consideration** is that the financial statements should present true and fair view of the state of affairs.
2. **Secondary Considerations :**
   a) **Prudence (i.e. principle of Conservatism):** Anticipate no profits but anticipate every loss. Since uncertainty is attached to future events, profits are not anticipated but recognised only when realized. But provision is made for all known liabilities and losses.
   b) **Substance over form:** The accounting treatment and presentation in financial statements shall be governed by their substance and not by the legal form.
   c) **Materiality:** Financial statements should disclose all material items. **(MTP N17)**
   An item is considered to be Material, if its commission or omission will influence the economic decisions of users of financial statements.

Q.No.20. Write short note on changes in accounting policies. (A) (PM, M 16 – 4M)

1. CONSISTENCY :
   a) **Consistency** is one of the fundamental accounting assumptions. It denotes that the accounting policies should be consistently applied and followed from years to years.
   b) Then only users can compare the financial statements of an enterprise over a period of time in order to identify trends in its financial position, financial performance and cash flows.
2. CIRCUMSTANCES WHEN A CHANGE IN ACCOUNTING POLICIES CAN BE MADE:
   Change in accounting policy is permitted only if such change is
   a) To bring accounts in compliance with Accounting Standards or
   b) Required by Provisions of any law or
   c) For appropriate presentation of financial statements.
3. DISCLOSURE REQUIREMENTS:
   a) Any change in an accounting policy which has a material effect should be disclosed.
   b) The amount by which any item in the financial statements is affected by such change should also be disclosed if it is ascertainable. If the amount is not ascertainable, wholly or in part, the fact should be disclosed.
   c) Any such change which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

SIMILAR QUESTIONS:

1. **Under what circumstances change in accounting policies is permissible? (PM)**

A: Refer above answer.

Q.No.21. "Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated." Discuss. (A) (PM, RTP N17, M 15 RTP)

DISCLOSURE OF ACCOUNTING POLICIES:

1. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the Accounting policies followed in the preparation and presentation of the financial statements.
2. The Accounting policies followed vary from enterprise to enterprise.
3. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.
4. To ensure proper understanding of financial statements, it is necessary that all significant Accounting policies adopted in the preparation and presentation of Financial statements should be disclosed. Such disclosure should form part of the Financial statements.
5. It would be helpful to the reader of Financial statements if they are disclosed at one place instead of being scattered over several statements, schedules and notes which form part of Financial statements.
6. **Change in accounting policy:**
   a) Any change in an Accounting policy which has a material effect should be disclosed.
   b) The amount by which any item in the financial statements is affected by such change should also be disclosed if it is ascertainable. If the amount is not ascertainable, wholly or in part, the fact should be disclosed.
   c) Any such change which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

Conclusion: Therefore, disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

SIMILAR QUSTIONS:

1. **"Disclosure of accounting policies used in the preparation of the Financial statements increases/ enhances the intelligibility (clearness, transparency) of Financial statements". Explain (PM)**
2. **Write a short note on Disclosure of accounting policies. (PM)**

A. Refer above answer for both these questions.

QUESTIONS FOR ACADEMIC INTEREST – FOR STUDENT SELF STUDY

Q.No.22. Principles vs. Techniques of auditing. (C) (SM)

1. MEANING:
   a) **Principles of auditing:** It means fundamental considerations/rules that should be followed by an auditor while doing audit.

      According to SA 200, Integrity & objectivity, Independence, Confidentiality etc. are some of the basic principles governing an audit.

b) Auditing techniques: It means the tools adopted by the auditor to obtain the audit evidence.

These are Vouching, Posting, Casting, Confirmation, Physical examination, Year-end scrutiny, Test check, Tracing, scanning etc.

2. APPLICABILITY:

a) Principles are universal i.e., they are common to all audits irrespective of nature of organization.

b) Whereas the audit techniques to be applied depends upon the auditors professional judgment For example, whether to verify the debtors by inspection of books or by direct confirmation would be decided by the auditor.

Audit techniques also vary with nature of organization.

Q.No.23. "The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time". Explain. (C) (M 17 RTP)

Nature and Timing of the Audit Procedures:

a) The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available

- only in electronic form or
- only at certain points or periods of time.

b) Certain electronic information may not be retrievable after a specified period of time, For example, if files are changed and if backup files do not exist.

c) Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

PRACTICAL QUESTIONS

Q.No.1. What are the obvious assertions in the following items appearing in the financial statements?

a. Profit and Loss Statement - travelling expenditure Rs.50,000

b. Balance sheet – Debtors Rs.2,00,000 (PM, N14 RTP)

a) Travelling Expenditure Rs 50,000:

i) Expenditure has been actually incurred for the purpose of travelling.

ii) Travelling has been undertaken during the year under consideration.

iii) Total amount of expenditure incurred is Rs.50,000/- during the year.

iv) It has been treated as revenue expenditure and charged to profit and loss account.

b) Debtors Rs.2,00,000:

i) These include all the credit sales transactions occurred during the year.

ii) These have been occurred and recorded properly during the year.

iii) These constitute assets of the entity.

iv) These have been shown at proper value i.e. after showing the deduction on account of provision for bad and doubtful debts.

SA 500 (Revised) AUDIT EVIDENCE (w.e.f. April 1, 2009)

A) DEFINITIONS:

1. **Audit evidence:**
   - Information used by the auditor in arriving at the conclusions on which the auditor basis his opinion.
   - Audit evidence includes both the information contained in the accounting records underlying the financial statements and other information.

2. **Management's expert:**
   - An individual or organization
   - possessing expertise in a field other than accounting or auditing,
   - whose work in that field is used by the entity
   - to assist the entity in preparing the financial statements.

B) SUFFICIENT APPROPRIATE AUDIT EVIDENCE: Refer Q.No:9 in Above.
(N10 – 6M, M15 RTP)

C) FACTORS INFLUENCING THE AUDITOR'S JUDGMENT AS TO WHAT IS SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE: Refer Q.No:10 in Above. **(N10 – 6M, M15 RTP)**

D) METHODS TO OBTAIN AUDIT EVIDENCE: Refer Q.No:12 in Above.
(PM, M11 – 8M, M15 – 4M, N15 – 6M, N14 - RTP)

E) INQUIRY: Refer Q.No:13 in Above. **(M13 – 5M, M17 – RTP)**

F) INFORMATION TO BE USED AS AUDIT EVIDENCE:

a) When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

b) Using the work of a management's expert: When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall,

i) Evaluate the competence, capabilities and objectivity of that expert;

ii) Obtain an understanding of the work of that expert; and

iii) Evaluate the appropriateness of expert's work as audit evidence for the relevant assertion.

c) Using information produced by the entity: the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes.

G) RELIABILITY OF AUDIT EVIDENCE: Refer Q.No:11 in Above.

SA 520 (Revised) ANALYTICAL PROCEDURES (on or after April 1, 2010)

A) DEFINTIONS:

1. **Analytical procedures:**

a) It means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

b) Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

B) NATURE OF ANALYTICAL PROCEDURES:

1. **Nature of Comparisons:** Analytical procedures include the **consideration of comparisons** of the entity's financial information with
   c) Comparable information for prior periods (Inter period analysis)
   d) Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor (budgetary analysis)and
   e) Similar industry information, such as a comparison of the entity's ratio of sales to Accounts Receivable with industry averages or with other entities of comparable size in the same industry (Inter firm analysis).
2. **Nature of Relationships:** Analytical procedures also include **consideration of relationships** among
   a) Elements of financial information ,such as gross margin percentages; and
   b) Financial information and relevant non-financial information, such as payroll costs to number of employees.
   c) Elements of Non-financial information such as input – output ratio, efficiency ratio etc.

C) PURPOSES OR OBJECTIVES OF ANALYTICAL REVIEW PROCEDURES:

1. To assist the auditor in planning the nature, timing and extent of other audit procedures.
2. As substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions; and
3. As an overall review of the financial statements in the final review stage of the audit.

   i.e., to design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor understanding of the entity.

D) SUBSTANTIVE ANALYTICAL PROCEDURES (SAP): When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

1. **Suitability of SAP for the given assertions:**
   a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
   b) These procedures may not be relevant for Public sector undertakings.
2. **Evaluate the reliability of data:** The following are the factors relevant for determining whether data is reliable for the purpose of designing substantive analytical procedures. **(N10 – 8M)**
   a) **Source** of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity
   b) **Comparability** of the information available. For example, two entities within the same industry should be of equal standing in order to make them comparable;
   c) **Nature and relevance** of the information available. For example, whether budgets established are reasonable and feasible and
   d) **Controls over the preparation of the data used for analysis**: When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore the results of analytical procedures will be reliable.
3. **Develop an expectation** of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify material misstatement.

4. **Determine the amount of any difference** of recorded amounts from expected values that is acceptable without further investigation.

E) INVESTIGATING RESULTS OF ANALYTICAL PROCEDURES

If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount,

Then the auditor shall investigate such differences by:

1. Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
2. Performing other audit procedures as necessary in the circumstances.

EXAMINATION QUESTIONS:

1. **What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures". (N10 – 8M)**
2. **Write a short note on extent on reliance on analytical review procedures.**
3. **What are the factors to be considered for evaluating the reliability of data used for performing analytical procedures?**

A. Refer point no. (D)(2) "**Evaluate the reliability of data**" in above.

4. **What factors should be considered while analytical procedures are performed as substantive procedures?**

A. Refer point no. (D) in above.

5. **What do you mean by Analytical procedures? How such procedures are helpful in auditing? (M15 RTP)**

A. Refer point no. (A), (B), (C) in above.

6. **Write a short note on "Analytical review". (PM)**

A. Refer point no. (A), (B), (C) and (D) in above.

THE END