J.K. SHAH®
CLASSES
CAFC→INTER CA→FINAL CA↗

INTER CA
MAY '19
REVISION NOTES
AUDIT

PART - II

CHAPTERS 5 7 8

CHAPTER 5 FRAUD AND RESPONSIBILITIES OF AUDITOR IN THIS REGARD

Q	Reference	Question	Answer
1	ICAI Module	What do you understand by the term 'fraud'? Provide its meaning as given under the Standard on Auditing (SA) 240	Meaning: "an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage Two types of intentional misstatements are relevant to the auditor– a) misstatements resulting from fraudulent financial reporting and b) misstatements resulting from misappropriation of assets
2	ICAI Module	Briefly explain self-revealing errors with the help of some illustration	These are such errors the existence of which becomes apparent in the process of compilation of accounts. A few illustrations of such errors are given hereunder, showing how they become apparent: a)Omission to post a part of a journal entry to the ledger. b) Wrong totaling of the Purchase Register c) A mistake in recording amount received from X in the account of Y.
3	ICAI Module	There are many ways for cash defalcation, one of which is by suppressing cash receipts. List out few techniques of how the receipts are suppressed	Few techniques of how receipts are suppressed are: (1) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier (2) Adjusting unauthorised or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them (3) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated (4) Not accounting for cash sales fully
4	ICAI Module	Fraud Risk Factors are the events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Further, the nature of the industry or the entity's operations also provides opportunities to engage in fraudulent fi nancial reporting. List out some of the cases from where theses opportunities may arise.	Opportunities: The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following: 1. Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another fi rm. 2. A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions. 3. Assets, liabilities, revenues, or expenses based on signifi cant estimates that involve subjective

			judgments or uncertainties that are difficult to corroborate. 4. Signifi cant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions. 5. Signifi cant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.
5	ICAI Module	You notice a misstatement resulting from fraud or suspected fraud during the audit and conclude that it is not possible to continue the performance of audit. As a Statutory Auditor, how would you deal?	If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall: (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and (c) If the auditor withdraws: (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
6	ICAI Module	Fraud can be committed by management overriding controls using such techniques as engaging in complex transactions that are structured to misrepresent the fi nancial position or fi nancial performance of the entity. In view of the above-mentioned circumstances of management fraud, explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from such Management Fraud.	Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud". The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records Reporting fraud as per Sec 143(12) of Companies Act, 2013 to the central government. Reporting fraud as per Clause X of CARO 2016 in audit report.

7	ICAI Module	Intelligent Ltd. entered into an agreement with Mr. Intellectual on 15th March, 2017, whereby it agreed to pay him ` 2 lakhs per month as retainership fee for consultation in IT department. However, no amount was actually paid and ` 24 lakhs was provided in the Statement of Profi t and Loss for the year ending on March 31st, 2017. Management of the company uttered that need-based consultation was obtained throughout the year. However, on investigation, no documentary or other evidence of receipt of such service was found. As the auditor of Innocent Ltd., what would be your approach? Would your approach be diff erent if the amount involved is ` 1 crore or above	As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as recording fi ctitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives Explain auditor's responsibilities as per Sec 143(12) of Companies Act, 2013 of reporting fraud to Board of Directors and Audit Committee (since amount is less than Rs. 1 Cr) Reporting fraud as per Clause X of CARO 2016 in audit report Consider Withdrawal from the engagement after ascertaining legal obligations and discussing the matter with management and those charged with governance.

CHAPTER 7 AUDIT SAMPLING

Q	Reference	Question	Answer
1	ICAI Module	What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling	"Audit Sampling" means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population
2	ICAI Module	With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing	**Audit Sampling**: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. The requirements relating to sample design, sample size and selection of items for testing are explained below- **Sample design** - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics

			of the population from which the sample will be drawn. **Sample Size-** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. **Selection of Items for Testing**- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection
3	**ICAI Module**	While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?	As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions: (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. (ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.
4	**ICAI Module**	Short note on Advantages of Statistical sampling in Auditing	The advantages of statistical sampling may be summarized as follows (1) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested. (2) The sample selection is more objective and thereby more defensible (3) The method provides a means of estimating the minimum sample size associated with a specified risk and precision. (4) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures. (5) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical

			mistakes are not as large.
5	ICAI Module	Short note on Stratified sampling	Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age

CHAPTER 8 ANALYTICAL PROCEDURE

Q	Reference	Question	Answer
1	ICAI Module	Define Analytical Procedures	As per the Standard on Auditing (SA) 520 "Analytical Procedures" 'the term "analytical procedures" means evaluations of fi nancial information through analysis of plausible relationships among both fi nancial and non-financial data. 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. Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.
2	ICAI Module	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	The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures: (i) Source of the information available. for example, information may be more reliable when it is obtained from independent sources outside the entity; (ii) Comparability of the information available. for

			example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products; (iii) Nature and relevance of the information available. for example, whether budgets have been established as results to be expected rather than as goals to be achieved; and (iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. for example, controls over the preparation, review and maintenance of budgets.
3	ICAI Module	While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement	Sustantive roceures to e performe to assess te ris of material misstatement: As per SA 330, "The Auditor's Response to Assessed Risk", substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. est of etails: The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. Substantive analytical procedures: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.