Chapter 1 — Model Answers

Nature, Objective & Scope of Audit

Part – A [Sept 24 to Jan 26 Attempts]

Foundations of the audit: assurance levels, scope, engagement standards and the auditor's objective.

Q 1.1 · Prospective vs Historical Financial Information — Level of Assurance

Explain the key differences between prospective financial information and historical financial information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information? *(5 Marks · Jan 25)*

MODEL ANSWER · Type: *Descriptive (Theory)*

Distinguishing the two, and explaining how that distinction caps the assurance the practitioner can give:

Historical financial information — relates to information expressed in financial terms about economic events, conditions or circumstances that have occurred in past periods.

Prospective financial information — relates to financial information based on assumptions about the occurrence of future events and possible actions by the entity; it is future-oriented.

Nature of supporting evidence — for prospective information, even where evidence supports the assumptions, that evidence is itself generally future-oriented and therefore inherently uncertain.

Nature of the practitioner's conclusion — the auditor is not in a position to express an opinion that the results shown in the prospective information will actually be achieved; he opines only on the reasonableness of the assumptions and the proper preparation of the projection.

Level of assurance provided — a negatively-worded report stating that nothing has come to attention to suggest the assumptions do not provide a reasonable basis for the projection i.e., only a 'moderate' (limited) level of assurance, against the reasonable (high) assurance available in an audit of historical financial information.

Conclusion: Because the underlying events lie in the future, the practitioner can offer only a moderate (limited) level of assurance on prospective financial information, not the reasonable assurance available for historical information.

Sachhin Sir's Memory Aid

Historical = high (reasonable) assurance — positive opinion. Prospective = moderate (limited) assurance — negative wording 'nothing has come to attention'.

Important Phrases To Use In Answer

'based on assumptions about the occurrence of future events' · 'negatively-worded report' · 'nothing has come to attention to suggest the assumptions do not provide a reasonable basis' · 'moderate (limited) level of assurance' · 'not in a position to express an opinion that the results will be achieved'

Q 1.2 · Scope of Audit vs Detection of Fraud

PD & Co. were appointed as statutory auditors of MR Limited. The appointment letter included a clause: "The Auditor shall be responsible for detecting the frauds that may happen in the company during the financial year 2023-24." The auditor objected to this clause. Discuss in light of the scope of audit. *(3 Marks · Sept 24)*

MODEL ANSWER Type: *Case Study (Application)*

Auditor's objective and the boundary between audit and investigation — IPAC analysis:

Provision — under SA 200, the objective of the auditor is to obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error, so as to enable expression of an opinion. The audit is therefore an opinion-forming exercise, not a fraud-hunting one.

Audit is not an official investigation — the auditor has no specific legal powers of search or of recording statements on oath that may be necessary for an official investigation.

Audit vs investigation distinguished — investigation is a critical examination of accounts with a special purpose, and is undertaken when, for example, fraud is suspected and the accounts are specifically called upon to be checked for it. Scope of audit is general and broad; scope of investigation is specific and narrow.

Application to facts — casting upon the auditor an absolute responsibility for detecting frauds extends his work beyond an audit into the territory of an investigation.

Conclusion: The auditor's objection is correct: a clause making the auditor responsible for detecting all frauds is outside the scope of audit under SA 200 and should not be included in the appointment letter.

Key Phrases From The Question

'Responsible for detecting frauds' in the engagement letter is the trigger — the moment you see it, point to SA 200 and the audit-vs-investigation distinction.

Sachhin Sir's Exam Tip

Always cite SA 200 first when scope of audit is questioned → it carries the mark by itself.

Important Phrases To Use In Answer

'reasonable assurance' · 'free from material misstatement, whether due to fraud or error' · 'no specific legal powers of search or of recording statements on oath' · 'scope of audit is general and broad; scope of investigation is specific and narrow' · 'outside the scope of audit'

Q 1.3 · Engagement Standards — Types and Purpose

Mention any three Standards issued under authority of ICAI Council which are collectively known as 'Engagement Standards'. Also mention the purpose of issue of these standards.

(5 Marks · May 25)

MODEL ANSWER · Type: *Descriptive (Theory)*

Standards issued under the authority of the ICAI Council and grouped as Engagement Standards:

Standards on Auditing (SAs) — apply in the audit of historical financial information.

Standards on Review Engagements (SREs) — apply in the review of historical financial information.

Standards on Assurance Engagements (SAEs) — apply in assurance engagements other than audits and reviews of historical financial information.

Standards on Related Services (SRSs) — apply in agreed-upon procedures, compilation engagements and other related-service engagements.

Purpose — to establish high-quality standards and guidance in the areas of financial statement audits and other types of assurance services, thereby ensuring consistency, quality and credibility across engagements.

Conclusion: The four Engagement Standards (SAs, SREs, SAEs and SRSs) together provide a structured framework that drives quality and uniformity in audit and assurance work.

Sachhin Sir's Memory Aid

Four families of Engagement Standards: SA / SRE / SAE / SRS — 'Audit / Review / Assurance other / Related services'.

Important Phrases To Use In Answer

'issued under authority of the ICAI Council' · 'apply in audit of historical financial information' · 'establish high quality standards and guidance' · 'areas of financial statement audits and other types of assurance services'

Q 1.4 · Applicable Engagement Standard — SRS 4410 and SAE 3400

Identify the applicable Engagement Standards in the following: (i) an assignment to assist the management of Healthy Foods Ltd. with the preparation and presentation of historical financial information, without obtaining assurance on that information; and (ii) an assignment to examine the prospective financial information of Digital Future Ltd. *(2 Marks · Jan 26)*

MODEL ANSWER · Type: *Case Study (Application)*

Matching each engagement to the correct family of Engagement Standards and the specific standard:

(i) Compilation without assurance — this is a related-services engagement and falls under Standards on Related Services. The applicable standard is SRS 4410 (Revised) — 'Compilation Engagements'.

(ii) Examination of prospective financial information — this is an assurance engagement (other than audit/review of historical information) and falls under Standards on Assurance Engagements. The applicable standard is SAE 3400 — 'Examination of Prospective Financial Information'.

Conclusion: Healthy Foods Ltd. → SRS 4410 (Revised); Digital Future Ltd. → SAE 3400.

Sachhin Sir's Memory Aid

Compilation without assurance → SRS 4410. Examination of prospective info → SAE 3400. Audit of historical info → SAs. Review of historical info → SREs.

Important Phrases To Use In Answer

'Standards on Related Services' · 'compilation engagements without obtaining assurance' · 'Standards on Assurance Engagements' · 'examination of prospective financial information'

Q 1.5 · Reasonable vs Limited Assurance Engagements

Explain the difference between reasonable assurance engagements and limited assurance engagements. *(3 Marks · Jan 26)*

MODEL ANSWER · Type: *Descriptive (Theory)*

Contrasting the two on level of assurance, extent of procedures and form of conclusion:

Level of assurance A reasonable assurance engagement provides a high (but not absolute) level of assurance	A limited assurance engagement provides a lower level of assurance than a reasonable assurance engagement.
Extent of procedures A reasonable assurance engagement involves elaborate and extensive procedures to obtain sufficient appropriate evidence;	A limited assurance engagement involves fewer procedures.
Form of conclusion A reasonable assurance engagement draws reasonable conclusions on the basis of sufficient appropriate evidence and is expressed in positive form (e.g., 'true and fair view');	A limited assurance engagement obtains sufficient evidence to draw limited conclusions, expressed in negative form (e.g., 'nothing has come to attention').
Example A statutory audit of financial statements is a reasonable assurance engagement;	A review of interim financial information is a limited assurance engagement.

Conclusion: The two engagements differ in assurance level, depth of procedures and form of expression. Reasonable assurance being high and positively worded, limited assurance being lower and negatively worded.

Sachhin Sir's Exam Tip

For 'difference between' questions, present in a 3–4 row comparative table — level, procedures, conclusion form, example. The examiner rewards visual contrast.

Important Phrases To Use In Answer

'high but not absolute level of assurance' · 'elaborate and extensive procedures' · 'draws reasonable conclusions on the basis of sufficient appropriate evidence' · 'fewer procedures as compared to reasonable assurance engagement' · 'obtaining sufficient appropriate evidence to draw limited conclusions'

Q 1.6 · Aspects Examined to Ensure Financial Statements Are Not Misleading

State some of the aspects examined by the auditor to ensure that the financial statements which are audited are not misleading. *(4 Marks · Sept 25)*

MODEL ANSWER · Type: *Descriptive (Theory)*

Aspects an auditor examines so that the audited statements are clear, complete and free from misleading content:

1. Linkage to books — the accounts have been drawn up with reference to the entries in the books of account.

2. Support for entries — the entries in the books of account are adequately supported by sufficient and appropriate audit evidence.

3. Completeness — none of the entries in the books of account has been omitted in the process of compilation.

4. Clarity — the information conveyed by the statements is clear and unambiguous.

5. Conformity with the framework — the financial-statement amounts are properly classified, described and disclosed in conformity with the applicable accounting standards.

6. True and fair view — the statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

Conclusion: Examining these six aspects gives the auditor reasonable assurance that the audited financial statements convey a true, fair and unambiguous picture to users.

Sachhin Sir's Memory Aid

Six checks for non-misleading FS: Books linkage → Support → Completeness → Clarity → Framework conformity → True & fair view.

Important Phrases To Use In Answer

'drawn up with reference to entries in the books of account' · 'adequately supported by sufficient and appropriate audit evidence' · 'classified, described and disclosed in conformity with accounting standards' · 'true and fair picture of the operational results and of the assets and liabilities'

Part – B [May 2024 and Earlier Attempts]

Skeleton to recall: *Name the standard/principle → Numbered points → Verdict.*

Q1.1 Validity of a transaction

State the factors to be considered to verify the validity of any transaction. *(May 2016)*

MODEL ANSWER *Type: List / state-the-factors*

To verify that a transaction is valid, the auditor should consider the following factors:

1. Legal provisions — The auditor should see that the transaction is in accordance with the laws and regulations that apply to the entity, keeping in mind its industry, its jurisdiction, and the statute that governs it.

2. Internal rules and regulations — He should check that the transaction is authorised by the entity's own constitutional documents, such as the Articles of Association, the Partnership Deed or the Trust Deed.

3. Minutes of meetings — He should see that the transaction is supported by a proper resolution or approval recorded in the minutes of the Board or the managing committee.

4. Agreements and contracts — He should check that the terms of the transaction match the relevant agreement, such as the managing director's agreement, a lease deed, or a vendor or employment contract.

5. Accounting principles and practices — He should see that the transaction has been recorded as per recognised accounting principles, with a proper distinction between capital and revenue, on an accrual basis, and at the correct value.

6. Legal opinion — Where the validity of the transaction is doubtful, he should obtain a legal opinion, and act on it only if it is reasonable and convincing.

Conclusion: By weighing all these factors, the auditor can conclude whether the transaction is valid and is in accordance with the applicable laws, regulations and the entity's internal policies.

Sachhin Sir's Exam Tip

A 'state the factors' question wants crisp, distinct points a bold tag and a short explanation each. The mark is for naming each factor clearly.

Q1.2 Statutory auditor & internal auditor

Explain the relationship between the statutory auditor and the internal auditor. *(Nov 2016)*

MODEL ANSWER *Type: Theory / relationship*

The statutory auditor and the internal auditor have different roles, but their work can complement each other. The relationship between them is as follows:

1. Role of the internal auditor — The internal auditor is a part of the entity's internal control system. He assesses and helps to improve the risk management, control and governance processes. **Under Section 138** of the Companies Act, 2013, internal audit is mandatory for certain classes of companies, and the scope of his work is decided by the Audit Committee or the Board.

2. Role of the statutory auditor — The statutory auditor is an independent auditor appointed from outside the entity, who reports to the shareholders whether the financial statements give a true and fair view and comply with the law.

3. Scope and co-operation — The statutory auditor may make use of the internal auditor's work (for example, on internal control, verification and risk), and if that work is found to be effective, he may modify the nature, timing and extent of his own procedures **(SA 610)**.

4. Evaluation of the internal auditor's work — Before relying on it, the statutory auditor evaluates the internal audit function's scope, competence, objectivity and the quality of its work.

5. Independence and reporting lines — The statutory auditor reports to the shareholders, whereas the internal auditor reports to the management or the Audit Committee. This difference in reporting lines helps to preserve the statutory auditor's independence.

6. Limited reliance — The statutory auditor cannot rely only on the internal audit; he must still carry out his own independent procedures before concluding that the financial statements are free from material misstatement.

Conclusion: Their roles are different, but good communication and a proper evaluation of the internal audit make the statutory audit more efficient and thorough, without reducing the statutory auditor's independence.

Sachhin Sir's Exam Tip

Two citations lift this answer: **Section 138** (internal audit is mandatory for certain companies) and **SA 610** (using the work of internal auditors). Always close on the 'limited reliance / independence preserved' point examiners look for it.

Q1.3 Ensuring a 'true & fair' view

'True and fair' view is a matter of the auditor's judgement. Mention any five points the auditor should review to ensure a true and fair view. *(May 2018)*

MODEL ANSWER *Type: List / state-the-points*

Prima facie auditor should keep in mind that FSs are in compliance with applicable Financial Reporting Framework. Although whether the financial statements show a 'true and fair' view depends on the auditor's judgement, the following are the key points he should review:

1. Valuation of assets — That the assets are neither overvalued nor undervalued, and are valued in accordance with the applicable accounting principles.

2. Disclosure of charges — That any charges created on the assets are properly disclosed.

3. No omission — That no material asset or liability has been left out of the financial statements.

4. Consistency of policies — That the accounting policies have been applied consistently and are in line with standard accounting practice.

5. Unusual or non-recurring items — That all unusual, exceptional or non-recurring items are separately disclosed.

Conclusion: By reviewing these points, the auditor can satisfy himself that the financial statements give a true and fair view.

Sachhin Sir's Exam Tip

'Any five' means five give exactly five clean points. Writing seven wastes time and earns nothing extra. Match the count to what is asked.

Q1.4 Inherent limitations of an audit (JK Ltd.)

JK Ltd. ran a pager plant which it expected to grow; mobile phones arrived and the plant shut down. Shareholders allege the auditor failed to warn them of the company's inability to continue and seek to blame him for their loss. List the factors giving rise to the inherent limitations because of which the auditor cannot guarantee that the financial statements are free from material misstatement due to fraud or error. *(May 2024)*

MODEL ANSWER *Type: Practical / case-study — Issue → Provision → Analysis → Conclusion*

Issue: Whether the auditor can be said to have failed simply because the business later collapsed that is, whether an audit can guarantee that the financial statements are free from material misstatement.

Provision: SA 200 - an audit provides reasonable assurance, and not absolute assurance, because of the inherent limitations of an audit.

Analysis — the inherent limitations are as follows:

1. Nature of financial reporting — The preparation of financial statements involves management's subjective judgements and estimates, which carry an inherent element of uncertainty.

2. Nature of audit procedures — The auditor tests only samples and not every item; he relies on evidence that is persuasive rather than conclusive; he depends on management providing complete and honest information; and a carefully planned or collusive fraud may escape detection.

3. An audit is not an investigation — An audit does not carry the legal powers of an official investigation, so it cannot give absolute assurance.

4. Timeliness and cost — Information loses its relevance with the passage of time, and the auditor has to balance the reliability of evidence against the time and cost of verifying every single detail.

5. Future events — Events occurring after the audit (here, the arrival of mobile phones displacing pagers) can undermine an entity that was a going concern on the date of the audit; the auditor cannot foresee all such future events.

Conclusion: Because of these inherent limitations, the auditor cannot guarantee that the financial statements are free from material misstatement. The later collapse of the pager business (a future event) does not, by itself, prove any failure of duty on the auditor's part; the auditor provides reasonable, and not absolute, assurance.

Sachhin Sir's Exam Tip

Even though the question says 'list', frame it as a case-study: a one-line Issue and the SA 200 anchor before the list show the examiner you have read the scenario and the conclusion (the collapse ≠ auditor failure) answers what the shareholders actually alleged.