WT 2 (Ch. 2 – Audit Strategy, Planning & Programme and Ch. 3 – Risk Assessment and IC)

Instructions: **Part A comprises of MCQ.**

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

Q.1	(b)	(1 Mark)
Q.2	(c)	(1 Mark)
Q.3	(c)	(1 Mark)
Q.4	(d)	(1 Mark)
Q.5	(a)	(1 Mark)
Q.6	(c)	(1 Mark)
Q.7	(d)	(1 Mark)

Part B (Descriptive Questions)

Q.1 **(a)** Statement is Incorrect:

Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Control risk, on the other hand is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. **(2 Marks)**

(b) Incorrect:

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.

Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources. **(2 Marks)**

(c) Statement is correct.

There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high. Acceptable detection risks need to be low to reduce audit risk to an acceptably low level.

On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level. **(2 Marks)**

Q.2 (a) **Risks of Material Misstatement - Greater for Significant Non-Routine Transactions:**

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- Greater management intervention to specify the accounting treatment.
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

2 Marks (1 Mark for each correct Point – Any two)

Risks of material misstatement - Greater for Significant Judgmental Matters:

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

2 Marks (1 Mark for each correct Point)

(b) **Elimination of disadvantages of audit programme:**

Disadvantages of an Audit programme may be eliminated by:

(a) imaginative supervision of the work carried on by the assistants;

(b) receptive attitude of auditor as regards the assistants;

(c) encouraging assistants to observe matters objectively and bring significant matters to the notice of supervisor/principal.

2 Marks (1 Mark for each correct Point – Any two)

Q.3 (a) Preliminary engagement activities include following activities:

(A) Performing procedures regarding the continuance of the client relationship
(B) Evaluating compliance with ethical requirements, including independence
(C) Establishing an understanding of terms of engagement

2 Marks (1 Mark for each correct Point – Any two)

Performing preliminary engagement activities assists auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement. **(1 Mark)**

(b) **Auditor's assumptions about users of the financial statements:**

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

(i) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

(ii) Understand that financial statements are prepared, presented and audited to levels of materiality;

(iii) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(iv) Make reasonable economic decisions on the basis of the information in the financial statements.

3 Marks (1 Mark for each correct Point – Any three Point)

Q.4 (a) IT related risks can have an impact on audit in different ways discussed as under:

Impact on substantive checking

Inability to address IT risks may lead to non-reliance of data obtained from systems. In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy. It could lead to increased substantive checking i.e. detailed checking. **(1 Mark)**

Impact on controls

It can lead to non-reliance on automated controls, system calculations and accounting procedures built into applications. It may result in additional audit work. **(1 Mark)**

Impact on reporting

Due to regulatory requirements in respect of internal financial controls in case of companies, it may lead to modification of auditor's report in some instances. **(1 Mark)**

(b) **Development of Audit Plan**:

SA-300 states that auditor shall develop an audit plan that shall include description of:

(i) Nature, timing and extent of planned risk assessment procedures;

(ii) Nature, timing and extent of planned further audit procedures at assertion level; an

(iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

In this case, auditor would like to inquire from inhouse legal counsel of the company as to status of pending litigation matters to identify and assess risk of material misstatement.

The objective of planned inquiry of inhouse legal counsel is to identify and assess risk of material misstatement. **(2 Marks)**

Conclusion: Planned risk assessment procedures are included in audit plan in accordance with SA-300.

(1 Mark)